

Capital Policy and Safeguards Statement for Merchant Acquirer Limited Purpose Banks

Capital

Each of the minimum capital requirements is designed to stand alone, and each of the capital requirements must, at a minimum, be maintained at all times by the MALPB in order to be considered adequately capitalized. In order to promote standards of safety and soundness, the Department may require an MALPB to maintain additional capital beyond the statutory and regulatory minimums based on the MALPB's specific risk profile and operating model. The requirement for any such additional capital will be determined by the Department through processes conducted in accordance with the Department's supervisory and examination guidance and in consideration of industry standards and best practice.

Statutory Capital

The statutory minimum capital requirement of \$3 million and the composition of statutory capital are established and defined in the Merchant Acquirer Limited Purpose Bank Act.

Tier 1 Capital

Tier 1 capital is comprised of tangible elements and cash equivalents available to absorb loss beyond that expected and otherwise reserved for by an MALPB in the normal course of business. Allowing for the use of alternative elements such as a capital letter of credit and the secured portion of a capital maintenance guaranty as capital provides a mechanism for investors in and/or the holding company of an MALPB to manage the deployment of funds in the best interest of the investor/holding company while still providing a timely and reliable source of funds available to the Department, if needed, to resolve an MALPB with little or no loss to the merchants for which it provides acquiring services and most of its creditors. The Department will require that a capital letter of credit be issued by a financial institution independent of either the MALPB or its holding company in order to limit the potential risk of an event simultaneously impairing the financial capacity of both the MALPB and its holding company and to introduce an additional element of market discipline to the financial soundness of an MALPB. Since a holding company is expected to serve as a source of strength to its MALPB subsidiary, a capital maintenance guaranty may be required by the Department, but only the portion of that guaranty that is properly secured by collateral of a type and form acceptable to the Department may be considered as tier 1 capital.

In its analysis of the acceptability of a secured guaranty for tier 1 capital purposes, the Department will only consider collateral in the form of an assigned deposit account or high quality investment security. Any such deposit must be non-checkable, have a remaining maturity of not less than 12 months, and be issued by a federally insured financial institution authorized to do business in Georgia that is independent of either the MALPB or its holding company and determined by the Department to be in a satisfactory condition. A copy of the certificate of deposit or other proof of ownership specifying the dollar amount of the deposit account must be provided to the Department along with proof of hold status (as appropriate), a properly executed assignment of the deposit account to the MALPB, and a corporate resolution under seal by the deposit account owner authorizing the assignment. Any assigned debt or equity investment securities must be issued by a company unaffiliated with the MALPB or its holding company and have an investment grade rating from at least two nationally recognized statistical ratings organizations within one of their three highest ratings bands. The investment securities must be publicly traded in active markets on an exchange located in the United States with sufficient depth to provide reasonable assurance that a current price quote will be available with a modest bid/ask spread. Debt securities must have a remaining maturity of not less than 12 months. The investment securities must be held in safekeeping by a third-party unaffiliated with the MALPB or its holding company that is acceptable to the Department for this purpose. In addition to proof of ownership (certificate or otherwise), safekeeping, and pledge, the investment securities must be properly assigned to the MALPB on an irrevocable stock/bond power form, along with a corporate resolution under seal by the investment security owner authorizing the assignment. In order to be considered for tier 1 capital treatment, the secured portion of the capital maintenance guaranty must at all times be fully collateralized by at least 100 percent of the dollar amount of assigned deposit accounts, 110 percent of the lesser of book or market value of the assigned debt investment securities, 200 percent of the market value of assigned equity investment securities, or any

combination thereof. The Department in its sole discretion reserves the right, at any point in time, to request substitution of any collateral that it determines has failed to meet the criteria set forth in this paragraph. If the Department, in its sole discretion, determines at any point in time that the collateral (even after substitution) is not acceptable, the Department may rescind any previous approvals of tier 1 capital treatment for the secured portion of the capital maintenance guaranty.

