FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION
DIVISION OF RISK MANAGEMENT SUPERVISION
Dallas Regional Office
600 North Pearl Street, Suite 700, Dallas, Texas 75201
(214) 754-0098 FAX (972) 761-2082

b8

June 28, 2023

Board of Directors

b4,b8

Subject: April 4, 2023 Visitation Findings

Dear Members of the Board:

A joint visitation of your institution was conducted by FDIC Division of Risk Management Supervision (RMS) Senior Risk Examiner b8 FDIC Division of Depositor and Consumer Protection (DCP) Field Supervisor b8 and b8 b8 The visitation commenced on April 4, 2023, and focused on the bank's proposed deposit activity with b4,b8.

b4,b8

As described in numerous meetings and correspondence prior to the beginning of the visitation, the Board is considering accepting deposit accounts from b4,b8 The bank's due diligence is in process, and the proposed activity consists largely of two accounts:

- An b4,b8 deposit account for the benefit of b4,b8 customers. The funds in this account represent US dollar balances resulting from the sale of the customer's crypto-asset investments, to be b4,b8 b4,b8 This account was potentially as large as b4,b8 before the b4,b8 b4,b8 and is currently held by b4,b8 Management estimates between b4,b8 in transactions through this account currently.
- A b4,b8 deposit account related to loans received by b4,b8, totaling b4,b8 b4,b8 b4,b8 b4,b8

Bank management became aware of this possible transaction through a current banking customer, third party payment processor b4,b8 b4,b8 has reportedly processed transactions for b4,b8 previously and would assist in processing ACHs out of the b4,b8 account. Notably, the bank has already opened deposit accounts for two inactive b4,b8 subsidiaries: b4,b8 b4,b8 These accounts total b4,b8 and are being used to pay legal fees unrelated to b4,b8

As proposed, management plans to service the accounts while keeping the funds off-balance sheet through products administered by b4,b8 Management is researching th b4,b8 and repurchase agreements (repo accounts). The b4,b8 b4,b8 would serve as custodian for the funds, b4,b6,b8 b4,b8 and the deposits would be secured by US Treasury or Agency securities with a margin between 100.25 percent and 101 percent if placed in repo accounts. Revenue consists of a 55 basis point fee generated for servicing the b4,b8 relationship and ACH transactions with b4,b8. Management expects to earn the overnight US Treasury rate, deduct their fee, and pass the remainder of accrued interest through to b4,b8 b4,b8 was initially projected to occur over a b4,b8 timeframe, but may accelerate with the approve b4,b8 No significant additional overhead expenses are anticipated at this time.

The Board and management needs to significantly expand the risk assessment process and conduct additional due diligence and contingency planning before accepting any additional deposits from b4,b8 or b4,b8 entities. Significant risks are presented by these transactions, related to legal, accounting, operational, capital, credit, liquidity, reputation, Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT), consumer protection, and potentially other areas. However, the risk assessment does not fully analyze these various and compounding risks, and failing plan for the risks of this transaction could result in substantial financial impact to the bank. Refer to Appendix A for detailed recommendations and items to consider in the risk assessment process. In addition, the bank may need to obtain significantly more capital and liquidity in the event the deposits are required to be held on the bank's balance sheet. The Board and management are reminded of their responsibilities to adequately identify, measure, monitor, and control risks prior to entering any new business lines, consider how new ventures impact the overall risk profile of the institution, and maintain adequate capital levels for the risk profile of the institution.

In addition, management notified us on May 2, 2023 that they have engaged a forensic accounting review of a preliminary finding by the bank's external auditor. The external auditor identified a discrepancy involving an outage in a contra-liability account to process ACH returns for b4,b8 After completing a forensic review, management determined the outage was an unpaid receivable from b4,b8 of more than $2 million, which was collected on June 9, 2023. Management should implement additional controls to prevent recurrence of this event, and should test the new controls frequently to ensure effectiveness. The

b4,b8

The Board should review this visitation letter and the attached documents in their entirety at the next regularly scheduled Board meeting, with a record of that review entered in the minutes. This letter of visitation findings includes confidential information and may not be disclosed or made public in any manner under Part 309 of the FDIC Rules and Regulations and b4,b8

The composite and component ratings assigned under the Uniform Financial Institutions Rating System were not included in the scope of this visitation and are unchanged.

