July 12, 2021

Via Electronic Mail

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Proposed Guidelines for Evaluating Account and Services Requests (Docket No. OP–1747)

To Whom It May Concern:

The Bank Policy Institute[1] and the Independent Community Bankers of America[2] (together, the "Associations") appreciate the opportunity to comment on the Board of Governors of the Federal Reserve System's proposed guidelines[3] for evaluating account and services requests. The question of which institutions should be permitted to open master accounts with a Federal Reserve Bank and obtain

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1 BPI is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans and are an engine for financial innovation and economic growth.

2 The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services. With nearly 50,000 locations nationwide, community banks constitute 99 percent of all banks, employ more than 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding more than $5 trillion in assets, over $4.4 trillion in deposits, and more than $3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation, and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at www.icba.org.

3 Board of Governors of the Federal Reserve System, Proposed Guidelines for Evaluating Account and Services Requests, 86 Fed. Reg. 25865 (May 11, 2021).

related services is a critical one, particularly in light of the increase in the availability of novel charters,[4] both at a federal and state level, that may seek such accounts and services. Reserve Bank accounts and services stand at the center of our payments and monetary ecosystem, and both the resilience and the risk management of institutions that hold such accounts are linchpins to the safety and effectiveness of the U.S. payments system. Accordingly, it is critical that the Board not only establish a uniform set of standards that each of the twelve Federal Reserve Banks will apply as they evaluate these requests, but also rigorously apply those standards in practice — particularly for novel charters.

The Associations and several other trade associations previously requested that the Federal Reserve adopt a uniform policy for the Federal Reserve Banks that would set forth criteria for novel charters seeking access to Reserve Bank accounts and services.[5] We appreciate the Board's response to this request and support the goals of the Board's proposal, which identifies the appropriate risks to the banking and financial systems and includes standards that will begin to address those risks. However, there remain critical questions that have not been answered by the proposal that the Federal Reserve should address in the final guidelines in order to ensure the safety and soundness of the nation's payment system and appropriately mitigate risks posed by novel charters that may obtain Reserve Bank accounts and services. In particular, as we describe in more detail below, it is important that the Board: (1) provide greater clarity about the *legal* standards for eligibility, (2) explain how it and the Reserve Banks will perform due diligence on and monitor whether novel charters meet the application standards that the Federal Reserve applies, (3) provide an appropriate mechanism to ensure that all decisions regarding novel charters are made with the consent or non-objection of the Board, given the important policy and systemic issues involved, (4) ensure that the Reserve Banks consider affiliate relationships in determining whether to approve or deny applications from novel charters, and (5) refrain from delegating the Board's statutory authority to set the rate of interest on reserve balances.

I. The guidelines should clearly identify which institutions are legally eligible to apply for Reserve Bank accounts and services so that commenters are able to evaluate any proposed principles in the context in which they will be applied.

The proposal seeks comments on proposed guidelines for evaluating applications for Reserve Bank accounts and services, but expressly declines to address the question of which institutions are *legally* eligible to apply under applicable law. While we appreciate the Board's indication that legal eligibility does not bestow a right to obtain a Reserve Bank account and services and that it may clarify its interpretation of the relevant statutes at some point, it is difficult to assess the appropriateness and effectiveness of the proposed assessment guidelines in the absence of a clear understanding of those firms to which those guidelines may apply. This is particularly important because, as the Board acknowledges in the proposal, the key question to be considered in any application is the risk profile and business model of the applicant, which may vary widely depending on the types of institutions the Board

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[4] Throughout this letter, we use the term "novel charters" to describe potential applicants for Reserve Bank accounts and services that are neither (i) insured depository institutions subject to federal prudential oversight under the Federal Deposit Insurance Act (or other applicable federal law regarding deposit insurance, such as the National Credit Union Act) nor (ii) uninsured institutions that are part of a bank holding company (for example, an uninsured national trust bank that is a subsidiary of a bank holding company), and thus subject to consolidated federal prudential oversight by the Board.

[5] *See* Letter to Federal Reserve, from the Bank Policy Institute et al re: Application of Kraken Financial for Access to Federal Reserve Account and Payments System Services (Oct. 5, 2020), *available at* https://bpi.com/bpi-and-joint-trades-coalition-caution-fed-against-granting-kraken-financial-access-to-payments-system/.

considers legally eligible to apply. Thus, as a threshold matter, we recommend that the Board clarify in the final guidelines which institutions are eligible for Reserve Bank accounts and services, rather than delay that action. This is especially important as the Board considers the unique risks posed by applications from novel charters, which are likely to pose unanticipated policy issues and require distinct supervisory approaches.

