



GOVERNMENT OF PUERTO RICO

George Joyner
Commissioner

Office of the Commissioner of Financial Institutions

April 12, 2018

TO: ENTITIES SEEKING TO ORGANIZE INTERNATIONAL FINANCIAL ENTITIES UNDER PUERTO RICO ACT 273-2012 TO ENGAGE IN FINANCIAL ACTIVITIES RELATED TO BLOCKCHAIN TECHNOLOGY AND VIRTUAL CURRENCIES

FROM: GEORGE JOYNER, COMMISSIONER OF FINANCIAL INSTITUTIONS

RE: OCFI STATEMENT AND GUIDELINES: Availability of IFE Charter under Puerto Rico Act 273-2012 to engage in certain financial activities related to Blockchain technology and virtual currencies¹

INTRODUCTION

The Office of the Commissioner of Financial Institutions ("OCFI" or "Office") has considered whether it is in the public interest to entertain applications for an international financial entity ("IFE") charter under Puerto Rico Act 273-2012, as amended ("Act 273" or "the IFE Act"), known as the "International Financial Center Regulatory Act", and Regulation 5653² issued by the Office pursuant to Puerto Rico Act No. 52 of August 11, 1989, as amended, ("Act 52", known as the "International Banking Center Regulatory Act"), from entities that intend to engage in the provision of financial services to

¹ These guidelines are fashioned after similar statements issued by the Office of the Comptroller of the Currency ("OCC") in connection with Special Purpose National Bank Charters for Financial Technology Companies. However, they have been modified to conform to the legislation implemented by the OCFI as well as to the OCFI's existing structure and organization.

² Article 27 of Act 273-2012 provides that regulations enacted under Act 52 shall apply to the organization and governance of IFES until such a time as regulations are enacted under Act 273-2012.

foreign persons³ which services involve the use of distributed ledger technology ("DLT") or Blockchain or are somehow related with virtual currencies.

The OCFI has met with several components of the DLT and virtual currency sector and has carefully considered some of the issues presented by this sector. While the licensing process of this type of IFEs is actually contemplated in Act 273 and Regulation 5653, this statement explains the OCIF's approach to these applications in order to provide guidance to any entity that may wish to file an IFE charter application to engage in financial services related to DLT or virtual currencies.

THE OCFI SUPPORTS RESPONSIBLE INNOVATION

The OCFI supports innovation in the provision of financial services by entities chartered under laws entrusted to this agency for implementation and supervision. We believe innovation has the potential to broaden access to financial services. We are cognizant of the efforts of financial institutions and of entities interested in being chartered as financial institutions under the laws of Puerto Rico to adopt new approaches and technologies in a constantly evolving marketplace to provide financial services to all types of consumers.

We envision the role of the OCFI as to encourage and support institutions' efforts to engage in responsible innovation to meet the needs of consumers, businesses and communities. The OCFI's decision to issue this Statement and Guidelines is consistent with that support.

The OCFI intends to provide a framework of uniform standards and robust supervision for entities that qualify to be chartered under Act 273. The Office is interested in ensuring that IFES organized under Act 273 operate in a safe and sound manner and fairly serve the

³ Section 2(j) of Act 273 defines "domestic person" as "Any natural person who is a resident of Puerto Rico, a person incorporated or organized under the laws of Puerto Rico, or a person whose principal place of business is located in Puerto Rico, or a foreign corporation that has an office that under the Code provisions deemed doing business in Puerto Rico, and the Government of Puerto Rico, its agencies, instrumentalities, political subdivisions, public corporations, or other entities of the Government of Puerto Rico. The Secretary of the Treasury may establish by regulation those instances in which this definition excludes foreign corporations doing business with offices in Puerto Rico." Section 2(k) of Act 273 defines "foreign person" as "Any person who is not a domestic person."

needs of the consumers, businesses, and communities which they intend to serve.

The underlying intention in this process is to better understand innovation occurring in the financial services industry and to develop a framework to support responsible innovation in the local financial system entrusted to the chartering and supervision by the Office.

To deepen our knowledge, in addition to extensive research and study of these matters, we intend to meet with each applicant in order to learn its particular technology, business model, intended recipient of financial services and other specific details related to its specific business plan for an IFE chartered under Act 273.

PRINCIPLES GUIDING OCFI'S EVALUATION OF APPLICATIONS

In evaluating applications from entities seeking an IFE charter to engage in financial services involving DLT or virtual currencies, the Office will be guided by the following threshold principles:

1. The OCFI will not allow the inappropriate commingling of banking and commerce.
2. The OCFI will not allow products with predatory features nor will it allow unfair or deceptive acts or practices.
3. IFES are deemed by the OCFI, not to be banks under federal banking and securities laws. Applicants holding a different position may submit legal argumentation in support of their particular position on this matter. In the absence of a binding determination from the appropriate federal securities or banking regulator pertaining specifically to the IFE, the OCFI will conduct an independent legal analysis and determination of this matter.
4. Any entity granted an IFE charter under Act 273 will be held to the same high standards that, by analogy, all federally chartered banks must meet. Accordingly, such institutions must be considered to be a safe and sound financial institution, in the manner provided by federal and state banking statutes and verification of which is provided for in federal examiners' manuals such as those used by the Federal Deposit Insurance Corporation.
5. IFES must meet the "well capitalized" criteria established in the manner provided by federal and state banking statutes and verification of which is provided for in examiners' manuals such as those used by the Federal Deposit Insurance Corporation.
6. IFES must comply with all pertinent provisions of the Bank Secrecy Act ("BSA") Anti-Money Laundering ("AML") provisions,

and the U.S. Treasury's Office of Foreign Assets Control ("OFAC") requirements.

