

OCC Policy Statement on Tax Refund-Related Products

The Office of the Comptroller of the Currency (OCC) is issuing the following policy statement setting forth the measures national banks are expected to follow if they offer tax refund-related products. These products include refund anticipation loans (RAL), “pay stub loans,” and refund anticipation checks.¹

The OCC previously issued guidance to its examiners regarding issues and expectations regarding these products because they present particular consumer protection and safety and soundness risks due to (1) their unique repayment and cost structures, and (2) banks’ reliance on third-party tax return preparers who interact with consumers. This policy statement is being issued to enhance, clarify, and increase awareness regarding the measures the OCC expects to see in place for tax refund-related products offered by national banks.

PURPOSE

This policy statement addresses the OCC’s expectations of a national bank’s risk management of tax refund-related products. It is intended to promote sound risk management and consumer protections for tax refund-related products and to address related supervisory concerns about legal compliance, consumer protection, reputation, and safety and soundness risks.²

RISK MANAGEMENT ELEMENTS

A national bank’s risk management practices related to tax refund-related products should be appropriate for the complexity and nature of such activity, consistent with safe and sound banking practices and relevant reporting requirements, and be undertaken with appreciation of and capacity to address the consumer protection requirements, legal compliance obligations, and reputation risk considerations associated with the activity. National banks must implement appropriate policies, procedures, and controls to address and ensure compliance with the following standards.

¹ A RAL is a short-term loan made in anticipation of a customer’s income tax refund being approved and paid by the IRS or state tax authority. The loan is made by a bank through third-party tax preparers who offer both tax preparation services and RALs. “Holiday loans” and “pre-file” or “pay-stub loans” also are offered through third-party tax preparers and exhibit more credit risk because funds are advanced based on prior years’ history or a current pay stub, before the customer receives a Form W-2 for the current year. With a “refund anticipation check,” instead of directly transmitting the customer’s tax refund to the customer, the IRS transmits the refund to a limited/special-purpose deposit account at the lending bank. The bank then transmits the refund, less fees associated with tax preparation and/or other deposit services, to the customer.

² This statement replaces the memorandum dated February 23, 2007, from Doug Roeder, Senior Deputy Comptroller, Large Bank Supervision, and Tim Long, Senior Deputy Comptroller, Mid-Size/Community Bank Supervision, to Examiners of Banks Offering Tax Refund Anticipation Loans and Related Products.

I. Board and Management Responsibility

The board should ensure that the bank maintains sound risk management policies, practices, and processes to oversee all tax refund-related products. This should include a comprehensive due diligence process for any new products or material changes to existing products as detailed in prior OCC guidance.³ The bank's compliance management program should identify, monitor, and control the consumer protection risks associated with higher fees, compensation incentives, and a general reliance by the customer on the third-party tax preparer for guidance.

II. Consumer Protection Standards

A. Disclosures⁴

Transparency of product terms and costs assists customer understanding of the fundamental characteristics of the product being offered and can help deter inappropriate marketing practices in connection with tax refund-related products. To be effective, clear and prominent disclosure of various aspects of tax refund-related products should be provided in writing to each prospective customer *before* the customer makes application for such a product or pays a nonrefundable fee. Banks offering these products should have appropriate procedures, such as requirements for written acknowledgments from customers, to verify that these disclosures were properly made.

Disclosures should include the following information, as applicable:

- In the case of a RAL, a statement, clearly more conspicuous than other information set forth, stating that a RAL is a *loan*, and not the consumer's tax refund, and that the consumer must repay the entire amount of the loan even if the tax refund is less than the amount that is borrowed.
- In the case of a RAL, a statement that the consumer may:
 - File his or her federal income tax return electronically without obtaining a RAL or other bank product and without any additional costs; and
 - Receive a check or refund deposit directly from the IRS without obtaining a RAL or other bank product or without incurring any additional costs, and an estimate of the average waiting time for an electronic refund to reach a consumer following the approval of an application.
- A statement of the total cost of the tax refund-related product, separately identifying fees relating to tax preparation services and tax return filing, and any fees for setting up a deposit account for receipt of the tax refund.

³See, OCC Bulletin 2004-20, Risk Management of New, Expanded or Modified Bank Products and Services, dated May 10, 2004.