In addition, the Board should also establish clear criteria for eligibility for Reserve Bank accounts and services, rather than principles merely to be considered, when the Board evaluates the impact of the proposed guidelines on its policy objectives. In the proposal, the Board indicates that the Federal Reserve System considers the following non-exhaustive policy goals, beyond legal eligibility, when evaluating a request for access to accounts or services: (1) ensuring the safety and soundness of the banking system, (2) effectively implementing monetary policy, (3) promoting financial stability, (4) protecting consumers, and (5) promoting a safe, effective, efficient, accessible and innovative payment system. We fully support each of these policy objectives. Different types of institutions, particularly novel charters with developing business models and risk management frameworks that may not offer sufficient protection to the Reserve Banks and the payments system as a whole, pose distinct concerns as related to each of those objectives, as the Board acknowledges in the proposal. However, the application of the proposed six principles will be substantially simpler where an applicant's basis for eligibility has been well established by the prior practices and procedures of the Reserve Banks, particularly with respect to prudentially regulated institutions. Accordingly, we believe it is not only useful, but also essential, for the Board to clarify its position on these issues. Moreover, we strongly encourage the Board to assess whether novel charters meet the definition of "national bank" and "depository institution" for purposes of the Federal Reserve Act.[6] Where appropriate, we encourage the Board to propose appropriate interpretative rulemaking to resolve the ambiguity of the meaning of such foundational concepts under the Federal Reserve Act, particularly as applied to novel charters.

II. The proposal should clearly explain how Reserve Banks will examine, audit and monitor applicants for compliance with the proposed guidelines, both as part of the application and on an ongoing basis.

Although the proposed guidelines establish appropriate principles for the evaluation of applicants, these principles ultimately involve subjective and discretionary criteria, such that any meaningful application of these principles will require the Reserve Banks to assess the operational and managerial capacity of the applicant and the risks it poses.

In the context of federally-insured depository institutions, Reserve Banks have relied, and should continue to rely, on the federal banking agencies' supervision of applicants, rather than conducting their own independent assessment, which is neither necessary nor appropriate. Similarly, in the context of other eligible institutions that are part of a bank holding company ("BHC"), Reserve Banks have and should continue to rely on the consolidated federal prudential oversight that the Board and Reserve Banks exercise over such institutions. These comprehensively-regulated applicants for Reserve Bank accounts and services are already subject to rigorous federal prudential regulation and supervision under the Federal Deposit Insurance Act, the Bank Holding Company Act, or other applicable federal law regarding deposit insurance, such as the National Credit Union Act. We strongly agree with the Board

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[6] *See* 12 U.S.C. § 461(b)(1)(A) (defining "depository institution" for purposes of the relevant provisions of the Federal Reserve Act). The Federal Reserve Act does not define "national bank," beyond the statement that it shall be interchangeable with "national banking association." *See* 12 U.S.C. § 221.

that the application of the proposed guidelines to applications by federally-insured depository institutions or other institutions that are part of a BHC will be fairly straightforward in most cases. We propose that the Board clarify in the final guidelines that such comprehensively-regulated applicants will be entitled to a presumption of eligibility to obtain access to Reserve Bank accounts and services, and that the Board will not undertake an independent supervisory assessment of such comprehensively-regulated applicants as part of an account or services application, nor conduct independent ongoing monitoring thereafter. This process will help achieve the Board's objective of consistent implementation of the guidance for eligible institutions with similar risk profiles. In addition, this approach would avoid duplicative assessments on such applicants that would impose burdens both on such applicants and the Reserve Bank staffs.

However, in the context of novel charters, the Reserve Banks should conduct a significantly greater degree of due diligence, examination and monitoring to ensure that applicants satisfy the guidelines, both at the time of application and periodically thereafter. These applicants pose distinct issues and heightened risks relative to some or all of the six principles which will need to be carefully vetted and considered. Although the particular risks will vary by novel charter applicant, it is reasonable to expect that such applicants will pose heightened risks regarding matters of anti-money laundering, cybersecurity and consumer protection, as well as safety and soundness. These are areas where, unlike comprehensively-regulated applicants, novel charters, which are not subject to consolidated federal supervision, may be subject to significantly less rigorous supervision and regulation (if any) prior to seeking access to Federal Reserve accounts and services.

