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National Association of Federally-Insured Credit Unions

July 12, 2021

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

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

Dear Ms. Misback:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the request for comment (RFC) issued by the Board of Governors of the Federal Reserve System (Board) regarding proposed guidelines for evaluating requests for accounts and services at Federal Reserve Banks (Reserve Banks). NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 125 million consumers with personal and small business financial service products. NAFCU supports efforts to promote a uniform and transparent framework for evaluating access requests for Reserve Bank services centered on a foundation of risk management and mitigation. As nontraditional applicants, including financial technology companies, seek access to the Federal Reserve payment system, it is critical that non-federally-insured institutions meet the same safety and soundness standards applicable to insured institutions. The Board should also exercise heightened due diligence when evaluating requests from non-depository institutions engaged in novel financial activities.

Federally-insured credit unions (FICUs) are subject to safety and soundness regulations promulgated by the National Credit Union Administration (NCUA), undergo regular examination, and file public statements of financial condition (Call Reports). By contrast, entities that are not insured depository institutions may not receive comparable oversight and supervisory information concerning their health may be less comprehensive. Certain entities eligible to apply for master account access could also be recipients of novel state charters, which might entail differing supervisory standards as compared with traditional depository institutions. Accordingly, NAFCU generally agrees with the Board's assessment that "application of the guidelines to access requests by federally-insured institutions would be fairly straightforward in most cases," however, "assessments of access requests from non-federally-insured institutions [...] may require more extensive due diligence."¹

¹ Board of Governors of the Federal Reserve System, "Proposed Guidelines for Evaluating Account and Services Requests," 86 Fed. Reg. 25865, 25866 (May 11, 2021).

General Comments

While NAFCU supports the Board's desire to promote uniform and transparent guidelines for Reserve Banks to follow when evaluating account and service applications, we urge the Board to avoid promoting standards that would be more burdensome than what currently exist for credit unions seeking access to Federal Reserve services today. When evaluating access or service requests submitted by credit unions, the Reserve Banks should rely upon the same types of supervisory ratings and information that has previously supported evaluation of such requests. Likewise, for incumbent credit union users of Federal Reserve services, the guidelines should not entail a more onerous standard for ongoing risk monitoring. Credit unions have demonstrated that they are responsible users of Federal Reserve services and are already subject to a variety of guidance concerning access to payment systems, including services operated by the Reserve Banks.²

The Board should also recognize that credit union users of Federal Reserve services are unlikely to generate the type of financial stability risks alluded to in the guidelines. The *Federal Credit Union Act* provides that credit unions must be organized as member-owned cooperatives. As a consequence, credit unions will not exhibit the type of complex, holding company arrangement that might exist between an industrial loan company and its parent, or a foreign bank entity and its U.S. domestic subsidiary. When a Reserve Bank evaluates a credit union for master account access, there is no need to consider the condition of a parent company, since there is none. Furthermore, nearly half of all credit unions are under \$46 million in total assets, which itself limits the magnitude of any potential stability risks.

For nontraditional applicants seeking a master account, the guidelines will promote more consistent evaluation practices (particularly in cases where an applicant presents a novel business plan) and reduce the potential for forum-shopping for Reserve Bank access.

Principle 1 – Eligibility.

Generally, only those entities that are member banks or meet the definition of a depository institution under section 19(b) of the *Federal Reserve Act* are legally eligible to obtain Federal Reserve accounts and financial services. NAFCU agrees with the Board's statement that legal eligibility is not a guarantee of access.³

Nontraditional applicants such as non-depository banks and trust companies may be eligible for master account access, but the Reserve Banks must carefully consider how the business plans of entities primarily focused on payment services might create novel risks. For example, the Office of the Comptroller of the Currency has approved applications for national trust banks that are substantially engaged in activities involving digital assets and cryptocurrencies, and one has issued

² See e.g., Federal Financial Institutions Examination Council, Retail Payment Systems – IT Examination Handbook, 36-37 (April 2016), available at https://ithandbook.ffiec.gov/media/274860/ffiec_itbooklet_retailpaymentsystems.pdf

