



STATE OF CONNECTICUT  
DEPARTMENT OF BANKING  
FINANCIAL INSTITUTIONS DIVISION



260 CONSTITUTION PLAZA • HARTFORD, CT 06103-1800

May 13, 2019

Ann E. Misback  
Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551

**Re: Connecticut Department of Banking Comments on Notice of Proposed Rulemaking – Regulation D: Reserve Requirements of Depository Institutions (Docket No. R-1652; RIN 7100-AF-40)**

Dear Ms. Misback:

The Connecticut Department of Banking (Department) submits the following comments in response to the Board of Governors of the Federal Reserve System's (Fed's) request for comments on proposed changes to the Fed's Regulation D. The Department believes that there are significant policy benefits of so-called Pass-Through Investment Entities (PTIEs) that outweigh any concerns related to such entities. A state-chartered bank should not be treated differently from a federally chartered bank, especially based on the premise that there is no federal regulator involved. We also have concerns, in the event the Fed does decide to treat PTIEs differently than other financial institutions, that any decision to pay a lower rate of interest paid on excess balances (IOER) to PTIEs could have negative ramifications for the banking system. We therefore respectfully request that the Fed recognize the monetary policy benefits of PTIEs and take no further actions to treat such entities differently than other financial institutions.

**PTIEs have significant monetary policy benefits that outweigh any raised concerns.**

Integrity of State Chartering System

We have concerns that restricting the viability of PTIEs would damage the integrity of the state bank chartering system. The concept of dual bank chartering, whereby state and federal regulators provide separate bank chartering options, is supposed to result in a balanced system that affords financial institutions a variety of chartering alternatives from which to choose. Adversely affecting PTIEs by taking away an essential service of the Fed (payment of an IOER equal to that paid to other financial institutions) would effectively eliminate certain banking business models. Eliminating or dramatically altering the rates paid in the PTIE business model would, in turn, disrupt the dual bank chartering system by rendering certain state charter alternatives no longer viable.

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Several states,<sup>1</sup> including Connecticut,<sup>2</sup> have alternative bank charters such as uninsured banks (i.e., banks whose deposits are not insured by the Federal Deposit Insurance Company). The Department has a rigorous application process for an uninsured bank charter that closely mirrors the process for an insured bank. For example, Connecticut uninsured bank charter applicants must undergo an independent feasibility study to make sure that the applicant's business model is sustainable and has a certain likelihood of success. Connecticut state chartered uninsured banks are also subject to minimum capital requirements as determined by the Banking Commissioner, in part, based on the institution's business model, the findings of the feasibility study, and consideration of the institution's risk profile. Restricting the viability of PTIEs would have a negative effect on Connecticut's uninsured bank charter by limiting access to Fed services through the arbitrary payment of a lower IOER to only a single class of institutions, even though that charter features many of the same requirements imposed on insured depository institutions.

### Promotion of Innovation

Eliminating or dramatically altering the PTIE business model would also restrict innovation in the financial system. In keeping with the axiom that states are the laboratories of innovation, the ability of states to maintain viable bank charter alternatives is essential for promoting innovation in banking and the next generation of financial services. In fact, the U.S. Department of the Treasury concurred in a recent report, stating that "innovation is critical to the success of the U.S. economy, particularly in the financial sector."<sup>3</sup> As the global financial system, the financial services industry, and technology rapidly evolves, the availability of innovative charter alternatives is critical to allowing the U.S. banking system to maintain its competitiveness in the world.

### Regulatory Costs

We disagree with the assertion in the Notice of Proposed Rulemaking that PTIEs avoid regulatory costs borne by other eligible institutions. As we described earlier, entities that apply for Connecticut's uninsured bank charter must undergo a rigorous application process similar in many respects to that of an insured bank, including an independent feasibility study and review of a three-year business plan. Moreover, uninsured bank charters are subject to minimum capital requirements commensurate with the risks of the institution and costs associated with resolution of a failed institution. These institutions are also regularly examined by the Department for safety and soundness, information technology, compliance, Bank Secrecy Act, and other specialty

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<sup>1</sup> Including Maine, Michigan, and Vermont.