For such novel charters, the final guidelines should require an initial examination and audit of applicants in connection with the application, as well as periodic examination and auditing of applicants to ensure they continue to meet the standards. The guidelines should also specify that such standards should be as rigorous as those applicable to federally-insured depository institutions or BHCs under federal banking law, including those regarding capital, liquidity, risk management, cybersecurity, anti-money laundering, consumer protection, affiliations and affiliate transactions and other prudential requirements. Similar to comprehensively-regulated applicants, novel charters should be subject to rigorous examination, in addition to audit and monitoring procedures, regarding these substantive areas of regulation on an ongoing basis.

This assessment, including accompanying examination, auditing and due diligence, should also take into account any important gaps in the regulatory regime applicable to novel charters. For example, in the context of anti-money laundering risks, applicants that are not subject to the full scope of requirements under the Bank Secrecy Act and federal banking law that apply to comprehensively-regulated applicants merit particularly close scrutiny. Similarly, and consistent with the Board's stated desire to further responsible innovation, novel charters engaged in distinctive or higher-risk activities that relate to Reserve Bank accounts or services also warrant particularly close scrutiny, given the absence of governance, risk management, and other requirements imposed under federal banking law to ensure comprehensively-regulated applicants innovate in ways that are responsible.

We also believe that state banking agencies and supervisors have an important role to play in the supervision of novel charter applicants for Reserve Bank accounts and services that are state-chartered. Further, we agree with the Board that, when applying the account access guidelines, the Federal Reserve should incorporate the assessments of an institution by its state supervisor(s) into its independent assessment of the institution's risk profile. However, the underlying statutory and regulatory requirements applicable to state-chartered financial institutions vary considerably.

Accordingly, where the applicant is neither an insured depository institution nor part of a BHC (and thus not subject to a clear "floor" of federal prudential oversight) the Federal Reserve should clarify that the assessments of state banking agencies or other state supervisors will be considered, but not treated as dispositive, when evaluating that applicant, particularly when the applicant is not subject to the full panoply of that state's standard requirements for a state-chartered bank.

III. Decisions about whether to grant Reserve Bank accounts or services to novel charters should be subject to review and non-objection by the Board of Governors, given the heightened policy and risk considerations such applications may involve.

The questions of whether and how novel charters may have direct access to Reserve Bank accounts and services are ultimately fundamental questions of U.S. payments systems policy. The proposal recognizes the important policy implications of account access, noting that "[t]he evaluation of an institution's access request should also consider whether the request has the potential to set a precedent that could affect the Federal Reserve's ability to achieve its policy goals now or in the future."[7] Accordingly, it is crucial that the Board, and not individual Reserve Banks, have ultimate authority to decide whether any individual or category of novel charters should be granted access to accounts and/or services.

We fully support the Board's objective of a transparent and consistent process for all applications, and believe that this objective would be best achieved by a Board-level process where decisions on novel charters are ultimately escalated to the Board for review. As noted above, novel charters are the most likely to pose new and distinct issues under the guidelines, and heightened risks to the financial and payments system if granted Reserve Bank accounts and services. Further, novel charters are more likely to raise distinct legal questions regarding eligibility for such accounts and services.

Any individual Reserve Bank will be unable to compare and assess whether they are applying the proposed guidelines differently from other Reserve Banks in the case of novel charters, particularly in the context of the pronounced risks they may pose. By contrast, a process in which decisions are ultimately made (or reviewed without objection) by the Board will ensure that a single, clear standard is being applied, and eliminate any risk of "forum shopping" when an application poses new and distinct issues, particularly when the guidelines are largely discretionary and subject to differential application. In addition, the Board will be best positioned to evaluate the application of the guidelines on an ongoing basis to address novel questions the resolution of which will have important *prospective* effects, and to provide further specific instructions and guidance to the Reserve Banks. It is especially important that the Board exercise this holistic oversight role because there will be no opportunity for the public to provide input on a case-by-case basis. Such a process would complement processes that the Board has established for ensuring consistent application of Board rules and policies at the Reserve Banks in other contexts.[8]

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[7] 86 Fed. Reg. at 25867.

