

## **GUIDELINES FOR CHARTERING A MERCHANT ACQUIRER LIMITED PURPOSE BANK**

It is the Department's expectation that an entity chartered as a merchant acquirer limited purpose bank ("MALPB") will conduct merchant acquiring activities in a sound manner so that payment systems are not disrupted. The Department does not intend to place undue restraint upon MALPB applicants and encourages competition. However, in chartering a MALPB, the Department will admit only those qualified applicants that have demonstrated technical expertise and experience in providing merchant acquiring services in a safe and economically viable manner. In evaluating a new MALPB application, in addition to statutory and regulatory requirements, the following general factors will be considered: Financial Structure and Business Plan, Capital Structure and Safeguards, Management, Information Technology Systems and Data Security, Number of Georgia Employees, and Affiliates and Organizers. There is no expedited processing.

### **Financial Structure and Business Plan**

The financial structure of the MALPB applicant must comply with all applicable regulations. Books and records of the MALPB must be maintained and made available to the Department in accordance with Department Rules. The MALPB may only establish subsidiaries and invest its funds as prescribed by Department Rules or otherwise approved in writing by the Department.

The applicant must submit a Business Plan and financial projections that are reasonable and achievable. The Business Plan must encompass at least a three-year period with financial projections provided on a quarterly basis. The applicant must clearly demonstrate that adequate resources will be employed to facilitate the successful implementation of the proposed Business Plan. The financial projections must indicate the MALPB has reasonable prospects to achieve profitability. Any special market niche or nontraditional activity will be scrutinized to determine consistency with statutory and regulatory requirements and appropriateness with the authority granted under a MALPB charter. The Business Plan must clearly indicate any plan to engage in settlement activities, and the MALPB must obtain the Department's specific, prior written approval before engaging in settlement activities.

### **Capital Structure and Safeguards**

Minimum capital requirements and safeguards for MALPBs are specifically designed to:

- 1) Promote confidence by the general public in the MALPB charter;
- 2) Provide mechanisms to protect merchant funds in process; and
- 3) Ensure adequate financial resources to support processes and systems that meet regulatory and industry standards for protection of confidential consumer information.

While not specifically designed for this purpose, it is recognized that the MALPB minimum capital requirements and safeguards indirectly provide a degree of protection to the interests of creditors, card networks, and the broader retail payment system, all of which are important to the acceptance and effective operation of MALPBs in the conduct of merchant acquiring activities. These capital requirements are designed to provide for minimum capital buffers that promote solvency and viability such that a MALPB can effectively serve the charter's role of facilitating the processing of payments accepted by merchants through card networks while safeguarding the

confidential consumer information in its possession. Capital buffers sufficient to support a MALPB's ability to safely and soundly carry out its role, even through periods of entity specific or broader economic stress, are important to general public and creditor confidence in both the individual MALPB and the charter as well as the acceptance of the charter by merchants and card networks as a desirable merchant acquiring platform. The minimum capital requirements are based in part on a combination of traditional banking capital standards and those applicable to similar entities currently operating as merchant acquirer members of card networks in the European Union (EU) under the framework established in the Payment Services Directive (PSD). Safeguards established in the Department's rules are designed to allow for the methodical and incremental ramp-up of merchant acquiring activities by a MALPB while incorporating similar safeguards to those currently applicable to merchant acquirers operating under the PSD and laws of the various EU countries. As a track record of performance for this new charter is established and payment systems continue to evolve through innovation and new standards, it is expected to be an ongoing process for the Department to review and modify, through its rulemaking authority and issuance of supervisory guidance, MALPB minimum capital requirements and safeguards as appropriate and prudent.

The minimum initial capital required for a MALPB must satisfy the requirements under applicable laws, Department Rules, and these Guidelines. 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. To promote standards of safety and soundness, the Department may require a 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 a 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 a 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 a 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 a 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 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 a MALPB for purposes of calculating average total assets. However, merchant funds in process that a 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 monoline 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 a 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 a 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 and legal costs of remediation have a positive correlation to PV. The adequacy and comprehensiveness of a MALPB's data security control environment, to include its insurance program, will be considered as mitigating factors in assessing the adequacy of a 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 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 a 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 a 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 a 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), and 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 a MALPB to operate with adequate levels of capital, whether statutory, regulatory, or additional capital required by the Department based on the risk profile of a MALPB, may result in fines and enforcement actions that include forfeiture proceedings and resolution of the MALPB by the Department. A 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, a 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 a 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

A 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.

### 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 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 a 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 an 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 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 and legal 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 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.

