



July 12, 2021

Via Electronic Submission

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 (FRB Docket No. OP-1747)**

Dear Ms. Misback:

The Clearing House Payments Company L.L.C. and The Clearing House Association (“TCH”)¹ appreciate the opportunity to provide comments to the Board of Governors of the Federal Reserve System (“FRB” or “Board”) in response to its proposed guidelines for evaluating account and services requests (the “Proposed Guidelines”).² TCH fully supports the Board’s efforts to create transparent and uniform guidelines for evaluating requests to access Federal Reserve accounts and services (“Access Requests”). We agree that guidelines are needed to ensure the safety and soundness of the U.S. financial system in the face of both a rapidly evolving payment landscape and the growth of novel charter types. As a payment system operator with a long history of reliable service and innovation – including the launch of the country’s first 24x7, end-to-end real time inter-bank payment system, the RTP® System, in 2017 – we embrace the goal of balancing robust risk management and continuous innovation in financial services. While the Proposed Guidelines incorporate a number of essential safety and soundness expectations, TCH believes that some clarification and refinement is needed in order for Reserve Banks to strike the appropriate balance between risk management and continuous innovation when evaluating Access Requests.

¹ Since its founding in 1853, The Clearing House has delivered safe and reliable payments systems, facilitated bank-led payments innovation, and provided thought leadership on strategic payments issues. Today, The Clearing House is the only private-sector ACH and wire operator in the United States, clearing and settling nearly \$2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume. It continues to leverage its unique capabilities to support bank-led innovation, including launching the RTP® System, a real-time payment system that modernizes core payments capabilities for all U.S. financial institutions. As the country’s oldest banking trade association, The Clearing House also provides informed advocacy and thought leadership on critical payments-related issues facing financial institutions today.

² FRB, Proposed Guidelines for Evaluating Account and Services Requests, Notice and Request for Comment, 86 Fed. Reg. 25865 (May 11, 2021).

As discussed in more detail below, TCH respectfully suggests that the Board:

- Clarify the concept of legal eligibility to maintain a Federal Reserve account by providing an analysis of Section 19(b) of the Federal Reserve Act;
- Enhance consistency in the application of the Proposed Guidelines, including by
 - expressly stating that Access Requests will be evaluated based on standards that are applied to federally-insured institutions
 - establishing a process by which Access Requests by non-federally-insured institutions are evaluated with input from a cross section of Reserve Banks and Board staff
 - developing a means of ongoing assurance for non-federally-insured institutions that are permitted access but are not subject to regular and reliable examination; and
- Incorporate into the Proposed Guidelines the potential impact to private sector operators, and their customers, that interoperate with Federal Reserve services.

Discussion

Federal Reserve Banks serve as the ultimate gatekeeper to our country's payment system and it is appropriate for them to hold institutions to uniform and robust expectations when evaluating Access Requests. For this reason, TCH commends the Board's clear statement in the Proposed Guidelines that "legal eligibility does not bestow a right to obtain an account and services."³ TCH also supports the goals set out in the Proposed Guidelines and believes each goal is critical (i.e., ensuring institutions are eligible and have a well-founded basis for their operations and preventing undue risks to Reserve Banks, the payment system, the U.S. financial system, the economy, and monetary policy).

TCH understands that the Board intends to support these critical goals through the risk management expectations set forth in Proposed Guidelines, which are based on principles that are fundamental in the supervision and regulation of federally-insured institutions. TCH strongly agrees with this risk management approach to evaluating Access Requests. We believe that the approach, if supplemented with the modifications we suggest in our comments, will ensure that the safety and soundness framework that has historically applied to institutions with Federal Reserve access continues to be applied, even if institutions that are eligible to request access do not fall under the statutes, regulations, or supervisory guidance that would otherwise subject them to that framework. If, however, the Proposed Guidelines are not supplemented as we suggest, we think the Proposed Guidelines will fall short of the Board's intended purpose and that the critical goals will not be met.

As further discussed below, TCH recommends certain clarifications and additions that we believe would overall improve the Proposed Guidelines.