7. In many instances, BSA, AML and OFAC requirements involve knowing your customer's customers. This matter will be addressed in the sessions during which each particular application is discussed with our Licenses and Permits Division. In order to accelerate the evaluation process, applicants should provide the Office with a proposal and argumentation in support of the position that such proposal complies with the federal laws on these matters.
8. Compliance with BSA, AML and OFAC provisions and regulations is a central part of the governance measures required by the IFE Act. The IFE's Board of Directors is required to be directly engaged in BSA, AML and OFAC compliance matters. Accordingly, to expedite consideration of application for an IFE charter, applicants should provide detailed information on their BSA/AML/OFAC compliance program and policies.
9. Background investigation of insiders and ultimate owners of the proposed IFE is the backbone of our analysis. Applicants should inquire with our Licenses and Permits Division on firms providing such investigative services.

DEFINITION OF KEY CONCEPTS

For purposes of this Statement and Guidelines, we define the following terms:

1. The phrases "Distributed Ledger Technology" or "Blockchain technology" means "distributed ledger technology that uses a distributed, decentralized, shared and replicated ledger, which may be public or private, permissioned or permissionless, or driven by tokenized crypto economics or tokenless. The data on the ledger is protected with cryptography, is immutable and auditable and provides an uncensored truth."

2. The phrase "Virtual currency" means any type of digital representation of value that: (A) Is used as a medium of exchange, unit of account or store of value; and (B) Is not recognized as legal tender by the United States government.

3. For purposes of this Statement and Guidelines, "IFE" means "an international financial entity chartered under Act 273 that engages in a limited range of financial activities listed in Section 12 of Act 273."

SCOPE OF STATEMENT AND GUIDELINES

The OCFI has regulations and policies that govern its review and decision making with respect to chartering IFEs under the IFE Act. Consistent with administrative law terminology, these guidelines frequently refer to chartering as a "licensing" process. The OCFI will apply the licensing standards and requirements in its existing regulations and policies to companies or entities applying for an IFE charter.

This Statement and Guidelines apply specifically to the OCFI's consideration of applications to charter an IFE that intends to provide financial services using DLT and/or are related to virtual currencies.

The OCFI recognizes that IFES that want to operate under an Act 273 charter will choose different ways of doing so. The OCFI anticipates that the activities of companies interested in an IFE charter for provision of financial services with DLT and related systems, including services connected with virtual currencies, may vary significantly. As noted above, IFE charter applicants are held to the same chartering standards and procedures whether seeking to become an IFE engaged in traditional financial services or an IFE engaged in financial services related to DLT and/or virtual currencies. In each of these cases, an applicant that receives OCFI approval for an IFE charter becomes a financial institution subject to the supervision of the Office and governed by the laws, regulations, and federal supervision that apply to all IFES.

INITIAL STEPS TOWARD AN IFE CHARTER

Applicable Licensing Procedures; Initial Contact with the OCFI

The OCFI uses its existing chartering standards and procedures as the basis for processing applications for all IFES. Companies or entities considering applying for an IFE charter should carefully review the materials which will be provided by the Division of Licenses and Permits of the OCFI (the "Licensing Division"), upon initial contact with the OCFI.

Companies or entities seeking an IFE charter should make an initial inquiry concerning a charter application through the OCFI's Licensing Division, irisj@ocif.pr.gov or 787-723-3131, extension 2222. The Licensing Division is the primary point of contact within the OCFI for all inquiries related to IFES, including questions and preliminary inquiries related to chartering. If a company is interested in further discussions regarding an IFE charter, the Office will schedule an

exploratory meeting with the prospective applicant. The meeting will include a discussion of the company's business model, this Statement, and the OCFI's expectations.

Prefiling Communications with the OCFI

Applying for an IFE charter is an iterative process, and the OCFI finds it mutually beneficial for the applicant and the OCFI to maintain an open dialogue throughout the process. After the exploratory meeting, the OCFI will begin to identify aspects of the proposed charter that present novel or complex issues.

The prefiling stage may include one or more formal prefiling meetings with the Commissioner of Financial Institutions (the "Commissioner") and the OCFI Licensing Division. The number and frequency of meetings will depend on the novelty and complexity of the applicant's proposal.

Before the initial formal prefiling meeting, organizers should provide the OCFI with an overview of the IFE charter proposal, including a discussion of the business plan and the relevant market, as well as any novel policy or legal issues and any unique aspects of the proposal. Applicants should also include information about the qualifications of the organizers, shareholders or stakeholders and proposed senior management. In addition, the OCFI will request informational submissions for review in advance of the submission of an application, such as a draft business plan.

ACTIVITIES OF THE PROPOSED IFE

Act 273 permissible activities: All activities of an IFE are limited to those that are permissible under Section 12 of Act 273.

In some cases, the activities proposed for an IFE may include activities that have not previously been determined to be part of the activities listed in Section 12 of Act 273. If so, the company should discuss in prefiling meetings with the OCFI the permissibility of the activities and their status under the IFE Act. The OCFI may ask applicant to prepare a legal analysis supporting its view that its proposed activities are permissible and fall within one of the categories listed in Section 12 of Act 273. In connection with the chartering process, the OCFI will conduct an independent legal analysis to determine whether the activities are permissible for an IFE.

FILING PROCEDURES—PUBLICATION AND PUBLIC COMMENT; CONFIDENTIALITY

After the prefiling phase, the organizers of an IFE should file the charter application, including the business plan and the appropriate Biographical or Background Report on all identified insiders, as required by the Licensing Division.