⁴ The OCC expects that national banks will have fully implemented these disclosure requirements no later than January 1, 2011.

- For consumers who claim the earned income tax credit (EITC), a statement that the costs of a RAL will be deducted from, and can substantially reduce, their EITC benefits, and that the consumer may obtain the full EITC benefit if they do not take out a RAL.
- A statement that a RAL may cost substantially more than other sources of credit and that the consumer should consider whether the loans offered are consistent with their personal needs and financial circumstances.
- If applicable, a statement that denied RALs will become refund transfer deposit products and are subject to the fees that apply to those deposit products.
- A statement of whether or not any fees imposed in connection with an application for a RAL will be refunded if the loan application is denied.
- An explanation of any cross-collection provisions, including, if applicable:
 - That the bank can and will determine whether the consumer has an outstanding unpaid RAL with the bank or any other lender identified in the application form;
 - That the consumer should determine whether he or she has such outstanding unpaid RAL debt before signing the application, and an explanation of how the consumer can obtain such information (such as by calling a toll-free number before the application is submitted); and
 - That, by signing the application, the consumer authorizes the bank to deduct from the consumer's refund any amounts necessary to repay such outstanding RAL debt.
- A statement that the consumer's application for a RAL will be denied if the consumer has outstanding unpaid taxes or delinquent child support, student loans, or other federal debt.
- A description of any low-cost deposit accounts offered by the bank and how to obtain more information from the bank about them.

B. Marketing

The bank should establish effective internal controls and review standards for in-house and third-party developed advertising and solicitations. Guidelines and review processes for advertising and solicitations developed by third-party providers should be clearly stated and be part of the binding agreement between the bank and the provider.

All advertising must comply with the federal laws and regulations governing credit advertising and all relevant IRS advertising standards. All advertising must be factually correct and should state specifically that it is a bank deposit product and/or loan product. If a loan product, advertisements and materials should clearly note that the money provided is a *loan* and not the actual income tax refund. In addition, RAL marketing should not include misleading statements, such as the following, to suggest that the product is a tax refund or not a loan:

- “Instant tax money”
- “Get your refund fast”

- “Rapid refund”

All advertising copy and video, whether prepared by the bank or by a third party tax preparer, should be reviewed and approved in advance by the bank’s compliance and/or legal personnel to ensure that all relevant terms and conditions are properly disclosed.

III. Third-Party Risk Management

National banks should exercise appropriate diligence and adopt adequate procedures and standards to ensure that tax refund-related products originated by third parties comply with applicable guidance and this policy statement. Prior OCC guidance on third-party relationships established measures that national banks should employ to implement effective risk management processes.⁵ To manage these risks and to monitor these activities, banks need a sound system of internal controls and comprehensive management information systems.

The system of internal controls should include oversight of third-party providers (e.g., tax preparers and key intermediaries such as servicers and data aggregators) tailored to products offered, size, complexity, and operating infrastructure of the third-party provider. Appropriate controls include:

- Performing substantive due diligence before entering into a business arrangement with a third-party tax preparer. This would include conducting background checks, assessing general competence and business practices and operations, and evaluating counter-party risk (i.e., potential conflicts of interest, reputation, financial capacity and condition, internal controls, record of compliance with applicable licensing, consumer protection and other laws). The reviews should also assess any litigation, enforcement actions, or pattern of consumer complaints.
- Entering into written agreements with third-party tax preparers that specifically and clearly address the rights and responsibilities of each party. In particular, agreements should specifically describe the products and services that the bank is committed to provide, should prohibit the third party from imposing higher fees

⁵ See, OCC Advisory Letter 2003-3, Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans, dated February 21, 2003, OCC Advisory Letter 2000-9, Third Party Risk, dated August 29, 2000 (recommendations for vendor management programs); and OCC Bulletin 2001-47, Third-Party Relationships: Risk Management Principles, dated November 1, 2001 (recommendations for third-party risk management process, including risk assessment and strategic planning, due diligence in selecting third-party providers, and contracting and oversight issues). See, generally, OCC Advisory Letter 2002-3, Guidance on Unfair or Deceptive Acts or Practices, dated March 22, 2002; OCC Bulletin 2001-6, Expanded Guidance for Subprime Lending Programs, dated January 31, 2001; OCC Bulletin 99-15, Subprime Lending: Risks and Rewards, dated April 5, 1999; OCC Bulletin 99-10, Interagency Guidance on Subprime Lending, dated March 3, 1999; and OCC Banking Circular 181 (REV), Purchases of Loans in Whole or in Part-Participations, dated August 2, 1984; OCC Bulletin 2004-58, Automated Clearing House, NACHA Rule Changes, dated December 20, 2004 (third-party senders); and OCC Bulletin 2006-39, Automated Clearing House Activities, Risk Management Guidance, dated September 1, 2006.