[8] For example, the Board's Division of Reserve Bank Operations and Payment Systems (RBOPS), which generally "oversees the policies and operations of the Federal Reserve Banks as providers of financial services to depository institutions" conducts audits of Reserve Bank operations, including compliance with Board regulations concerning payment, accounts and services, and the Federal Reserve's Policy on Payment System Risk. Board of Governors of the Federal Reserve System, "Reserve Bank Operations and Payment Systems," *available at* https://www.federalreserve.gov/econres/rbopsstaff.htm. *See also* Office

Accordingly, the guidelines should include criteria for the circumstances under which the Reserve Banks will escalate applications for review and input by the Board, particularly in the case of novel charters. This level of Board involvement is an important procedural safety valve that would help ensure consistency and transparency in the application of the guidelines.

IV. The standards in the proposal should account for relationships between novel charters and their affiliates.

The guidance should address the risks posed by transactions and relationships between an applicant and its affiliates. In the context of traditional applicants, such transactions and relationships are appropriately addressed through the affiliate transaction restrictions of sections 23A and 23B of the Federal Reserve Act and/or consolidated supervision by the Federal Reserve at the holding company level. However, in the context of novel charters where these safeguards are not applied, the Board should extend the principles in the final guidelines — as well as its examination, auditing, diligence and monitoring activities — to take into account the risks posed by affiliates themselves, and any transactions, business activities or other relationships between the applicant and its affiliates, including an applicant's dependence on affiliate transactions for operational or financial support.

Failure to assess affiliate transactions and relationships that could have a meaningful impact on an applicant's use of Reserve Bank accounts or services, or the risks such use poses could undermine each or all of the Federal Reserve's stated policy objectives. Applicants could structure their business models to make an applicant-entity eligible for an account and services, with the rights and privileges of that account and services passed indirectly to other parts of the organization, even though its business as a whole may be unsuitable for an account and services. The Board should perform a critical assessment of how credit, operational, settlement, cyber or other risks could emerge in affiliates of novel charters, before exposing the applicants, and potentially the Reserve Bank and financial system more broadly, to those risks by providing Reserve Bank accounts and services.

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of Inspector General, Audit Report 2014-FMIC-B-014 (Sept. 30, 2014) at 4 ("RBOPS is responsible for the oversight of Reserve Bank operations . . . ."); Federal Reserve 2019 Annual Report, "Oversight of Federal Reserve Banks," *available at* https://www.federalreserve.gov/publications/2019-ar-payment-system-and-reserve-bank-oversight.htm#xexaminationandoversightoffederalres-e5c44af8 ("The Board's reviews of the Reserve Banks include a wide range of oversight activities, conducted primarily by its Division of Reserve Bank Operations and Payment Systems . . . ."). The Federal Reserve uses a similar mechanism to ensure consistency in discount window lending. In that context, the Board establishes the interest rates that will be charged on the three types of available Discount Window loans (based on proposals from the Reserve Banks) and the criteria that must be met to qualify for each type of loan. Each Reserve Bank must decide, based on the Board's rules, whether an applicant qualifies for the type of credit for which it has applied, and the Reserve Bank then makes the lending decision. The Subcommittee on Credit Risk Management, or "SCRM," which is a System committee composed of representatives from the Reserve Banks and Board observers, ensures that each Reserve Bank is applying the rules uniformly. *See*, *e.g.*, Amy Kytonen, Vice President, Supervision, Regulation, and Credit "Credit risk management update: Contributions from the Ninth," (September 18, 2019), *available at* https://www.minneapolisfed.org/article/2019/credit-risk-management-update-contributions-from-the-ninth (The SCRM "assists Reserve Bank presidents in developing and implementing policies for managing discount window credit, condition monitoring, and payment system risk . . . . In a nutshell, SCRM ensures that all things related to managing credit risk are considered nationwide . . . .").

V. The final guidelines should not include the apparent delegation of decisions on the IORB rate to the Reserve Banks given the particular importance of System-wide consistency in this area.