The filing procedures for an IFE will be substantially the same as those applicable to any other entity seeking to obtain a traditional IFE charter.

Applicants may request that confidential treatment be afforded to certain portions of the application, for example, portions containing proprietary information.

CHARTERING STANDARDS

Standards and Policy Considerations

Under the OCFI's governing statutes and regulations, in evaluating an application to establish an IFE, the OCFI is guided by the following principles:

- Maintaining a safe and sound financial and banking system;
- Ensuring compliance with laws and regulations, including BSA AML and OFAC;
- Promoting fair treatment of customers, including efficiency and better service;
- Ensuring the protection of the reputation of the jurisdiction of Puerto Rico.

The OCFI's regulations and policies also set forth additional considerations, including whether the proposed IFE can reasonably be expected to achieve and maintain profitability and whether approving its charter will foster the best interest of Puerto Rico.

Once a firm submits a proposal, the OCFI determines whether it satisfies the chartering standards in the OCFI's regulations and policies. The OCFI will not approve proposals that are contrary to OCFI policy or other established public policy. For example, proposals to provide financial products and services that have predatory, unfair, or deceptive features or that pose undue risk to consumer protection, compliance, or safety and soundness would be inconsistent with the OCFI's chartering standards and will not be approved.

Further, the OCFI will not approve proposals that would result in an inappropriate commingling of banking and commerce. As noted earlier, under its chartering standards the OCFI considers whether a given proposal is consistent with maintaining a safe and sound financial and banking system. Proposals that inappropriately commingle banking and commerce could introduce into the banking system risks associated with non-banking related commercial activities, interfere with the efficient allocation of credit throughout the economy and foster anti-competitive effects and undesirable concentrations of economic power, and would thus be inconsistent with the OCFI's chartering standards. Proposals from companies that implicate such concerns will not be approved. The OCFI also will collaborate with other regulators as necessary to avoid the inappropriate mixing of banking and commerce.

In addition, depending on the business model proposed for the IFE, the OCFI will collaborate with the Securities and Exchange Commission ("SEC"), the Commodity Futures Trading Commission ("CFTC"); self-regulatory organizations ("SRO"); other state and federal regulators, including criminal enforcement agencies, in order to evaluate and act upon applications to organize IFEs.

EVALUATING AN APPLICATION

The OCFI will evaluate an application for an IFE charter to determine whether it meets the standards and policy considerations noted above. In evaluating whether these are met, the OCFI will consider, among other things, whether the proposed IFE:

- has organizers and management with appropriate skills and experience;
- has adequate capital to support the projected volume and type of business and proposed risk profile;
- has a business plan that articulates a clear path and a timeline to profitability;
- includes in its business plan, the required provisions for strict compliance with BSA/AML/OFAC requirements.

The OCFI's evaluation may identify specific controls or requirements that are necessary for the success of the applicant's business plan or to ensure the OCFI's chartering standards are met. In such circumstances, the OCFI will impose special conditions in connection with the charter approval to achieve these goals.

Moreover, the OCFI may impose certain conditions on certain IFE charters, including the requirement that an IFE obtain a supervisory non-objection letter from the OCFI if it intends to, or deviates significantly from its approved business plan.

COORDINATION WITH OTHER REGULATORS

As noted above, depending on the structure of the proposed IFE, regulators in addition to the OCFI may have oversight and supervisory roles over a particular IFE. In considering applications for IFE charters, the OCFI will coordinate as appropriate with other regulators with jurisdiction over the proposed IFE, to facilitate simultaneous consideration of any applications or approvals that may be required by those regulators.

The OCFI does not permit companies that are the subject of a formal investigation or enforcement action by another regulator to avoid the consequences of that investigation or enforcement action by seeking an IFE charter. A pending investigation or enforcement action may be grounds for denial of a charter application.

REQUIREMENTS FOR ORGANIZING GROUP, MANAGEMENT, AND DIRECTORS

OCFI regulations and licensing policy provide guidance regarding the qualifications of organizers, management, and directors, as well as the respective roles of each.

These criteria and qualifications are generally applicable to IFEs, although the OCFI may tailor certain criteria as appropriate. As with all other types of financial institutions, organizers, managers, and directors are critical to the success of an IFE. The OCFI expects them to be well qualified, with diverse experience in relevant areas. Although the OCFI would expect some members of the organizing group, the proposed board of directors, and management to have experience in regulated financial services, other relevant experience will depend on the specific products or services offered by the proposed IFE. In the case of IFEs engaged in the provisions of financial services connected with DLT and/or virtual currencies, it will be important for one or more of the organizers, managers, or directors of a proposed IFE with novel technology-based products or services to have experience with those activities.

BUSINESS PLAN

Overview

All applicants for an IFE charter must submit a business plan to the OCFI. As a minimum the business plan must include earnings prospects, management, capital, safety and soundness; BSA/AML/OFAC compliance.

Having a comprehensive proposed business plan, including the IFE's financial projections, analysis of risk, and planned risk management systems and controls, is critical to the OCFI's decision whether to approve a charter proposal. Proposals from companies without an established business record are subject to a higher degree of scrutiny to evaluate whether the proposed IFE has a reasonable likelihood of long-term success.

It is highly recommended that applicants comply with the detailed information about the elements of the business plan that appears in the Federal Interagency Business Plan Guidelines (the "Business Plan Guidelines"), a copy of which is attached as Appendix "B" to this Statement and Guidelines.