³ 86 Fed. Reg. 25867.

1. Clarification and Elaboration on Eligibility

In its first principle for the Proposed Guidelines the Board sets the baseline requirement that an institution must be eligible under the Federal Reserve Act or other federal statute to have an account at a Reserve Bank and receive Federal Reserve services and should have a well-founded, clear, transparent, and enforceable legal basis for its operations.

With respect to eligibility, the Proposed Guidelines identify institutions that are legally eligible to obtain Federal Reserve accounts and services as only those entities that are member banks or meet the definition of a depository institution under section 19(b)⁴ of the Federal Reserve Act, unless otherwise specified by federal statute.

Eligibility is an issue of tremendous concern. While the Board noted that it is considering whether it may be useful to clarify legal eligibility in the future,⁵ we believe there is a present need to do so. Therefore, we request that the Board provide an analysis of section 19(b), including (i) the definitions section 19(b) incorporates from other statutes, such as banks that are eligible to make application for insurance under section 5 of the Federal Deposit Insurance Act, and (ii) how section 19(b) relates to the provision in section 2⁶ of the Federal Reserve Act that requires all national banks to become member banks of the Federal Reserve System and upon such membership to be an insured bank under Federal Deposit Insurance Act.

This analysis should be provided either in the Proposed Guidelines or through another publication so that the Reserve Banks can apply this critical principle correctly and so that the public has an understanding of what a section 19(b) depository institution is. We further request that the Board affirm that state law is not dispositive to the question of eligibility even if a state asserts that its state charter has some relevance under federal law.

2. Consistent Application of Proposed Guidelines across Reserve Banks

While the Proposed Guidelines would articulate uniform principles that the Reserve Banks must apply when considering Access Requests, we believe it is also important that the principles be applied in a consistent manner and with the input of Federal Reserve staff with expertise in the different disciplines that the principles address.

To better enable consistency among Reserve Banks in the application of the principles, we think that the Proposed Guidelines should expressly state that in determining the effectiveness of an

⁴ 19(b) generally defines as depository institution as a bank or savings bank insured by the FDIC, a credit union insured by the NCUA, or a bank or credit union that is eligible for deposit insurance under the section 5 of the Federal Deposit Insurance Act or section 201 of the National Credit Union Act. It also includes members of a Federal Home Loan Bank, and certain associations.

⁵ 86 Fed. Reg. 25866.

⁶ "Every national bank in any State shall, upon commencing business or within ninety days after admission into the Union of the State in which it is located, become a member bank of the Federal Reserve System by subscribing and paying for stock in the Federal Reserve bank of its district in accordance with the provisions of this Act and shall thereupon be an insured bank under the Federal Deposit Insurance Act . . ." 12 U.S.C. § 222.

institution's frameworks for managing risk and its governance arrangements, such frameworks and arrangements should be measured against the standards that are applied to federally-insured institutions by federal supervisors. Given that the Board has incorporated risk management expectations that are at the core of the safety and soundness regime for federally-insured institutions, we believe that this standard is both appropriate and the only coherent way that the expectations can be applied. As part of this standard we believe it is also important the Proposed Guidelines incorporate relevant supervisory guidance, such as third party/ vendor management expectations and model risk management guidance, since supervisory guidance informs the risk management expectations for federally-insured institutions.

We also suggest that the Board incorporate into the Proposed Guidelines, and further expand upon, its observation that application of the guidelines to federally-insured institutions "would be fairly straightforward in most cases" as this provides important context to how the Proposed Guidelines should be applied.⁷ We understand this phrasing to mean federally-insured institutions would not be held to a new or higher standard. Nor would we expect Federal Reserve supervisory staff to use ongoing access to Federal Reserve accounts and services as a new means of imposing supervisory consequences on federally-insured institutions. We request language affirming both concepts in the Proposed Guidelines.