for tax preparation services to consumers based on whether they obtain a RAL, prohibit the third party from imposing higher fees for tax preparation services to borrowers who claim the EITC, and should provide that the bank can terminate the agreement if directed by the OCC, based on a written determination by the OCC of unacceptable safety and soundness, regulatory, or consumer compliance risks.⁶

- Maintaining an oversight program during the tax season to prevent or control potentially abusive practices and noncompliance with policies and procedures. Key components of the program include:
 - A process to collect, review, and appropriately respond to customer complaints on tax refund-related products. The bank should have the necessary systems to capture and monitor customer complaints independent of the third-party provider;
 - Development and monitoring of exception reports designed to identify variances from predetermined acceptable levels of fees and interest charges on bank products and tax preparation services; and
 - Development of customer surveys to assess all facets of product delivery. Surveys should be timely and focus on a statistically representative population of tax preparers as well as a sample of tax preparers identified as high risk through exception reports and other means.
- Performing due diligence regarding the appropriateness of the third-party provider relationships on an ongoing basis. Management should periodically meet with third-party providers to discuss performance and operations issues, periodically monitor the adequacy of training provided to third-party provider employees, especially front line personnel, and regularly review third-party provider audit reports. Management should develop a process in which the third-party provider is required to notify bank management prior to implementation of any critical changes in policies, procedures, or training that would affect product delivery, solicitation, or marketing.

IV. Verification

National banks should have processes and procedures to monitor and verify independently practices of third-party tax preparers who offer products on behalf of the bank to ensure that the practices of these third parties are consistent with this policy statement and with the standards that bank would apply for its direct dealings with customers. This should include testing of transactions at key points in product and service delivery, monitoring of all facets of the product delivery from initial inquiry by the customer to the deposit of funds into the customer's account or delivery of the refund check, and an appropriately designed mystery shopping program to ensure objectivity and integrity of the process. This audit process may be conducted pursuant to an independent internal process or through the use of independent third parties, but should encompass risk-based factors and appropriate geographic diversity to assure meaningful testing and

⁶ The OCC expects that national banks will incorporate these terms into any new, renewed, or revised contracts as appropriate.

verification across a bank's tax refund-related business. The results of such audits should be documented and available to OCC examiners.

With respect to the mystery shopping element of this verification program, an effective mystery shopping program should:

- Be tailored to assess compliance with procedures and applicable laws;
- Focus on an appropriate sampling methodology of tax preparers as well as a sample of tax preparers identified as high risk because of such factors as length of experience, lack of resources devoted to compliance oversight, complaints, and/or other red flags identified through exception reports and other means;
- Ensure that undue pressure is not brought to bear on the customer to select a tax refund-related product;
- Ensure that the customer is provided with the key information necessary to make an informed decision *before* the customer applies for a tax refund-related product or pays a nonrefundable fee; and
- Ensure that oral statements made by tax preparation personnel to the customer regarding the product do not contradict or dissuade a customer from considering such information.

V. Fraud and Anti-Money Laundering Compliance

RAL fraud is a common method of consumer loan fraud that typically uses identity theft, falsified electronically filed tax returns, and falsified W-2 forms to obtain a RAL from a bank or other lender, with the proceeds from this type of consumer loan fraud being laundered through the bank.⁷ Bank management must ensure that the bank's compliance risk management systems pertaining to the Bank Secrecy Act (BSA) and related regulations cover tax refund loan and deposit products.