<sup>2</sup> Conn. Gen. Stat. § 36a-70(t) provides for the organization of a Connecticut chartered uninsured bank. Connecticut chartered uninsured banks "have all of the powers of and [are] subject to all of the requirements and limitations applicable to [insured state-chartered banks], except no uninsured bank may accept retail deposits." Conn. Gen. Stat. § 36a-70(t)(2).

<sup>3</sup> U.S. Dept. of the Treasury, *A Financial System That Creates Economic Opportunities Nonbank Financials, Fintech, and Innovation*, July 2018, available at <https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financi....pdf>.

examination areas. These examinations of uninsured banks are conducted with a rigor and frequency that mirrors the examinations of insured depository institutions. Uninsured banks are also subject to state regulatory assessments and similarly subject to examination costs. PTIEs, particularly uninsured banks, are not avoiding regulatory costs. The regulatory costs of an uninsured bank are, therefore, similar to those of their insured bank counterparts.

### Financial Intermediation

We do not share the Fed's concern that the presence of PTIEs could raise the costs of private financial intermediation. Functionally, we do not consider there to be a difference between deposits going in and out through PTIEs as compared to similar transactions at other traditional financial institutions. Moreover, we note that many of the assumptions in the Notice of Proposed Rulemaking are not supported by historical data, so it is uncertain whether many of the Fed's concerns will ultimately be borne out. Given the lack of data, we believe it is premature to make any changes as suggested in the Notice of Proposed Rulemaking.

### Paying a lower IOER to PTIEs raises significant regulatory and fairness concerns.

We are concerned with a possible scenario in which the Fed would pay a lower IOER to PTIEs than it would to other institutions.

One proposal discussed in the Notice of Proposed Rulemaking would apply a lower IOER to entities who are not supervised by a federal banking agency. Such a possibility raises significant concerns related to disparate treatment between those entities supervised by a federal banking agency and financial institutions solely regulated by a state banking agency, including state chartered uninsured banks. We note that the Department is an accredited agency.<sup>4</sup> The accreditations issued by CSBS and NASCUS afford the Department with the ability to conduct alternating and joint examinations with our federal agency counterparts, signaling a recognition of the Department's strong examination program.

PTIEs, by the nature of their business models, have less risky balance sheets than traditional financial institutions. The payment of a lower IOER would have the effect of essentially penalizing a PTIE for having a less risky business model than its traditional financial institution competitors. In any event, PTIEs should not receive an IOER of zero.

Finally, while we caution against the Fed paying a lower IOER to PTIEs, should the Fed decide to pursue such a policy, we urge the Fed to allow significant time for then-existing PTIEs and PTIEs with pending applications for a Fed account to adjust to any new regulatory framework.

Thank you for the opportunity to provide comments on the Fed's proposed revisions to Regulation D. It is our belief that the policy considerations we have outlined above, particularly preserving

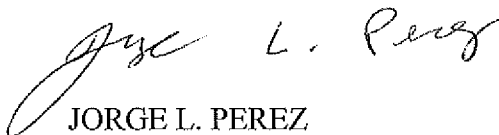
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<sup>4</sup> The Department was accredited by the Conference of State Bank Supervisors (CSBS) in November of 2012 and by the National Association of State Credit Union Supervisors (NASCUS) in October of 2015.

the integrity of the state chartering system and fostering financial innovation, outweigh any of the policy concerns that the Fed may have with PTIEs. Furthermore, based on our concerns with any proposal to treat PTIEs differently than other financial institutions, we urge the Fed to (1) take no further action to amend Regulation D and (2) treat PTIEs similarly to other financial institutions, including giving PTIEs similar access to a Fed account.

We are available to answer any questions and work with the Fed on addressing its concerns with these unique low-risk business models.

Sincerely,

A handwritten signature in cursive script that reads "Jorge L. Perez". The signature is written in black ink and is positioned above the printed name and title.

JORGE L. PEREZ  
BANKING COMMISSIONER