We think it is equally important that there be more context with respect to how the Proposed Guidelines should be applied to non-federally-insured institutions. In particular, the Board should include a presumption in the Proposed Guidelines that non-federally-institutions will require more extensive due diligence.⁸ Such institutions may not be subject to consolidated supervision or the same safety and soundness expectations as federally-insured institutions. And, unless a non-federally-insured institution holds private deposit insurance⁹, there would be an increased risk that unprotected depositors would be more inclined to suddenly withdraw their deposits upon any concern with the health of the institution and that such sudden withdrawals could cause the institution to become quickly insolvent. A sudden failure of a financial institution of course increases risk to payment systems and the broader financial system. And a foreseeable consequence of one or more sudden failures of non-federally insured institutions is increased regulatory expectations for federally-insured institutions to manage risk related to their participation in systems with non-federally insured institutions. Hence, it is appropriate for the Proposed Guidelines to presume that non-federally-insured institutions present increased risk and require increased due diligence.

In addition, we suggest that there be some process by which Access Requests by non-federally-insured institutions be reviewed by staff from a cross section of Reserve Banks as well as the Board. We note that different Reserve Banks have different areas of focus and expertise (e.g., FRB Atlanta and retail payments; FRB New York and wholesale and international; FRB Richmond and technology) and that the review process would be enhanced by having subject matter experts from these Reserve Banks participate

⁷ 86 Fed. Reg. 25866. This observation is made in the supplementary information of the Federal Register notice but not in the Proposed Guidelines themselves.

⁸ The supplementary information states that non-federally-insured institutions "may" require more extensive due diligence.

⁹ Nine states permit state chartered credit unions to be privately insured: Alabama, California, Idaho, Illinois, Indiana, Maryland, Nevada, Ohio, and Texas. Similarly, in Puerto Rico savings and loan cooperatives are insured by a Puerto Rican agency rather than the FDIC.

in the review of such Access Requests. Board staff would have expertise in applying principles related to monetary policy, the stability of the U.S. financial system, and payment system risk. Board staff are also best suited to apply special conditions or limitations on the payment of different rates of interest on balances held in an account, limit the amount of balances on which interest paid, or establish a cap on the amount of balances held in an account.

We believe it is important that Reserve Banks also include staff from their supervision and regulation teams to assist in the review of principles that address matters that are routinely examined at federally-insured institutions, such as capital and liquidity, operational risk, and AML and sanctions programs. This will ensure that the Reserve Banks apply such principles consistently with current supervisory practice for federally-insured institutions.

3. Reserve Bank Risk Management

The Board describes the Proposed Guidelines as prompting the Reserve Banks to identify risk mitigation strategies adopted by both the institution and by the Reserve Bank. As discussed above, TCH finds that the Proposed Guidelines are thorough and specific in their identification of risk mitigation strategies for institutions. TCH finds that the Proposed Guidelines are less specific in their identification of risk management by a Reserve Bank and generally focus on controls and limitations on accounts and services.

TCH believes that in some circumstances the Reserve Banks may also need to consider as part of their risk management a means of ongoing assurance for institutions that are allowed access. In particular, if the supervisory framework for an institution does not incorporate a regular and reliable review of the institution's risk management frameworks and governance arrangements that are contemplated in Proposed Guidelines, the Reserve Bank should determine if certifications, audits, special reporting, or other tools beyond a Reserve Bank's usual monitoring may be needed to provide ongoing assurance of the sufficiency of the institution's ability to operate in a safe and sound manner. We think that such ongoing assurance may also be needed to ensure that non-federally-insured institutions' risk management frameworks and governance arrangements remain consistent with evolving expectations that are applied to federally-insured institutions through new or revised regulations and guidance by federal agencies.

We note that such ongoing assurance may be needed not only for Reserve Bank risk management but also for other participants in the payment system. For example, national banks, as part of their risk management, are expected to consider whether a payment system has processes and controls in place to verify and monitor on an ongoing basis the compliance of each participant with admission and participation requirements.¹⁰ To the extent that a Reserve Bank allows institutions with significantly different supervisory frameworks to use its services and does not compensate for that variance in its risk management framework, this may result in undue risk to the payment system and its participants.