Key elements are:

- Risk assessment consideration and documentation;
- Risk-based Customer Information program (CIP);
- Risk-based Customer Due Diligence (CDD), including Enhanced Due Diligence (EDD), as appropriate;
- Risk-based suspicious activity monitoring and reporting; and
- Office of Foreign Assets Control (OFAC) screening.⁸

In addition to the third-party risk management factors previously discussed, banks should consider on a risk basis, the tax preparer's customer base, ownership, expected volume of business, financial condition, and references. If the bank processes Automated

⁷ For a discussion of fraud and money laundering risks including "red flags" of possible RAL fraud, *see*, The SAR Activity Review, Trends, Tips & Issues, Issue 7 pp. 15–20 (August 2004).

⁸ *See, e.g.*, FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual, Office of Foreign Assets Control – Overview, pp. 137–145 (2007).

Clearing House (ACH) transactions related to the program, the bank should also implement risk-based CDD/EDD and suspicious activity and reporting systems related to those transactions and OFAC screening. For example, it may be appropriate to monitor transactions for level, trend, amount, and common beneficiaries.

VI. Training

Annual training programs for both bank personnel and tax preparation office personnel are an important component of risk management. Properly trained employees and business partners can significantly reduce the risks inherent in these products. Training should include regulatory requirements (such as consumer and BSA laws, regulation, and guidance) and the bank's internal policies, procedures, and processes. In addition, the bank, typically, should provide an overview of the regulatory requirements to new staff and temporary employees during employee orientation. This training will need to be customized for temporary employees who are usually hired during the tax season.

Changes to internal policies, procedures, processes, and monitoring systems should also be covered during training. The program should reinforce the importance that the board and senior management place on the bank's compliance program and should ensure that employees understand their roles in maintaining an effective compliance program.

Training should include an annual certification process. This provides management an assurance that the tax preparers have reviewed and understand the products and materials. Banks and tax preparers should document their training programs. They should maintain training and testing materials, calendars of training sessions, and attendance records and make them available for examiner review.

VII. Management Information Systems (MIS)

National banks should develop timely and accurate MIS for tax refund-related products. MIS could include reports and analysis of the following:

- Production and portfolio trends (such as volume, approval rate, interest and fees) by IRS refund transmittal cycle, by product, originator channel, IRS Debt Indicator (DI), Earned Income Tax Credit (EITC), and credit score (if any);
- Exception (override) tracking;
- Reasons for denial by product and originator channel;
- Delinquency and loss distribution trends by product and originator channel with accompanying analysis of significant underwriting characteristics (such as DI, EITC, and credit score, if any);
- Vintage tracking (IRS payment delinquency by IRS transmission, by IRS e-file refund cycle);
- IRS Payment Analysis segmented by EITC or Non-EITC;

- Conversion of pre-file products to IRS-accepted products by new and existing RAL customers and by originator channel;
- Profitability by product; and
- The performance of third-party originators by tax preparer location. Include volume, profitability (show incentive fees paid), and quality information by product type.

Given the short-term life cycle of the tax refund-related products, most reports, to be relevant and useful, must be generated daily or weekly.

VIII. Loss Recognition

Tax refund-related product lenders are expected, at a minimum, to follow the interagency guidance for retail credit. This guidance requires closed-end retail loans past due 90 cumulative days from the contractual due date to be classified Substandard. Closed-end retail loans that become past due 120 cumulative days from the contractual due date are to be classified Loss and charged off. Lenders are free to adopt a more conservative treatment of delinquent retail loans.

RALs do not have a contractual due date. Therefore, the bank should determine a reasonable date to begin the delinquency calculation. Generally, this will be no more than three e-file refund cycles after the tax return is submitted to the IRS. Other tax refund-related loan products, such as “holiday loans” and “pre-file loans,” have a stated contractual due date. These products should follow the delinquency and charge-off guidelines based on that date.

Some RAL lenders have entered into cross-collection agreements with other RAL lenders. Banks that enter into these agreements must comply with all applicable laws and regulations and accurately disclose the existence and operation of such agreements to their customers.

IX. Capital and Liquidity

The seasonal influx of significant amounts of tax refund-related products may present extraordinary stress on a bank’s capital and liquidity levels. A bank should ensure that reliable contingency plans are in place before engaging in these activities to a material degree. Banks should be mindful that the OCC’s established position on tax refund-related loan products is that they are risk-weighted at 100 percent for risk-based capital purposes.