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Proposal and Comment Information

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Please see the uploaded letter.

Re: Request for Information and Comment on Reserve Bank Payment Account Prototype,
Docket No. OP-1877

To: Board of Governors of the Federal Reserve System

From: Rodney J. Garratt (Department of Economics, University of California at Santa Barbara)
and Charles M. Kahn (Department of Finance, University of Illinois)

Dear Board of Governors of the Federal Reserve System,

In this comment we provide our assessment of the proposal for Reserve Bank Payment Accounts, and we offer answers to specific questions listed in the request for information and comment.

In our opinion, Governor Christopher Waller’s proposal for “skinny” accounts represents a thoughtful evolution in how we think about access to the Federal Reserve’s payment infrastructure. At its core, the Reserve Bank Payment Account prototype addresses a fundamental question: which financial institutions should have direct access to the central bank’s payment systems, and what form should that access take? The skinny account framework offers an answer that promotes a more competitive and resilient payments landscape, while balancing financial stability concerns with the principles of equitable access that have guided U.S. payment systems policy for decades.

Broadening Access to Payment Infrastructure

The current Federal Reserve account system operates on an all-or-nothing basis: institutions either receive full master accounts with all services including potential Fed credit access, or they are denied accounts entirely and must rely on correspondent banking relationships. The skinny account proposal would create a middle option, offering streamlined accounts with access to core payment services like Fedwire and FedNow, but without certain other services, such as Fed credit facilities and daylight overdrafts. For institutions that already hold or can obtain bank charters, skinny accounts could provide a path to direct Fed payment system access that is more accessible than the current master account application process.

Direct access to Federal Reserve payment systems offers substantial operational advantages for payment service providers. Network externalities dominate the payments industry; providers who cannot easily link their customers to customers of other providers are at a severe disadvantage. Rather than routing transactions through correspondent banks, adding intermediary costs, processing delays, and dependency on third-party relationships, direct access enables real-time settlement between providers on Federal Reserve infrastructure. This reduces counterparty risk, lowers transaction costs and provides greater control over payment processing. For businesses like stablecoin issuers or specialized payment processors, direct Fed access means faster, cheaper, and more reliable payment operations, which translates into a more level playing field when it comes serving their customers.

Financial Stability Benefits

Critics of expanded access sometimes raise financial stability concerns, arguing that encouraging a broader set of institutions to become banks and gain Federal Reserve services could introduce new risks. However, it is arguable that the skinny account framework *enhances* financial stability in several important ways.

First, the restrictions inherent in skinny accounts mitigate moral hazard concerns. Unlike full master accounts, skinny accounts would not provide access to Federal Reserve credit facilities, discount window lending, or other services that might create expectations of government support. Even as more institutions are encouraged to enter the banking system, they would be responsible for their own liquidity and risk management, without access to Fed credit that might encourage excessive risk-taking. This clear delineation preserves market discipline while still providing the efficiency benefits of direct payment system access.

Second, encouraging more institutions to become chartered banks with direct Federal Reserve relationships improves regulatory visibility and oversight. Currently, many payment service providers operate outside the banking system entirely, or work through complex arrangements with partner banks that can obscure the true nature and scale of payment flows. When these institutions obtain bank charters and establish direct Fed relationships for payment services, regulators gain much clearer insight into their operations. By bringing institutions into the regulated banking framework who might otherwise operate in less regulated spaces, the proposal enhances overall system stability. The Federal Reserve can monitor payment flows more comprehensively across the full spectrum of payment activity and identify emerging risks more quickly.¹

Third, skinny accounts could reduce concentration risk in the payment system. Currently, a relatively small number of large banks with full master accounts handle the majority of payment flows, with many other institutions routing transactions through correspondent banking relationships. This creates concentration points at which operational failures, cyber incidents, or disruptions at major correspondent banks could cascade across the payment system. By enabling more institutions to access Fed payment systems directly, skinny accounts would distribute payment flows across more direct participants, reducing vulnerability to single points of failure and making the overall payment infrastructure more resilient to shocks.

The Value Proposition for Stablecoin Issuers

While the operational benefits of direct Federal Reserve access are significant, an important question remains for potential applicants: is the value proposition compelling enough to justify the substantial regulatory burdens associated with obtaining a bank charter? This question is particularly acute for stablecoin issuers such as Tether (USDT) and Circle (USDC).

Stablecoin issuers are among the most likely candidates for pursuing skinny accounts. Under the proposed framework, they would benefit from direct access to Fed payment rails for handling issuance and redemption operations. Rather than routing customer transactions through commercial bank intermediaries, issuers could receive payments directly into their Fed accounts

when customers purchase stablecoins and could send redemption payments directly back to customers through Fedwire or FedNow. This would streamline the day-by-day flow of mint and redemption requests that characterizes stablecoin operations, reducing settlement times from days to minutes and eliminating intermediary costs and dependencies.