The proposal appears to cede to individual Reserve Banks the Board's statutory authority to establish the interest rate that Reserve Banks would pay to any particular accountholder, noting that a Reserve Bank may impose conditions on the use of an account or services, including through assessing different interest rates on balances held in the account.[9]

This aspect of the proposal is untenable for a number of reasons. First, by statute, the Board sets the interest rate the Reserve Banks pay on reserve balances (the IORB rate). Section 19 of the Federal Reserve Act provides that the Board may prescribe regulations concerning the payment of interest on balances at a Reserve Bank.[10] There is no comparable authority provided to Reserve Banks under section 13 of the Federal Reserve Act. Further, while the Board may delegate some functions to the Reserve Banks, it may not delegate those related to rulemaking or principally to monetary and credit policies.[11] Thus, it is not within the Board's authority to delegate this function, as it is related to (1) rulemaking, and (2) "principally to" monetary policy.[12] The Board has explained that "[t]he interest rate on required reserves (IORR rate) is determined by the Board and is intended to eliminate effectively the implicit tax that reserve requirements used to impose on depository institutions. The interest rate on excess reserves (IOER rate) is also determined by the Board and *gives the Federal Reserve an additional tool for the conduct of monetary policy* . . . the Federal Reserve intends to move the federal funds rate into the target range set by the FOMC primarily by adjusting the IOER rate."[13]

Second, as noted, even if it were within a Reserve Bank's authority to set the IORB rate for certain types of accounts, or the Board was able to delegate this function, doing so would undermine one of the key goals of the proposal to ensure consistency across the System. Indeed, inconsistency would be likely, as the proposal includes no mechanism by which the Board and Reserve Banks would agree to or enforce common rates, as described previously.

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9 86 Fed. Reg. at 25867 n.5.

10 *See* 12 U.S.C. § 461(b)(12).

11 Section 11(k) of the Federal Reserve Act provides that the Board, by published order or rule, may delegate any of its functions, other than those related to rulemaking or principally to monetary and credit policies. 12 U.S.C. § 248(k).

12 *See id*.

13 Federal Reserve Board, "Policy Tools: Interest on Required Reserve Balances and Excess Balances" (emphasis added) (last updated June 3, 2021), *available at* https://www.federalreserve.gov/monetarypolicy/reqresbalances.htm. The Board issued an interim final rule in 2008 implementing the authority it was provided by Congress in the Financial Services Regulatory Relief Act of 2006 to pay interest on excess reserves. In adopting the interim final rule, the Board stated that "[t]he ability to pay interest on balances held at Reserve Banks should help promote efficiency and stability in the banking sector. Paying interest on excess balances will permit the Federal Reserve to expand its balance sheet as necessary to provide sufficient liquidity to support financial stability while implementing the monetary policy that is appropriate in light of the System's macroeconomic objectives of maximum employment and price stability. Paying interest on excess balances should also help to establish a lower bound on the federal funds rate." Board of Governors of the Federal Reserve System, Reserve Requirements of Depository Institutions, Interim Final Rule, 73 Fed. Reg. 59482, 59482 (Oct. 9, 2008).

Third, delegation of interest rate setting would be inconsistent with the Board's 2019 advance notice of proposed rulemaking for evaluating master account requests from narrow banks or "pass-through-investment-entities" (PTIEs).[14] The Board requested comment on whether Reserve Banks should pay PTIEs a different rate of interest on their excess reserves than they pay to other banks. The questions in that ANPR made clear that it would be the Board that would set the interest rate.[15] Accordingly, any final guidelines should remove this apparent delegation of interest-rate setting authority to the Reserve Banks.

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The Associations appreciate the opportunity to comment on the proposal and would welcome the opportunity to discuss them further with you. If you have any questions, please contact Dafina Stewart by phone at (202) 589-2424 or by email at *dafina.stewart@bpi.com*, or Deborah Matthews Phillips by phone at (202) 697-1266 or by email at *deborah.phillips@icba.org*.

Respectfully submitted,

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14 Board of Governors of the Federal Reserve System, Advanced Notice of Proposed Rulemaking, Regulation D: Reserve Requirements of Depository Institutions, 88 Fed. Reg. 8829 (March 12, 2019). The advanced notice of proposed rulemaking has not advanced since its initial publication.

15 88 Fed. Reg. at 8831. The proposal asked "If the Board were to determine to pay a lower IOER rate to PTIEs, how should the Board define those eligible institutions to which a lower IOER rate should be paid?" and "If the Board were to determine to pay a lower IOER rate to PTIEs, what approach should the Board adopt for setting the lower rate?"