³ See 86 Fed. Reg. 25867 (“The Board believes it is important to make clear that legal eligibility does not bestow a right to obtain an account and services.”).

its own virtual currency branded as a stablecoin.⁴ Despite the name, it is not entirely clear that these digital assets are in fact stable, particularly when disclosure regarding underlying assets backing the stablecoin is less than transparent, or when the asset portfolio is far riskier than portrayed by the stablecoin-issuer.⁵ Opining on the risks of stablecoins, the President and CEO of the Federal Reserve Bank of Boston observed that “there’s a financial stability concern that a future crisis could easily be triggered as [stablecoins] become a more important sector of the financial market.”⁶

NAFCU recommends that the Reserve Banks apply enhanced scrutiny when reviewing applications from entities that are primarily engaged in issuing or transacting in virtual currencies, particularly when those institution are not subject to federal supervision.

Principles 2 and 3 – Avoid undue credit, operational, settlement, cyber or other risks to the Reserve Bank and overall payment system.

The guidelines provide that a Reserve Bank should confirm that an institution has an effective risk management framework and governance arrangements to ensure that it is operating in a safe and sound manner. The guidelines further note that effective risk management should at a minimum identify, measure, and control the particular risks posed by the institution’s business lines, products and services. Credit unions are already subject to regulatory guidance that requires such a framework, including operational controls tailored to electronic payment system products offered by the Federal Reserve.⁷ Credit unions also comply with the information security provisions of the *Gramm-Leach Bliley Act* (GLBA) and security guidelines promulgated by FFIEC agencies.

The guidelines suggest that the Reserve Banks primarily rely upon existing supervisory information to conduct risk assessments of entities seeking account or service access and further state that a Reserve Bank should incorporate, to the extent possible, assessments of an institution by state and/or federal supervisors into its independent assessment of the institution’s risk profile. NAFCU believes the scope of current Reserve Bank risk assessment and monitoring activities is already appropriately tailored for credit union account holders and incumbent users of Reserve Bank services. More generally, NAFCU urges the Board not to adopt standards for evaluating the financial condition of credit unions that entails a more burdensome standard of review than what exists today.

The guidelines note that a Reserve Bank should use its judgment to determine whether an institution has adequate capital to continue as a going concern and to meet its current and projected

⁴ Office of the Comptroller of the Currency, Preliminary conditional approval of Paxos National Trust, New York (April 23, 2021), available at <https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-49a.pdf>.

⁵ See Coindesk, “US Fed Official Calls Tether a ‘Challenge’ to Financial Stability” (June 25, 2021), available at <https://www.coindesk.com/us-fed-official-calls-tether-a-challenge-to-financial-stability>

⁶ Federal Reserve Bank of Boston, “Official Monetary and Financial Institutions Forum Fed Week Financial Stability Session” (June 25, 2021), available at <https://www.bostonfed.org/news-and-events/speeches/2021/official-monetary-and-financial-institutions-forum-fed-week-financial-stability-session.aspx>.

⁷ See National Credit Union Administration, Examiner’s Guide – Electronic Payment Systems, available at <https://publishedguides.ncua.gov/examiner/Pages/default.htm#ExaminersGuide/ElectronicPaymentSystems/FedLineAccessSol.htm%3FTocPath%3DElectronic%2520Payment%2520Systems%7CEPS%2520Types%7C> 5

operating expenses under a range of scenarios. As an initial matter, NAFCU believes that a discretionary standard of review in this domain undermines the purpose of a uniform and transparent set of guidelines. On the other hand, NAFCU recognizes that a range of capital management practices may exist for different types of institutions and that a one-size fits all standard may not be desirable. The Board should clarify the meaning of “adequate capital” and refer to the capital adequacy standards issued by the NCUA and other banking regulators.

The Board should also clarify how it will consider capital adequacy under “a range of scenarios” for institutions not subject to formal stress testing requirements and for whom capital plans are evaluated as part of an agency’s supervisory process. Not all credit unions are required to undergo formal stress testing.⁸ Accordingly, NAFCU recommends that the Board not impose new requirements for credit unions in this domain given their existing supervision, which is tailored to their size and complexity, as well as credit unions’ limited capacity to undertake such a significant and costly compliance function.