Leverage Capital Ratio

The minimum leverage capital ratio requirement is an on-balance-sheet measure designed to ensure that the MALPB remains financially solvent. The numerator is tier 1 capital, which focuses on tangible equity and cash equivalents in order to ensure that the MALPB can be resolved, if needed, by the Department through the receivership process with little or no loss to the merchants for which it acquires and most of its creditors. The denominator of this ratio is the average total assets of the MALPB calculated using end-of-day balances. Merchant funds in process, along with any related receivables or payables, when properly segregated and safeguarded in conformity with the law and the Department's rules, are considered to be the property of the individual merchant held by the MALPB in a "trust" capacity. Accordingly, assets and liabilities associated with properly segregated and safeguarded merchant funds in process are not reflected on the balance sheet of an MALPB for purposes of calculating average total assets. However, merchant funds in process that an MALPB treats as its own property or fails to properly segregate and safeguard would be on-balance-sheet, included in average total assets, and included in the denominator of average total assets for capital adequacy calculations. The 10 percent minimum threshold for the leverage capital ratio is based in part on a best practice standard in traditional banking companies. Although a higher level than the "adequately capitalized" for prompt corrective action (PCA) standard for traditional banks of 4 percent, a level which has proven in practice to be wholly inadequate to ensure solvency, the lack of diversification and mono-line nature of the MALPB business model warrants a higher minimum requirement. In addition, the PCA standard for traditional banks inadequately captures the operational risk inherent in the MALPB business model with its substantial number and dollar volume of daily payment transactions. The Department considered a 14 percent leverage ratio requirement based on a Canadian proposal for a charter/licensee similar to the MALPB, but targeted the 10 percent minimum threshold as a reasonable, supportable, but prudent middle ground.

Payment Volume (PV) Capital

The minimum PV capital requirement is an off-balance-sheet measure designed to ensure maintenance of adequate capital to absorb loss beyond that expected and otherwise reserved for by an MALPB in relationship to the number and dollar amount of transactions processed. The minimum PV capital requirement is based in large part on the EU Payment Services Directive (EU PSD) "own funds" calculation with percentages and tiers that roughly approximate the PSD plus a modest incremental increase to account for differences between the U.S. and European retail payment systems, most notably the potential for higher fraud risk in the U.S. system due to the absence of broad implementation of pin and chip technology. A forward-looking element is incorporated into the minimum PV capital requirement in that its calculation is based upon the greater of an MALPB's actual PV experience or stressed projections subject to the Department's supervisory and examination oversight.

The PV capital calculation captures the inherently higher level of operational risks associated with greater volumes of payment transactions. Most notably, the inherent risk of events such as a data breach and the associated operational, legal, and reputational costs of remediation have a positive correlation to PV. The adequacy and comprehensiveness of an MALPB's data security control environment, to include its insurance program, will be considered as mitigating factors in assessing the adequacy of an MALPB's minimum PV capital requirement relative to the residual risk of such events. The adequacy of operational and information technology controls as well as outsourcing arrangements with eligible organizations, support organizations, and other third-party service providers, including the quality of oversight and risk management of these third-parties, will be assessed. In addition, changes in MALPB business model and strategy, changes in environmental factors such as emerging technologies and innovations in payment systems that either improve or degrade operational controls and risk profile of the MALPB, and changes in legal and compliance factors that impact the risk of litigation, fines, and penalties will also be assessed. In addition to operational risk, PV capital is a broad measure which accounts for the inherently higher credit and fraud risk associated with greater volumes of payment transactions. The minimum PV capital requirement increases at a diminishing rate at each higher tier of PV in recognition of diversification benefits across a large number of transactions. The assumption of diversification across individual customer transactions,

merchants, industries, and geographies reflected in the diminishing rate will be assessed through the Department's supervisory and examination processes. In general, concentrations of exposure in any category will be considered to be inherently higher risk with stronger controls and/or higher PV capital levels expected. Based on the evaluation of these and any other factors considered by the Department to be pertinent, the Department will determine, in accordance with its established supervisory and examination guidance and in consideration of industry standards and best practice, whether additional PV capital beyond the minimum will be required. It is recognized that the broad and somewhat crude nature of PV capital results in a calculation that is neutral to differences in the credit and fraud risk profiles of various MALPB business models. Those differences are most directly accounted for in the risk capital calculation.

