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M E M O R A N D U M

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To Our Clients and Friends

Re: FDIC Guidance on Third-Party Servicer Arrangements

The Federal Deposit Insurance Corporation (“FDIC”) has issued guidance to FDIC-supervised banks which outlines risk management principles that should be considered in connection with engaging third-party service providers. The guidance applies to both affiliated and unaffiliated third parties.

BACKGROUND

The FDIC’s guidance provides a general framework that banks may use to provide appropriate oversight and risk management of significant third-party relationships. A third-party relationship is considered significant if the institution’s relationship with the third party:

- is a new relationship or involves implementing new activities;
- has a material effect on the institution’s revenues or expenses;
- involves the performance of critical functions;
- requires the third party to store, access, transmit, or perform transactions on sensitive customer information;
- anticipates that the third party will market bank products or services;
- involves the third party providing a product or performing a service involving subprime lending or card payment transactions; or
- poses risks that could significantly affect bank earnings or capital.

IDENTIFICATION OF POTENTIAL RISKS

The FDIC’s guidance indicates that banks should identify and understand the types of risk raised by the bank’s use of third parties. These include assessment of

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reputation risk, operational risk, transaction risk, credit risk, compliance risk and other risks, such as liquidity, interest rate, price, exchange rate and country risks.

RISK MANAGEMENT PROCESS

According to the guidance, a bank's risk management process involves the following main elements:

- risk assessment
- due diligence in selecting a third party
- contract structuring and review
- oversight

The guidance provides an extensive discussion of the scope of coverage of each of the above elements.

The FDIC will review a bank's management of significant third-party relationships in the course of its normal supervisory process. The FDIC also reminds banks that the Bank Service Company Act requires insured institutions to notify their federal supervisor in writing of contracts with third parties that provide certain operational services to the institutions.

A copy of the FDIC's guidance can be found on our website at http://www.schwartzandballen.com/whats_new.html.

If you have any questions, please call Gilbert Schwartz, Robert Ballen, Tom Fox or Heidi Wicker at (202) 776-0700.