Please contact FDIC Case Manager b8 at b8 or b8 b8 if you have any questions. Correspondence to the b8 may be addressed to b8 and sent via email to b8 As a reminder, written correspondence should be addressed to Kristie K. Elmquist, Regional Director, FDIC, Dallas Regional Office, and sent as a PDF document through the FDIC's Secure Email portal (https://securemail.fdic.gov/) using the following e-mail address: DALMailRoom@fdic.gov. Information about how to use secure email and FAQs about the service can be found at https://www.fdic.gov/secureemail/.

Sincerely,

/s/ Joseph A. Meade

Joseph A. Meade
Acting Deputy Regional Director
Dallas Regional Office
Federal Deposit Insurance Corporation

Sincerely,

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Appendix A

Management must address the recommendations below, at a minimum, to demonstrate a full understanding of the potential risks with the b4,b8 deposit relationship and proposed activities.

Due Diligence/Planning

- Complete a legal review of the Uniform Depository Agreement, proposed contracts with all third parties including b4,b8 and b4,b8 the b4,b8, and other b4,b8 b4,b8 documents to ensure proposed accounts and activities are structured appropriately, identify any conflicting clauses or prohibitive acts, and minimize potential risks to the bank. Failure to do so could expose the bank to unidentified legal liability. Some of the items to consider include:
  - FDIC deposit insurance requirements versus collateralization requirements on deposits that exceed FDIC insurance limits.
  - The current Depository Agreement established a 115 percent collateral coverage, which the repo accounts do not have. Legal review and management's due diligence must determine if the repo accounts are an acceptable option for b4,b8. If the b4,b8 does not approve of the current repo collateralization structure, management must assess the potential risk of any alternative arrangements to the bank's capital, liquidity, and earnings.
  - Proper titling of the Estate and Reserve accounts.

- Obtain a legal analysis and opinion of whether the incoming funds for the Estate account constitute brokered deposits to properly identify the risks of a possible funding concentration. The bank is responsible for determining whether these deposits are brokered deposits.

- Expand the due diligence to cover all of b4,b8 related entities (affiliates and subsidiaries) to determine their status in the b4,b8 and their potential impact to the proposed deposit activities and bank's risk profile. This process is necessary to properly assess the risk profile of other entities that may be involved in this transaction.

- Expand the third party vendor due diligence for b4,b8 and b4,b8 to specifically assess their liquidity positions and how it could affect the bank's credit, liquidity, and capital positions. Delays in processing transactions or the counterparties' inability to pre-fund transactions could result in financial exposure to the bank.

- Ensure any agreements and contracts made between the bank and third parties clearly outline the expectations of each party's role and responsibilities in regards to ongoing reporting requirements, AML/CFT, consumer compliance, and funding of ACH activities. Clarifying roles and responsibilities allows accountability and accurate risk assessment for all parties.

- Research accounting and call report treatment of b4,b8 Repo balances or one-way ICS sales to ensure compliance with GAAP and regulatory guidance, and to assess the potential impact on capital and liquidity and ensure accurate communication of the bank's financial condition.

- Clarify and document b4,b8 b4,b8 to allow accountability, including the following:
  - Who maintains records of the b4,b8 customers?
  - Who controls the funds?
  - Who authenticates the customer and balance?
  - Who will authorize the ACH or provide transfer instructions to b4,b8?
  - Does the b4,b8 need to provide approval for all transactions and how would this requirement potentially affect timing?
  - How will the bank receive the ACH file?
  - How will OFAC and any other transaction monitoring occur?
  - Who will reconcile and verify the ACH transaction at the bank end?
  - How will funds be requested from b4,b8
  - What is the timing required to receive those funds?
  - Who will communicate to b4,b8 customers as transactions are processed?
  - Other necessary and prudent steps to ensure the provisions of all contracts and agreements are met.