While additional specificity concerning how capital and liquidity will be evaluated for non-depository institutions would be helpful, these components of the guidelines, when applied to credit unions, should not translate into a mandate to maintain capital or liquidity levels in excess of what is presently required.⁹ Existing safety and soundness standards have cultivated ample capital and liquidity within the credit union system and supervision by the NCUA ensures that credit unions’ financial health will always be transparent. Credit unions have limited capacity to shoulder additional compliance burdens and changes that would make the terms governing master account or service access more onerous would be inappropriate given the industry’s low risk profile. However, it would be prudent for the Federal Reserve to establish minimum financial reporting requirements, similar to credit unions’ existing obligation to submit a Call Reports, for entities that do not already disclose such information.

The guidelines also provide that Reserve Banks should confirm that an institution is in “substantial compliance” with its supervisory agency’s regulatory and supervisory requirements. NAFCU recommends that the guidelines clarify how the Reserve Banks will undertake such verification. For credit unions, the Reserve Banks should seek to maintain the current framework for evaluating account or service requests and coordinate with the NCUA as appropriate to reduce reporting burdens. However, for entities that are recipients of novel bank charters, such as a special purpose depository institution license, the Reserve Banks should determine whether the supervisory framework applicable to these entities is comparable to that of traditional, insured depository institutions.¹⁰ While certain states like Wyoming provide general descriptions of how its intended supervisory framework should function for special purpose institutions, it is not always clear how this supervision operates in practice.¹¹

⁸ See 12 CFR Part 702 Subpart E.

⁹ See 12 CFR Part 702 – Capital Adequacy; *see also* NCUA, Letter to Credit Unions, “Guidance on How to Comply with NCUA Regulation §741.12 Liquidity and Contingency Funding Plans,” 13-CU-10 (October 2013).

¹⁰ See e.g., Wyoming Division of Banking, Special Purpose Depository Institution, <http://wyomingbankingdivision.wyo.gov/home/areas-of-regulation/laws-and-regulation/special-purpose-depository-institution>.

¹¹ For example, Wyoming SPDIs may enter into an agreement with the Wyoming Banking Commissioner to use “real-time supervisory technology that permits monitoring of the investments and liquidity position of the

Before granting requests for account or service access, the Reserve Banks should ensure that novel or special purpose institutions meet safety and soundness, consumer protection, and data security standards comparable to those that apply to federally-insured depository institutions. Furthermore, as more states consider whether to offer special purpose charters to attract fintech companies, the end result could be a race to the bottom in terms of supervisory expectations, potentially leading to under-regulation of risk among certain fintech companies not subject to federal supervision. To clarify how the Reserve Banks might address such a gap, the guidelines should address how the term “substantial compliance” applies in cases where a nontraditional startup may be relying on a provisional assessment of its compliance management system before it has been evaluated at scale.

Lastly, the guidelines indicate that the Reserve Banks will use the guidelines to re-evaluate the risks posed by an institution in cases where existing condition-monitoring activities indicate potential changes in the institution's risk profile. NAFCU recommends that such re-evaluations be calibrated to focus on significant risk changes.

Principle 4 – Avoid undue risk to the stability of the U.S. financial system.

The guidelines provide that a Reserve Bank should determine, in coordination with the other Reserve Banks and the Board, whether access to an account and services by an institution itself or a group of like institutions could introduce financial stability risk to the U.S. financial system. NAFCU believes this is a reasonable requirement. As a class of financial institutions, credit unions are well capitalized, maintain strong levels of liquidity, and do not present financial stability risks. Credit union capital and liquidity is monitored closely by the NCUA and Call Reports provide ample information regarding their financial condition. By contrast, under-regulated, non-depository entities could be subject to differing capital and liquidity standards and are likely to pose greater risks from a supervisory standpoint. Limited purpose, non-depository charters targeted at fintech companies with payments-oriented business models could allow some bank license recipients to avoid registration as a Bank Holding Company Act (BHCA) bank. This loophole creates additional risk to the extent that the holding company of a non-depository firm might avoid consolidated supervision by the Federal Reserve. Lack of BHCA coverage would frustrate the Reserve Banks’ ability to effectively evaluate the health or safety of an institution whose risks are linked to its holding company’s activities.