The Business Plan Guidelines describe the general elements of a business plan, including: description of the business; marketing plan; management plan; records, systems, and controls; the financial management plan; monitoring and revising the plan; alternative business strategies; and financial projections. The OCFI recognizes, however, that applicants for an IFE charter may have structures and business models that differ from those of traditional IFES or other types of financial institutions. Thus, in addition to the generally applicable information in the Business Plan Guidelines, applicants should consider the supplemental guidance below on specific parts of the business plan.

Applicants are also encouraged to contact the OCFI with questions regarding the content of their business plans.

SUPPLEMENTAL GUIDANCE ON BUSINESS PLANS

(1) Risk Assessment

An applicant's business plan should include a risk assessment that identifies and discusses the particular risks the organizers expect the proposed IFE to face given its business model. Such risks may include, for example, concentration risk, compliance risk, reputation risk, strategic risk, and operational risk, including cybersecurity risk. The risk assessment should set out the degree of risk the IFE would generally assume (its "risk appetite") and how it would effectively manage the identified risks⁴. It should also include the

⁴ In addition the Business Plan should address OCFI expectations for all areas of operating an IFE, including, without limitation, audit

risk assessment factors in the target markets' economic and competitive conditions, including the proposed products, services, and customers; the targeted geography (e.g., regional, nationwide); and any regulatory considerations regarding serving those markets.

These regulatory considerations include risks related to Bank Secrecy Act/Anti-Money Laundering (BSA/AML) and OFAC, consumer protection, and applicable fair lending requirements. The risk assessment should also address the internal and system controls to monitor and mitigate risk, including management information systems, in accordance with the IFE's established risk appetite.

(2) Records, Systems, and Controls

This section of the Business Plan should describe the IFE's system for customer record keeping and transaction processing and the internal controls that will enable the IFE to protect customer data and process transactions in an accurate and efficient manner. This section also describes the IFE's compliance management programs. This section should, as a minimum, include:

- A description of the IFE's information technology program, including:
 - a general description of internal controls ensuring transaction and data integrity, security, and auditability;
 - overviews of the operational architecture, security framework, and resiliency structures; and
 - a description of the framework that provides for effective cyber-risk governance, including continuous monitoring and management of cyber risk; strategies for cyber resilience; and processes for maintaining awareness of cybersecurity postures enterprise-wide.
- A description of the compliance management program, which should support a culture of compliance that includes a top-down, enterprise-wide commitment to understanding and adhering to applicable laws and regulations, including, but not limited to: the BSA, other AML statutes, OFAC economic sanctions obligations, statutes prohibiting discrimination or unfair or

requirements, information technology, and corporate and risk governance.

deceptive acts or practices, and other applicable consumer protection laws and regulations;

- A description of a structured plan to provide for independent testing of the business activities, systems and controls, and compliance management requirements, including but not limited to plans for independent audits.
- A description of outsourcing and third-party risk management, including a description of any functions or services that will be outsourced and risk management processes that are commensurate with the level of risk and complexity of the third-party relationships.

(3) Financial Management

As noted above, an IFE will be subject to the same minimum leverage and risk-based capital requirements which apply to all federally insured depository institutions. However, these requirements, which measure regulatory capital levels relative to an entity's assets and off-balance-sheet exposures, may not be sufficient for measuring capital adequacy for some IFEs. The risks posed by an IFE with limited on-balance-sheet assets or nontraditional strategies may not be fully captured in its reported assets and off-balance-sheet exposures. As a result, additional approaches may be necessary to determine the minimum amount of capital needed to support the IFE's activities. For example, for a proposed IFE with limited on-balance-sheet assets, the OCFI may consider other metrics related to activity—such as revenue—and the risks associated with the applicant's business plan when evaluating capital adequacy.

This section of the business plan should propose both minimum capital levels the IFE will adhere to initially that are sufficient to support the proposed IFE's business plan until the IFE can achieve and sustain profitable operations and minimum capital levels the IFE will adhere to after profitability that would be appropriate for its ongoing operations. This section should also discuss how the proposed IFE would address adverse market conditions that could deplete capital, such as broad market volatility or volatility specific to a business line. Additional factors that applicants should consider include the following:

- On- and off-balance-sheet composition, including credit risk, concentration risk, market risk, operational risk, and compliance risk associated with nontraditional products, services, or operating characteristics.
- Proposed activities and anticipated volume (new accounts, transactions) and impact on capital.

- Plans and prospects for growth, including any material action necessary to address business activity that is either below or above expectations and management's past experience in managing growth.
- Stability or volatility of sources of funds and access to capital.
- Sufficient additional capital to implement the exit strategy laid out in the business plan.

Consistent with the process for chartering other IFES, preliminary conditional approval for an IFE will include a condition specifying a minimum capital level the IFE must be at or above at all times. This amount would be based on the OCFI's analysis of quantitative and qualitative factors, including those described above. The OCFI expects that capital in an entity with an IFE charter would increase beyond the initial minimum amount as the size, complexity, and corresponding risks of the IFE evolve.

The financial management section should also address liquidity and funds management. Liquidity is an IFE's capacity to readily meet its cash and collateral obligations at a reasonable cost without adversely affecting either daily operations or the IFE's financial condition. The OCFI will consider the proposed IFE's specific business model when evaluating the IFE's liquidity profile and processes for monitoring and mitigating liquidity risk.

(4) Monitoring and Revising the Plan

The attached Business Plan Guidelines provide that this section should include a discussion of how the board of directors will monitor adherence to the business plan and adjust or amend the business plan as appropriate to accommodate significant or material changes. This is an ongoing requirement, and technology-dependent businesses will need to have mechanisms in place to accommodate new or evolving technologies.