- Specifically consider and document that b4,b8 and all other relevant parties have the information and controls necessary for the disbursements. Failing to complete this step could result in legal risk to the bank.
  - Confirm the entity having the rights to disburse funds also has appropriate controls to ensure funds are delivered to the intended recipient.
  - If the disbursing entity is a third party, the bank must determine and document what oversight is necessary and ensure they have the contractual ability, staffing, and expertise to perform such oversight.

- Document expectations of transaction inflow/outflow for each deposit account, as well as the plan of action should activity deviate from these projections. Establishing expectations in advance would allow management to identify if any changes to the program are necessary to manage higher or lower volume as the transaction proceeds.

- Establish a more detailed cost/benefit analysis of the proposed deposit relationship and activities to identify cost overruns or revenue shortfalls relative to the risk of the transaction. This analysis should itemize the following items:
  - Interest income received and paid on deposit accounts.
  - Personnel expense allocated to due diligence, contingency planning, and administration.
  - Potential ancillary expenses associated with each scenario (legal, accounting, contract employees or additional staffing, insurance).

- Develop a written plan for enhanced, ongoing intraday liquidity and capital monitoring to deal with any resulting issues regarding transfer of funds between the bank and b4,b8 requests, or demands from b4,b8 Inadequate monitoring could result in severe negative consequences to the bank's financial condition.

- Review blanket bond and other insurance requirements to determine the cost of additional coverage and what specific procedures are needed. Inadequate insurance coverage could result in significant loss exposure for the bank.

Risk Assessment

- Complete an expanded risk assessment of the proposed deposit relationship and activities. Comprehensive risk assessment is vital to identify and measure the risks presented by this transaction and confirm a sound financial condition. Management must ensure the risk assessment details all potential risks and any mitigating factors, including but not limited to the following:
  - Liquidity, capital, and credit risks that may arise due to timing differences between receiving ACH requests from b4,b8 and processing the transaction to receive the funds from b4,b8
  - Liquidity and capital risks arising from b4,b8 terminating the repo account or b4,b8 ending their relationship with the bank, or ceasing to exist as an entity for any reason during the projected term of the relationship.
  - Risk that could arise from any future litigation, liquidity concerns, or negative publicity surrounding the liquidation of funds or the parties tangentially involved in the transaction.
  - Legal and regulatory risks associated with the Uniform Depository Agreement requirement to ensure deposits are appropriately collateralized and the bank's plan to use the b4,b8 service.
  - AML/CFT risks associated with the accounts and their beneficial owners.
  - Consumer protection and compliance issues, including Unfair, Deceptive, or Abusive Acts or Practices (UDAP) and customer disclosures.

Contingency Planning

- Develop contingency funding and operating plans to prepare for potential disruptions in the proposed deposit account activities. These plans are vital and must be thoroughly developed to consider all potential risks and ensure adequate financial condition. Plans must include detailed capital and liquidity plans and projections in case the b4,b8 relationship is terminated or the b4,b8 requires the deposits to be held at the bank.

- Develop an exit strategy to unwind the relationship should the Board or management decide to exit the arrangement prior to the full liquidation of the accounts. This exit strategy must include income and expense projections and measure the potential impacts to capital and liquidity. Failure to document an exit strategy could result in unexpected expenses and impair the financial condition of the bank.

Policies

- Revise the AML/CFT policy to include the proposed deposit relationship and activities. Ensure the policy addresses the risks identified in the related risk assessment. The policy should consider and clearly document the responsibilities of the bank and third parties in this area, such as ensuring OFAC searches on ACH transactions and files. Failure to complete these steps could result in facilitating suspicious activity or processing illicit transactions.

- Review and revise, as needed, the bank's consumer compliance policies to ensure they address any additional risks or requirements associated with the proposed deposit relationship and activities. The policies should clearly spell out the responsibilities of third parties to ensure the bank is meeting its consumer disclosure and UDAP requirements to avoid causing customer harm.