### Management

The application must clearly demonstrate that the proposed Board of Directors and day-to-day management team have the character, experience, competence, and ability to oversee a sound institution and achieve the goals of the Business Plan. The organizers, proposed executive officers, directors, control persons, and principal shareholders of the proposed MALPB should be of good moral character, should have successful employment and business histories, should be responsible in personal and financial affairs, and must not have any felony conviction. The majority of directors should not be officers or employees of the MALPB.

The name and resume of the proposed Chief Executive Officer must be submitted with the MALPB charter application. To protect the proposed Chief Executive Officer's current employment, such information may be included in the confidential section of the application. The proposed Chief Executive Officer should have been continuously employed in a field related to merchant acquiring or credit card processing for the five years immediately preceding the filing of the application.



Before a MALPB charter will be granted, the applicant must submit qualified candidates for the supporting executive officer positions of Chief Risk Officer and Chief Information Officer. The Chief Risk Officer shall be responsible for oversight of the MALPB's infrastructure to measure, monitor, report, and control risks inherent in the business of merchant acquiring (including, but not limited to, operational/technological, credit, liquidity, legal/compliance, market, and strategic risk), and the Chief Information Officer shall be responsible for oversight of the integration of business and technological resources in the conduct of merchant acquiring activities in a safe and sound manner (including, but not limited to, the maintenance of robust data security, systems performance, and compliance standards). Additional executive officer positions may be required as warranted by the applicant's Business Plan and scope of proposed activities. An individual shall not serve simultaneously in more than one MALPB executive officer position. All executive officers should have demonstrated sufficient abilities and experience commensurate with the position for which proposed. Compensation for executive officers shall be reasonable based upon the proposed Business Plan and normal and customary levels of compensation within the industry.

A detailed review of internal operations and policies, control processes, and audit procedures will be conducted as part of the evaluation of Management. In addition, a detailed review of risk mitigation strategies will be conducted. The applicant shall deploy sufficient resources to ensure the proposed MALPB complies with all applicable state and federal laws, regulations and guidance including, but not limited to, *Interagency Guidelines Establishing Information Security Standards*, *Interagency Guidance on Response Programs for Unauthorized Access to Customer Information and Customer Notice*, customer identification standards, suspicious transaction reporting, anti-money laundering requirements, and Office of Foreign Assets Control requirements.

### **Information Technology Systems and Data Security**

The application shall clearly demonstrate that information technology systems and data security controls are sufficient for the size and scope of the proposed activities of the MALPB applicant. The application should describe in detail policies and procedures to protect against data compromises, data processing errors, and data theft and include the level and coverage of insurance policies. The application should describe in detail procedures for evaluating and selecting eligible organizations, support organizations, and third-party service providers to mitigate any potential breaches. Sufficient resources and personnel shall be committed to the Information Technology and Data Security areas.

### **Number Of Georgia Employees**

The applicant must submit a detailed plan for achieving full compliance with the statutory requirement of employing no fewer than 50 employees located in Georgia devoted to merchant acquiring activities within one year of issuance of the MALPB charter. The application must clearly indicate if the applicant intends to invoke the eligible organization allowance provision, under Section 7-9-4(c) and Rule 80-12-4-.04(2) and (3), to meet the minimum employee requirement. In such case, the total number of required employees at the eligible organization will be determined pursuant to Department Rule 80-12-4-.04.

### **Affiliates And Organizers**

The financial condition, standing, and performance of all affiliates and organizers of the applicant will be considered in the evaluation of the MALPB charter application. Organizers should be of good moral character, must not have any felony conviction, should have successful employment and business histories, and should be responsible in personal and financial affairs. An entity seeking to form a new MALPB charter must submit all information as required under the MALPB charter application. An entity will be considered a MALPB Holding Company if it will own or control a MALPB institution. The proposed MALPB shall not engage in self-acquiring activities at any time.

All expenses incurred in connection with the organization of the MALPB are to be assumed by the organizers. If a charter is issued, expenses determined to be reasonable by the Department may be reimbursed by the MALPB after the commencement of business. In no event shall the amount of or payment of any fee be solely contingent upon action, decision, or forbearance on the part of the Department. A contingent expense or fee will ordinarily result in disapproval of the application.

### **Other Matters**

Requests for reconsideration of disapproved applications will not be accepted. A new application along with the required filing fee may be filed at any time by submitting substantive new or additional information to the Department. To the extent relevant, the Department will consider and incorporate the prior administrative record. If a charter application is disapproved, a written statement of the general factors influencing the decision will be provided to the applicant.

The time allowed to open for business normally will be one year from the date of issuance of the MALPB charter. The MALPB charter will expire if the MALPB is not open for business within this one-year period unless an extension is approved in writing by the Department.