Unlike banks, credit unions face strict limits on investments they can carry, business loans they can originate, and investments they can make. In general, these limits reduce the complexity of credit union balance sheets and greatly minimize the already remote possibility that credit unions would give rise to risks capable of affecting the broader U.S. financial system. Accordingly, NAFCU recommends that the Board continue to evaluate credit unions as they have done in the past for the purpose of Principle 4. For nontraditional entities seeking access to accounts or services at Reserve Banks, heightened review may be necessary, particularly in cases where an entity proposes to orient its business plan around virtual currency transactions or does not engage in the

institution.” Wyoming Administrative Rules, Chapter 20, § 9(f), available at <https://docs.google.com/viewer?a=v&pid=sites&srcid=d31vLmdvdxixYW5raW5nfGd4OmZIMTYzNDYlNmM3ZjQ2Ng>.

core banking activities of lending and deposit taking which have traditionally justified discount window privileges.

Principle 5 – Avoid risk of financial crime.

The guidelines provide that a Reserve Bank should confirm that an institution has an anti-money-laundering (AML) program consistent with the requirements in 31 CFR 1020.210(b) and complies with the Office of Foreign Asset Control (OFAC) regulations at 31 CFR Chapter V. Credit unions follow all AML and *Bank Secrecy Act* (BSA) laws and regulations and are closely supervised by the NCUA for compliance. NAFCU agrees that entities should not be granted account or service access if they cannot demonstrate compliance with these laws or regulations. The Reserve Banks should also consider whether entities engaged in virtual currency transactions and services may face unique challenges in terms of complying with AML/BSA requirements, given cybercriminals propensity for using digital currency as a mechanism for ransomware payments and OFAC’s prohibition on facilitating the payment of such ransoms to sanctioned entities.¹²

Principle 6 – No adverse effect on implementation of monetary policy.

Granting individual credit unions account and service access is unlikely to influence the Board’s administration of monetary policy. Due to a combination of statutory limits on membership, investments, and lending, credit unions are unlikely to influence (by any material degree) demand for and supply of reserves, the level and volatility of key policy interest rates, or the structure of key short-term funding markets. The total assets of the entire credit union industry are eclipsed by the assets held by the four largest U.S. banks. Accordingly, NAFCU does not regard the guidelines embedded in Principle 6 as a barrier to credit union account or service access.

However, NAFCU recommends that the Board consider whether non-depository institutions that are substantially engaged in providing cryptocurrency services might, in fact, present risks that could bear upon the efficient execution of monetary policy. The volatility of digital assets such as Bitcoin is well understood, and entities built around cryptocurrency payment services could frustrate efforts to manage the Federal Funds Rate if borrowing patterns are not tied to lending activities. Furthermore, the Financial Stability Board has noted that even less volatile digital currency, such as stablecoins, “may challenge the comprehensiveness and effectiveness of existing regulatory and supervisory oversight.”¹³

Conclusion

NAFCU appreciates the opportunity to share our thoughts on the proposed guidelines. NAFCU supports principles which recognize the unique risks posed by nontraditional entities not subject to the same close supervision as credit unions and other federally-insured institutions. At the same time, we ask that the Board avoid promulgating requirements or guidance that would adversely

¹² See U.S. Department of the Treasury Office of Foreign Assets Control, “Advisory on Potential Sanctions Risks for Facilitating Ransomware Payments” (October 2020).

¹³ Financial Stability Board, “Crypto-assets and Global “Stablecoins,” available at <https://www.fsb.org/work-of-the-fsb/financial-innovation-and-structural-change/crypto-assets-and-global-stablecoins/>.

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affect credit unions' current ability to access accounts and services at the Reserve Banks. Should you have any questions or require any additional information, please contact me at amorris@nafcu.org or (703) 842-2266.

Sincerely,

A handwritten signature in black ink that reads "Andrew Morris". The signature is written in a cursive style with a long, sweeping underline.

Andrew Morris
Senior Counsel for Research and Policy