(5) Alternative Business Strategy; Contingency Plans; Recovery and Exit Strategies

Depending on the applicant's proposed business strategy and structure, the OCFI may require an applicant to include an alternative business strategy detailing how the IFE will manage potential scenarios when

expectations, such as operating expenses, marketing costs, or growth rates—differ significantly from the original plan.⁵

While it will not always be necessary for a IFE to develop an alternative business strategy, all applicants should discuss:

- realistic contingency plans based on critical assumptions;
- recovery planning, including financial or other risk triggers, and a range of credible options to remain viable under stress; and
- exit strategies that provide a means for the IFE to unwind in an orderly manner.

CHARTERING DECISION

As noted in the official form of an Application to Organize an IFE, the OCIF grants approval of an IFE charter application in two steps: (1) a permit to organize the IFE and (2) final approval which consist of a license and a permit to commence operations. The period between the preliminary approval to organize the IFE and the final approval and issuance of the permit to operate and the license is referred to as the organization phase.

Preliminary Conditional Approval

Following review of the application, the OCFI determines whether to grant the permit to organize the IFE or deny the application.

A permit to organize the IFE indicates the OCFI's permission to proceed with the organization of the IFE according to the plan set forth in the application and specifies standard requirements and enforceable supervisory conditions.

A permit to organize an IFE is not an assurance that the OCFI will grant final approval for a new IFE charter. Granting the permit to organize provides the organizers of the IFE with assurances that the application has passed the first phase of OCFI review before the organizers expend additional funds to raise capital, hire officers and employees, and fully develop policies and procedures, including those relating to financial inclusion. An IFE must generally open for

⁵ If the IFE's alternative business strategy would be considered a significant deviation from the approved business plan, the OCFI would expect the applicant to obtain a supervisory non-objection before executing the strategy.

business within 6 months of the OCFI's permit to organize, unless the OCFI grants an extension.

Standard and Special Requirements

The OCFI imposes a number of standard requirements on an IFE when it grants a permit for its organization. Standard requirements are requirements imposed on all IFES. For example, these requirements include establishing appropriate policies and procedures and adopting an internal audit system appropriate to the size, nature, and scope of the IFE's activities. The OCFI may also place additional special requirements on IFES charters with certain characteristics. While standard requirements apply to all IFES, special requirements are tailored to a particular applicant. A requirement for an IFE to raise a higher amount of capital than proposed in the business plan is an example of a special requirement. The organizing group must satisfy standard and special requirements before the OCFI grants the license and permit to commence operations.

Standard and Special Conditions

In addition to the standard and special requirements discussed above, the OCFI may also impose standard and special conditions that remain in place after the IFE opens for business.

The OCFI imposes certain standard conditions on all categories of IFES and those would apply to IFES engaged in DLT systems and virtual currencies. These standard conditions address a variety of issues, including ensuring that the IFE does not significantly deviate from the business model proposed in its application without prior OCFI non-objection and guaranteeing maintenance of minimum capital levels commensurate with the prospective risk of the IFE's business plan.

The OCFI may also impose special conditions on an individual IFE. Examples of such conditions include requiring the IFE to have a resolution plan to sell itself or wind down, if necessary, and requiring the IFE to adhere to specific commitments, such as a requirement to enter into an operating agreement. In addition, in the case of an uninsured depository IFE, the OCFI can impose special conditions similar to those in laws that apply by statute to insured banks only. Where a law does not apply directly, the OCFI may work with an IFE to achieve the goals of a particular statute or regulation through the OCFI's authority to impose conditions on its approval of a charter, taking into account any relevant differences between a full-service IFE and an IFE with limited non-depository or non-lending activities.

FINAL APPROVAL

Receipt of license and permit to commence operations from the OCFI means the OCFI has issued a license for the IFE, and the IFE can begin to conduct its authorized activities. After the OCFI issues final approval and issues the license and the IFE opens for business, the OCFI will supervise the IFE under scheduled supervisory cycles and non-scheduled special examinations, including on-site examination and periodic off-site monitoring. Any conditions imposed with the granting of a charter will remain in place until removed or modified by the OCFI and will be reviewed for compliance during the examination process.

Because this Statement is focused on the licensing process for IFEs, it does not provide extensive guidance regarding the OCFI's supervisory expectations and the supervision of IFEs. Key supervisory considerations, however, are highlighted in Appendix "A" to this Statement.



GOVERNMENT OF PUERTO RICO

Office of the Commissioner of Financial Institutions

APPENDIX A: SUPERVISORY CONSIDERATIONS

OCFI SUPERVISORY FRAMEWORK

The supervisory framework for IFES will incorporate core elements already in place for all IFES supervised by the OCFI. These elements include a blend of on-site and off-site supervisory activities conducted by an experienced, knowledgeable examination team.

In addition to the statutory examination requirements and consistent with longstanding OCFI supervision policy, newly chartered IFES will be subject to more frequent and intensive supervision in their early years of operation. The scope of supervision activities will follow a risk-based approach commensurate with the size and complexity of the institution, focusing on any elevated risks and unique supervisory challenges presented by a given IFE. Examples of IFE examination and supervision activities include frequent contact with the board of directors and management.

Rating Framework

IFES will be subject to the same ratings framework as commercial banks and other IFES. These financial institutions are assessed in accordance with the Uniform Financial Institutions Rating System (UFIRS). Composite ratings are based on an evaluation of, among others, an institution's managerial, operational, financial, risk management, and compliance performance.

