



Office of Inspector General

Board of Governors of the Federal Reserve System
Consumer Financial Protection Bureau

Executive Summary, 2024-SR-B-004, February 7, 2024

Material Loss Review of Heartland Tri-State Bank

Finding

Heartland Tri-State Bank failed because of alleged fraudulent activity conducted by the bank's chief executive officer (CEO), who initiated a series of wire transfers totaling about \$47.1 million of Heartland's funds, among other suspicious activities, as part of an apparent cryptocurrency scheme referred to as "pig butchering." Significant internal control breakdowns and the influence of the CEO as a dominant management official created an opportunity for the series of apparently fraudulent wire transfers to be initiated and processed. These wire transfers significantly impaired Heartland's capital and liquidity, causing the bank to become insolvent.

The Federal Reserve System began supervising Heartland in 2017, when the bank converted from a national bank to a state member bank. From 2017 through 2022, the Federal Reserve Bank of Kansas City (FRB Kansas City) participated in one full-scope examination led by the Kansas Office of the State Bank Commissioner (OSBC) and conducted two risk-focused full-scope examinations. These examinations included reviews of Heartland's compliance with the Bank Secrecy Act and related anti-money laundering regulations. FRB Kansas City examiners determined that Heartland had adequate internal control policies for a bank of its size.

FRB Kansas City promptly initiated a target examination on July 25, 2023, after Heartland's chief financial officer contacted FRB Kansas City and the OSBC to discuss the CEO's alleged fraudulent actions and Heartland's deteriorated condition. As a result of a target examination of Heartland's condition, FRB Kansas City examiners concluded that the wire transfers significantly impaired Heartland's capital and liquidity and that the volume and severity of problems identified appeared to be beyond the ability of the bank's board and management to control or correct. These weaknesses prompted a significant downgrade of the bank's CAMELS composite rating and each of the component ratings to a 5, or *critically deficient*.

On July 28, 2023, the OSBC closed Heartland and appointed the Federal Deposit Insurance Corporation as the receiver.

Recommendations

Our report contains recommendations designed to increase awareness of cryptocurrency scams and relevant preventive and detective controls at banks. In response to our draft report, the director of the Division of Supervision and Regulation concurs with our recommendations and outlines actions to address them. We will follow up to ensure that the recommendations are fully addressed.

Purpose

In accordance with the requirements of section 38(k) of the Federal Deposit Insurance Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, we conducted a material loss review of Heartland to determine why the bank's failure resulted in a material loss to the Deposit Insurance Fund (DIF); to assess the Board's and FRB Kansas City's supervision of Heartland during our period of review, January 2017 through July 2023; and to make recommendations, as appropriate.

Background

Heartland, headquartered in Elkhart, Kansas, a rural community in southwestern Kansas, was a state member bank primarily focused on agricultural lending with about \$139 million in assets as of March 31, 2023. FRB Kansas City, under delegated authority from the Board, supervised Heartland along with the OSBC. On August 9, 2023, our office received notice that Heartland's failure would result in a material loss to the DIF.