Risk Capital

The minimum risk capital requirement directly accounts for the MALPB's actual chargeback experience and is designed to ensure maintenance of adequate capital to absorb loss at least to the level expected by an MALPB in relationship to its credit and fraud risk profile. A forward-looking element is incorporated into the minimum risk capital requirement in that its calculation is based upon the greater of an MALPB's actual experience or stressed projections subject to the Department's supervisory and examination oversight. Assessments of risk capital adequacy will include changes in an MALPB's business model or strategy, underwriting standards, and business mix in addition to environmental factors such as changes in the credit or fraud risk characteristics of particular merchants or industries with which the MALPB does business. Other pertinent factors to be considered include, but are not limited to, the transaction type (e.g. debit-PIN, debit-signature, credit), transaction nature (e.g. in-store, online, mobile), transaction characteristics (e.g. high dollar, extended delivery period, fragile/perishable), merchant characteristics (e.g. established-public, established-private, start-up, online), industry characteristics (e.g. subscription, adult only, drug-pharmaceutical, gaming, legal-jurisdiction specific), concentrations (e.g. transaction, merchant, industry, geography). Based on the evaluation of these and any other factors considered by the Department to be pertinent, the Department will determine whether additional risk capital will be required. The Department considered various methodologies made available to it by non-bank merchant acquirers in developing the approach and time frames used in the minimum risk capital requirement.

Capital and Dividend Policy

In addition to these statutory, regulatory, and supervisory capital requirements, the Department expects every MALPB to have a capital and dividend policy that aligns capital quality and levels to the risk appetite and business strategy of the MALPB's board of directors and senior management. The capital and dividend policy is expected to incorporate stress scenarios and a stress testing methodology that adequately capture the inherent and residual risk exposures of the MALPB based on current and planned operations as well as expected changes in the industry and its operating environment. Contingency capital raising strategies should be addressed and incorporated into the stress scenarios. Capital preservation from a safety and soundness perspective should be incorporated into the dividend section of the policy. It is expected that the analysis underlying the development and review of the capital and dividend policy will assist the MALPB's board of directors and senior management in strategy development as well as decisions on the sufficiency of investment in risk management and controls. The MALPB's capital and dividend policy must be reviewed and approved by its board of directors on at least an annual basis, or more frequently as warranted by material changes in strategy or the operating environment.

Consequences of Inadequate Capital

Failure by an MALPB to operate with adequate levels of capital, whether statutory, regulatory, or additional capital required by the Department based on the risk profile of an MALPB, may result in fines and enforcement actions that include forfeiture proceedings and resolution of the MALPB by the Department. An MALPB operating with inadequate capital levels must promptly provide the Department with a written capital restoration plan that describes how and when the MALPB will be restored to an adequate capital position. Should the MALPB be unable to meet and maintain an adequate capital position and the MALPB is placed in receivership, the receivership letter of credit will be used to defray the costs and expenses associated with the receivership. Because the holding company, if any, is expected to serve as a source of strength to its MALPB subsidiary, the Department or receiver may pursue collection efforts against the holding company for any deficiency in funds available to resolve fully the MALPB.

Should any funds remain after fully resolving the MALPB, including the costs and expenses associated with the receivership, the remaining funds will be returned to the MALPB holding company and/or investors.

Calculating Capital Using Projections

In the absence of actual financial data to calculate the minimum regulatory capital ratios, such as in the case of a de novo MALPB at start-up or in its initial months of operation, projected financial data provided by the MALPB will be used as the basis for establishing the minimum regulatory capital requirement, subject to review and adjustment by the Department. For example, an MALPB at start-up will be required to have and maintain minimum PV capital based on its projected payment volume for the upcoming 12 months, subject to review and adjustment by the Department. Once actual data becomes available, the MALPB must use the actual data in place of the projected data covering the same time period. For example, a de novo MALPB has been in operation for 4 months. Its minimum PV capital is calculated using the greater of its actual payment volume for the 4 month period plus its projected payment volume for the upcoming 8 months or its projected payment volume for the upcoming 12 months, subject to review and adjustment by the Department. The same procedure is applicable to chargebacks and end of day total asset used to calculate the minimum risk capital and the denominator for the leverage capital ratio requirements, respectively.