Under this uniform system, the OCFI ensures that all IFES are evaluated in a comprehensive and uniform manner and that supervisory attention is focused appropriately on those IFES that exhibit financial and operational weaknesses or adverse trends. The UFIRS helps identify adverse trends or deteriorating financial institutions, as well as categorizing deficiencies. The rating system assesses components of an IFE's performance as well as specialty areas that include: capital adequacy, asset quality, management, earnings, liquidity, sensitivity to market risk, information technology, trust, consumer compliance, and performance under the Community Reinvestment Act (if applicable). Each component is rated based on an evaluation of factors relevant to the specific area.



GOVERNMENT OF PUERTO RICO

Office of the Commissioner of Financial Institutions

OCFI's Statement and Guidelines
Financial activities related to
DLT technology and virtual currencies
April 12, 2017
Page 18 of 20

Risk Management Framework

The OCFI expects every IFE to have appropriate risk management systems to address all relevant risks in the entity. The structure, sophistication, and oversight of these systems should be commensurate with the complexity and volume of risk an IFE assumes. Regardless of the IFE's size or complexity, sound risk management systems should do the following:

- **Identify risk:** IFES must recognize and understand existing risks and risks that may arise from new business initiatives, including risks posed by third-party relationships, by external market forces, or by regulatory or statutory changes. Risk identification should be a continuing process and occur at both the transaction and portfolio levels.
- **Measure risk:** IFES must have effective risk management systems that measure risks accurately and timely. An IFE that does not have an effective risk measurement system has limited ability to control or monitor risk levels.
- **Monitor risk:** IFES must monitor risk levels to ensure timely review of risk positions and exceptions to risk limits. Monitoring reports must be timely, accurate, and relevant, and should be distributed to appropriate individuals to ensure action, when needed.
- **Control risk:** IFES must establish and communicate risk limits through policies, standards, and procedures that define responsibilities and authority. These limits serve as a means to control exposures to the various risks associated with the IFE's activities.

The OCFI employs a risk-based supervisory philosophy focused on evaluating risk, identifying material and emerging problems, and ensuring that individual IFES take corrective action before problems compromise their safety and soundness. This supervision-by-risk approach provides a consistent definition of risk and a system for assessing risks (known as the Risk Assessment System or RAS), and it



GOVERNMENT OF PUERTO RICO

Office of the Commissioner of Financial Institutions

OCFI's Statement and Guidelines
Financial activities related to
DLT technology and virtual currencies
April 12, 2017
Page 19 of 20

integrates risk assessment into the supervisory process. The RAS is applicable to all risks identified across an IFE and can include (although it is not limited to): credit risk, information technology systems and controls, operational risk, cybersecurity risk, liquidity and funds management, consumer compliance risk, and strategic and reputation risks. Following risk evaluations, the supervisory office tailors and conducts supervisory activities based on the risks identified, and periodic testing is completed in order to validate an IFE's risk assessment.

Corporate Governance Framework

The OCFI expects the governance structure for any proposed IFE to be commensurate with the risk and complexity of its proposed products, services, and activities, as it is for other IFES and financial institutions. The OCFI sets standards for governance and for risk management systems that identify, measure, monitor, and control risk in IFES. The OCFI expects IFES to have expertise, financial acumen, and a risk management framework that includes the three lines of defense. The three lines of defense model explains governance and roles among the IFE's business units, support functions, and the internal audit function from a risk management perspective.

- First line of defense risk management activities take place at the frontline units where risks are created and owned.
- The second line of defense risk management activities occur in an area or function separate from the frontline unit, sometimes referred to as independent risk management (IRM). IRM oversees and assesses the frontline units' risk management activities.
- The internal audit function is often referred to as the third line of defense in this model. In its primary responsibility of providing *independent* assurance and challenge, the internal audit function assesses the effectiveness of the policies, processes, personnel, and control systems created in the first and second lines of defense. Internal audit (including co-sourcing and outsourced arrangements) must be an independent function and report directly to the Audit Committee of the board of directors.



GOVERNMENT OF PUERTO RICO

Office of the Commissioner of Financial Institutions

OCFI's Statement and Guidelines
Financial activities related to
DLT technology and virtual currencies
April 12, 2017
Page 20 of 20

The board of directors must have a prominent role in the overall governance structure by participating on key committees and guiding the IFE's risk management framework. Board members also must actively oversee management, provide credible challenge, and exercise independent judgment.

OCFI Communication

The OCFI is committed to ongoing communication with the financial institutions it supervises and with other banking or securities regulators. This includes formal and informal conversations, meetings, examination reports, sharing of information and other written communications. At a minimum, the OCFI intends to provide an IFE's board of directors a report of examination (ROE) at least once each supervisory cycle. The ROE conveys the IFE's overall condition, ratings, and risk assessment summary. It will also summarize examination activities and findings identified during the supervisory cycle.

Business Plan Guidelines

Preparation and Use

The business plan should be an integral part of the management and oversight of a financial institution (institution). It should establish the institution's goals and objectives. It is a written summary of how the business will organize its resources to meet its goals and how the institution will measure progress.

The business plan should be a comprehensive plan, which is the result of in-depth planning by the institution's organizers and management. It should realistically forecast market demand, customer base, competition, and economic conditions. The plan must reflect sound banking principles and demonstrate realistic assessment of risk in light of economic and competitive conditions in the market to be served. An institution with a special purpose or focus (for example, credit card, trust only, cash management, or bankers' bank) should address this special or unique feature in detail in the appropriate sections of the plan.