¹⁰ 12 U.S.C. § 7.1026(f)(1)(vii).

Reserve Banks may also need to consider conducting stress tests for non-federally-insured institutions individually or as groups to the extent such institutions have (i) substantially different capital levels than federally-insured institutions, (ii) sources of liquidity that are volatile in value and are held in greater proportion than federally-insured institutions, or (iii) monolithic or narrow business lines. Such institutions may be impacted in different ways by economic events or have different sources of financial stress than federally-insured institutions. Without stress test analyses, the Federal Reserve may be impaired in its understanding of risk that an institution poses to the Reserve Bank, the payment system, and the broader financial system. Hence, stress tests may be needed both when evaluating an Access Request and on an ongoing basis.

Finally, in considering the operational risk of de novo non-federally-insured institutions to a Reserve Bank or payment system, the Proposed Guidelines should consider whether the institution's risk management framework is designed to ensure its payment activity grows safely. Less experienced institutions may need to demonstrate their capacity to reliably participate in payments systems before they are permitted to send or receive high value payments or high volumes of payments.

4. Consideration for Impact to Private Sector Payment Systems

When considering the risk that an institution presents to the payment system, Reserve Banks should also consider the potential impact to private sector operators and their customers. Allowing institutions access to Federal Reserve accounts and services has the potential to impact the private sector payment systems that interoperate with Federal Reserve services, namely the ACH network and check collection. Private sector operators do not have the same visibility or control that Reserve Banks have in understanding the role and risk of institutions granted access. Hence, Reserve Banks should consider not only whether an institution has sufficient liquid resources to meet its obligations to the Reserve Bank under applicable agreements, Operating Circulars, and Board policies¹¹ but also to meet obligations to the broader network in which the institution will have access. For example, the Reserve Bank should consider the ability of the institution to pay obligations resulting from warranties and indemnities that the institution will give as an ODFI under the Nacha Rules or bank of first deposit under UCC Articles 3 and 4, Regulation CC, and the ECCHO Rules.¹²

For non-federally-insured institutions that are allowed access we believe the Reserve Banks should also consider the resolution authority and resolution regime that would address the institution's failure and whether the nature of the resolution presents risks to payment systems (or more broadly to the financial system) that are different than the failure of federally-insured institutions.

The Reserve Banks should also consider whether the nature of the activity that an institution (or a large number of similar institutions) will engage in through its Federal Reserve account and services will cause material changes in the volume or value of payments within or between payment systems. In

¹¹ 86 Fed. Reg. 25869, Principle 3(d)(iii)(A).

¹² The ECCHO Rules are clearinghouse rules under the UCC, and used by financial institutions to govern the exchange of Electronic Checks through private sector check image networks or through direct financial institution exchanges.

addition, they should consider whether the nature of the institution's activity may have material impact on the timing of payments throughout the day and liquidity needs across payment systems. If material impact is foreseeable, the Reserve Bank should put in place controls that will mitigate shocks to payment systems and participants.

Lastly, TCH, as a payment system operator, believes that the operational resilience and cyber security expectations of the Proposed Guidelines are especially important and that the Reserve Banks should apply these expectations stringently. We note that under Operating Circular 5 the Reserve Banks require each institution that has electronic access to Federal Reserve services to conduct an annual self-assessment of its compliance with specified security requirements and that Reserve Banks have discretion to require that such assessments be conducted by an independent third party.¹³ We believe that non-federally-insured institutions that are permitted access and that a Reserve Bank determines are not subject to regular and reliable review by a supervisory authority should be required to provide an independent third party assessment of their compliance with the security requirements.

Thank you for your consideration of these comments. If you have any questions or wish to discuss this letter, please do not hesitate to contact me.

Yours very truly,

A handwritten signature in dark ink, reading "Alaina Gimbert". The signature is fluid and cursive, with the first name "Alaina" and last name "Gimbert" clearly distinguishable.

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¹³ Operating Circular 5, Appendix A, § 3.1.