Safeguards

The following safeguards are primarily designed to promote confidence in the MALPB charter by providing reasonable assurance to merchants and card networks that merchant funds processed through an MALPB will reach the intended recipients. Each of the following safeguards is a critical element to MALPB capital adequacy. Accordingly, weaknesses in any of these safeguards will result in consideration of capital requirements in excess of the minimums calculated, or such higher amounts required, by the Department following processes set for the in the Capital section. For example, weaknesses in the segregation of merchant funds in process should result in those funds along with related receivables and payables being reflected on the MALPB's balance sheet for calculation of average total assets, and inadequacies in insurance coverage should be added to the regulatory capital requirements. Serious deficiency in any of these safeguards in and of itself establishes the basis for regulatory capital requirements substantially higher than the minimums.

Segregation of Funds

An MALPB is required to implement controls that preclude the comingling of merchant and MALPB funds and which account for merchant funds in process at the individual merchant level, thereby increasing the level of accountability and transparency to the Department and auditors. In order to isolate processing funds from creditors, even in the event of bankruptcy, the MALPB is prohibited from pledging or otherwise granting a security interest in merchant funds. With the exception of contractually provided for netting arrangements covering the MALPB's costs of providing merchant acquiring services, all merchant funds in process must be immediately deposited and maintained in a deposit account administered by a financial institution that is federally insured and authorized to do business in Georgia. Merchant funds in process are deemed to be the property of each individual merchant. All account records shall expressly provide that the deposit account is maintained for the benefit of the MALPB's individual merchants and shall be kept in such a manner that the total amount held in the deposit account can be readily ascertained for each individual merchant. The MALPB is expected to structure the deposit account so that federal deposit insurance coverage, up to the maximum insurable limit, passes through to the funds held on behalf of each individual merchant.

Fidelity Insurance Coverage

Fidelity insurance (bond) coverage protects, among other things, merchant funds in process from misappropriation or defalcation by MALPB insiders, not otherwise adequately protected by the MALPB's system of internal controls, and serves to provide another element of market discipline on the MALPB's operational controls through the insurance underwriting process. The minimum required level of fidelity insurance covers the maximum expected volume of processing funds flowing through an MALPB without regard to seasonal or processing period

fluctuations. On an exception basis, the Department may consider and approve other reasonable levels of fidelity insurance coverage that provide for comparable protection. Any requests for exception must be supported by an analysis, prepared by or on behalf of the MALPB, that includes stress scenarios in addition to the MALPB's actual experience, and which addresses anticipated changes in both business model and operating environment. The analysis should be reviewed and approved by the MALPB's risk and governance infrastructure before being presented to the Department for its consideration. In assessing the sufficiency of fidelity insurance coverage, both physical and logical controls over the movement of funds, in addition to the framework for independent oversight and testing of those controls, should be considered. Particular, but not exclusive, focus should be placed on the dollar amount of merchant funds in the care, custody, or control of the MALPB, its agents, or contractors, which includes its affiliates.

Data Breach Insurance Coverage

Data breach is considered to be one of the greatest risks to the financial stability of a merchant acquirer as well as to confidence in the MALPB charter and the broader retail payment system. Since the inherent risk of a data breach and the associated operational, legal, and reputational costs of remediation have a positive correlation to PV, current and projected levels of PV are key elements to be considered in evaluating the adequacy of data breach insurance coverage. Every MALPB is required to obtain data breach insurance coverage sufficient to provide protection and indemnification against the release of nonpublic confidential information in the care, custody, or control of the MALPB, its agents, or contractors, which includes its affiliates. The amount and form of coverage is specific to each MALPB and its particular business model, but the amount should be well supported by an analysis prepared by or on behalf of the MALPB that includes stress scenarios in addition to the MALPB's actual experience, and should address anticipated changes in both business model and operating environment. The analysis should be reviewed and approved by the MALPB's risk and governance infrastructure before being presented to the Department for its consideration. In the absence of a well-supported analysis, the Department should base minimum data breach insurance coverage requirements on the assumption of a high risk operating environment. Data breaches are generally low frequency, high impact events that are prone to being underestimated. Potential costs considered in the analysis should include, at a minimum, forensics, legal fees, first- and third-party liabilities (such as the cost of compromised account closures and replacements by payment card issuers), notification requirements, remediation costs, restoration costs, and business impact.