The business plan should cover three years and provide detailed explanations of actions that are proposed to accomplish the primary functions of the institution. The description should provide enough detail to demonstrate that the institution has a reasonable chance for success, will operate in a safe and sound manner, and will have adequate capital to support the risk profile.

For any institution with an Internet or alternative electronic delivery channel, the plan should contain a clear and detailed definition of the market the institution plans to serve and the products and services it will provide through electronic channels. Because the Internet has a potential global market and can reach anyone with Internet access, the selected information on market area and products and services is essential. The marketing plan should explain how the institution would achieve brand recognition.

Confidentiality

Any Applicant desiring confidential treatment of specific portions of the plan and projections must submit the request in writing. The request must discuss the justification for the requested treatment. The Applicant's reasons for requesting confidentiality should specifically demonstrate the harm (for example, loss of its competitive position, invasion of privacy) that would result from public release of information (5 U.S.C. 552 or relevant state law). Information for which confidential treatment is requested should be: (1) specifically identified in the public portion of the application (by reference to the confidential section); (2) separately bound; and (3) labeled "Confidential." The Applicant should follow the same procedure when requesting confidential treatment for the subsequent filing of supplemental information to the plan.

The Applicant should contact the appropriate regulatory agency for specific instructions regarding requests for confidential treatment. The appropriate regulatory agency will determine whether the information will be treated as confidential and will advise the Applicant of any decision to publicly release information labeled as "Confidential."

BUSINESS PLAN

I. Table of Contents

II. Executive Summary

Describe the highlights of the plan.

III. Description of Business

- A. Describe the institution's business and any special market niche, including the products, market, services, and nontraditional activities.
- B. If in a holding company structure, discuss the operations of the organization, including a brief detail of the organizational structure and interaction between the institution and its affiliates.
- C. Describe the extent, if any, that there are or will be transactions with affiliated entities or persons. Include terms.
- D. Discuss the legal form and stock ownership of the institution and any investment in subsidiaries or service corporations.
- E. For an operating company, describe the present financial condition and current resources, such as office network, staff, and customer base. Specifically discuss the strengths and weaknesses.
- F. Describe the proposed location, office quarters, and any branch structure.
- G. Discuss any growth or expansion plans, including additional branches, other offices, mergers, or acquisitions.

IV. Marketing Plan

A marketing plan should provide in detail factual support that the institution has reasonable prospects to achieve the revenue projections, customer volume, and key marketing and income targets. The analysis should be based on the most current data available, and the sources of information should be referenced. This section should contain an in-depth discussion of the major planning assumptions for the market analysis, economic, and competitive components used to develop the plans, objectives, and the basis for the assumptions.

A. Product Strategy

- 1) List and describe the general terms of the planned products and services, including activities of any subsidiaries. Discuss any plans to engage in any subprime or speculative lending, including plans to originate loans with high loan-to-value ratios.
- 2) Discuss how the institution will offer products and services over the three years, indicating any variation in the different market areas or distribution channels,

and include the time frame for the introduction and the anticipated cost associated with each.

- 3) Describe the institution's plans to engage in any secondary market/mortgage banking activity, including loan participations. Discuss plans to use forward take-out commitments or engage in loan securitization. Describe any plans to engage in hedging activity to mitigate the risks of this activity. Also, discuss plans to retain recourse and servicing.
- 4) Describe the primary sources of loans and deposits and the major methods to solicit them. If using brokers or agents, provide full details of the nature and extent of all such activities, including sources, amounts, fees, and any intended tie-in of compensatory arrangements with the broker or agent.
- 5) Describe any arrangements with e-commerce businesses (for example, links to another's Web site to shop, order, or purchase goods and/or services online).

B. Market Analysis

- 1) Describe the intended target market and the geographical market area(s).
- 2) Describe the demographics of the target market population (for example, age, education, and occupation).
- 3) *For an OTS filing*, discuss in detail any current and/or proposed actions to accomplish the institution's commitment to promote home financing.

C. Economic Component¹

- 1) Describe the economic forecast for the three years of the plan. The plan should cover the most likely scenario and discuss possible economic downturns.
- 2) Indicate any national, regional, or local economic factors that may affect the operations of the institution. Include an analysis of any anticipated changes in the market, the factors influencing those changes, and the effect they will have on the institution.
- 3) Describe the current economic characteristics of the proposed market(s), for example, size, income, and industry and housing patterns.
- 4) Based on the economic characteristics described previously, discuss the economic factors that influence the products and services to be offered. A more in-depth discussion is warranted when different types of services are identified for different market areas in the Description of Business section.

¹ If obtained, discuss any independent economic survey or market feasibility study.

D. Competitive Analysis

- 1) Compare and contrast the institution's product strategy with its principal competitors in the target market(s). Include expected results in terms of relative strength, market share, and pricing.
- 2) Discuss the overall marketing/advertising strategy, including approaches to reach target market through the marketing of brand, products, and services. Outline the specific medium that will be used, including timing and level of advertising efforts.
- 3) Discuss potential competition in the target market(s).

V. Management Plan — Directors and Officers

- A. Provide the number of organizers and/or directors. Provide a list of board committees and a brief explanation of the responsibilities of each committee.
- B. Describe the organizational structure and provide an organizational chart, indicating the number of officers and employees. Describe the duties and responsibilities of the senior executive officers. Describe any management committees that are or will be established.
- C. Discuss the institution's plans to address management succession, including any management training program or other available resources.

VI. Records, Systems, and Controls

- A. Describe the institution's current and/or proposed accounting and internal control systems, indicating any use of electronic processing systems.
- B. Describe management's proposed internal audit function. The description should set forth the independence of the department and the scope and frequency of audits. Discuss the experience and education of the audit staff. If external auditors will be used for internal audits, provide similar information for the external auditors.
- C. Describe the compliance management programs, addressing independence, scope, frequency, and staff qualifications. Discuss how the institution will respond to consumer complaints.
- D. State plans for an annual audit by independent public accountants.
- E. Discuss the functions that will be outsourced and what the institution will do in-house.

VII. Financial Management Plan

- A. Capital and Earnings
 - 1) Discuss the capital goals and the means to achieve them.

- 2) Discuss the earnings goals in terms of return on assets, net interest margin, or other profitability measurements, and summarize the strategies to achieve those goals.
- 3) Discuss the plan for raising capital and for financing growth, with particular emphasis on conformance with regulatory capital requirements.
- 4) Discuss the adequacy of the proposed capital structure relative to internal and external risks, planned operational and financial assumptions, including technology, branching, and projected organization and operating expenses. Present a thorough justification to support the proposed capital, including any off-balance-sheet activities contemplated.
- 5) Describe the debt service requirements for any debt that will be issued at the holding company level to capitalize the institution.
- 6) Discuss the use of options, warrants, and/or other benefits associated with the institution's capital.
- 7) Summarize the dividend policy.

B. Liquidity and Funds Management

- 1) Discuss how the institution will identify and measure liquidity risk.
- 2) Discuss the institution's plan to monitor and control its liquidity risk, including funding sources (deposits, borrowings, securitizations). Include holding company support, if any.
- 3) Describe any plans to borrow funds from any financial institutions or other sources, including the amount, composition, interest rate, maturity, purpose, and collateral.
- 4) Discuss the type of investment securities the institution plans to purchase.

C. Sensitivity to Market Risk

- 1) Discuss the institution's objectives, strategies, and risk tolerance for interest rate risk.
- 2) Discuss how the institution will identify and measure interest rate risk.
- 3) Discuss the institution's asset and liability portfolio in terms of sensitivity to interest rate changes and the impact of earnings and capital and net portfolio value.² Discuss the risk limits to control interest rate risk.
- 4) Describe any plans to use hedging activities (for example, futures, options, interest rate swaps, or other derivative instruments).

² For OTS filing, see Thrift Bulletin 13a.

D. Credit Risk

- 1) Discuss how the institution will identify and measure credit risk.
- 2) Describe the loan review program, addressing independence, scope, frequency, and staff qualifications.
- 3) Describe the methodology used to determine the allowance for loan and lease losses.

VIII. Monitoring and Revising the Plan

- A. Describe how the board of directors will monitor adherence to the business plan.
- B. Describe how the board of directors will adjust and amend the plan to accommodate significant or material economic changes.

IX. Alternative Business Strategy (Optional unless your regulator requires)

An alternative business strategy details how an institution will operate under scenarios in which market conditions differ significantly from those projected in this business plan. This alternative business strategy should be realistic about the business risks and incorporate sound management of such risks. This alternative strategy should consider potential adverse scenarios relating to the asset or liability mixes, interest rates, operating expenses, marketing costs, and growth rates. This discussion should include realistic plans for how the bank would access additional capital, if needed, in the future and, if applicable, contingency funding plans that address strategies for managing potential liquidity fluctuations. This plan also should discuss any financial safeguards to offset unexpected costs and remain well capitalized.

Periodically, the institution should update this section, especially as the institution becomes more complex and as industry conditions change.

X. Financial Projections

- A. Provide financial information for opening day *pro forma* and quarterly projections for the three years of operations. Also provide annual totals for the Income Statement. The line items in the financial statements should be consistent with the Consolidated Reports of Condition and Income or the Thrift Financial Report (Report)³ so that projected items may be compared conveniently with actual performance. The following reports should be used:

Projected Balance Sheet (Schedule RC or SC)

Projected Income Statement (Schedule RI or SO)

Regulatory Capital Schedule (Schedule RI-A or CCR)

³ See FDIC's Web site, <http://www.fdic.gov/regulations/resources/call/crinst/callinst.html> or <http://www.ots.treas.gov> (link to TFR form and instructions).

The financial statements should be presented in two ways: (1) showing the dollar amounts, and (2) as a percentage of total assets.

- 1) Describe in detail all of the assumptions used to prepare the projected statements, including the assumed interest rate scenario for each interest earning asset and interest costing liability over the term of the business plan. Also present a thorough justification to support proposed capital, including any branch expansion and off-balance-sheet activities contemplated.
 - 2) Provide the basis for the assumptions used for noninterest income and noninterest expense. Indicate the amount of lease expense, capital improvements, and furniture, fixtures, and equipment, including systems and equipment upgrades.
 - 3) Describe the assumptions for the start-up costs, volumes, expected returns, and expected time frame to introduce each new product and service.
- B. Discuss how the institution used marketing studies or surveys to support the institution's projected growth.
- C. Discuss the level of marketing expenses necessary to achieve the projected market share for both loan and deposit products. Assumptions should be consistent with those experienced by other institutions in the target market. Explain any significant variances between the assumptions in the target market.
- D. Provide a sensitivity analysis of the financial projections. A sensitivity analysis provides a realistic stress test of the major underlying assumptions used in the business plan and the resultant financial projections. For example, adjust the financials to reflect the effects of adverse changes in the interest rate environment, changes in the asset/liability mix, higher than expected operating expenses, marketing costs, and/or growth rates.