The proposed account limits mean that stablecoin issuers would still need to maintain extensive relationships with commercial banks to hold the majority of their reserve assets. According to the Federal Reserve's proposal, the Board is considering overnight balance limits for Payment Accounts that would be the lesser of \$500 million or 10 percent of the institution's total assets. Currently, Tether has over \$130 billion in outstanding stablecoins and Circle has over \$40 billion in outstanding stablecoins. A stablecoin issuer with tens or hundreds of billions of dollars in outstanding tokens cannot hold those reserves in a skinny account subject to overnight balance limits. Instead, the bulk of backing assets would continue to reside in traditional bank deposits, Treasury securities, money market funds, and other instruments held at other financial institutions.

From the stablecoin issuer's perspective, this limited scope must be weighed against the considerable costs of obtaining and maintaining a bank charter: capital requirements, ongoing examination and supervision, compliance infrastructure, restrictions on permissible activities, and the various operational burdens of functioning as a regulated depository institution. For institutions that have successfully operated outside the banking system, often with significant scale and profitability, the question becomes whether streamlining issuance and redemption operations alone justifies accepting comprehensive bank regulation.

This suggests that the success of the skinny account framework in attracting stablecoin issuers may depend on additional design considerations that strengthen the value proposition. Possible approaches include more generous balance limits calibrated to actual operational needs for high-volume issuers,² expedited and less burdensome charter application processes for payment-focused institutions,³ tailored capital and liquidity requirements that recognize the distinct risk profile of payment operations versus traditional banking, and clear regulatory guidance on permissible stablecoin-related activities that reduce compliance uncertainty. Without such calibrations, stablecoin issuers may rationally conclude that the operational efficiencies of direct Fed access, while valuable, do not outweigh the substantial regulatory costs of entering the banking system.

Other Potential Limitations

The payments industry is breathtakingly dynamic, generating a bewildering variety of new models for doing business. While it is prudent for the Federal Reserve to begin with restrictions on the system for payments accounts, it is important to be aware that some proposed restrictions will limit the use cases for potentially valuable new payments arrangements.

First, the current proposal excludes Payment Account holders from use of FedACH, a service which is currently central to retail payment activity. Second, the proposal envisages Payment Account holders as acting solely for customers who are end users of the services; they are explicitly forbidden to act as correspondent banks. However, many payments service providers

are in the business of supplying services to other financial intermediaries—particularly to community banks and credit unions. These services provide a valuable tool for reducing bank concentration, keeping smaller institutions competitive with the giants in the field by enabling them to offer the most advanced payments products to their customers. It is an open question whether such business models will be at a disadvantage if payment funds associated with these services cannot be routed through a common account.

While it is important to be aware of these two limitations, they should not be overemphasized. On the one hand, access to full master accounts through appropriate review may be sufficient to satisfy needs of payments service providers that act as correspondents. The need to restrict use of FedACH can be eliminated by improvement in its monitoring capabilities. Alternatively, proposed and planned improvements in FedNow could reduce the need for Payment Account holders to resort to FedACH. In this case, introducing Payment Accounts could provide an important source of growth for the customer base for FedNow, in line with the long-term goals of the Federal Reserve for that system.

Alignment with the Monetary Control Act of 1980

The proposal for Federal Reserve Payments Accounts resonates strongly with the principles embodied in the Monetary Control Act of 1980 (MCA). That landmark legislation fundamentally restructured the relationship between the Federal Reserve and the banking system, establishing that Federal Reserve payment services should be available broadly rather than limited to member banks alone. The MCA required the Fed to offer payment services to all depository institutions on an equal footing and to price those services to recover costs, treating the payment system as a public utility that should be accessible to all qualified institutions.

The MCA was based on the principle that payment systems are essential infrastructure that benefits the entire economy when made broadly available. Just as the Act extended access beyond the relatively small circle of Federal Reserve member banks to all depository institutions, the skinny account proposal extends that same logic to address barriers that currently keep many new types of financial institutions, including crypto firms, fintechs and specialized payment service providers, out of the system entirely.

The MCA's requirement that Federal Reserve services be priced to recover costs also aligns with the skinny account framework. By charging appropriate fees for payment services while not providing subsidized credit facilities, the Fed can ensure that skinny accounts are available to qualified banking institutions on transparent, non-discriminatory terms, without creating distortions or unfair competitive advantages. Institutions entering the banking system through the skinny account pathway would pay for the services they use, just like all other depository institutions under the MCA framework.

Implications for Monetary Policy

New payments institutions inevitably raise concerns about their effects on the implementation of monetary policy.⁴ Will the changes affect the day-to-day operation of the markets in which the

Federal Reserve intervenes to control interest rates? In particular, will disruptions arise from the magnitude or volatility of the balances in the new Payments Accounts?

In the past, such fears have turned out to be unwarranted, and in the short to medium term, the effects of the development of Payments Accounts are not likely to be any more serious than previous innovations. Nonetheless, to address such concerns, it is understandable that a prohibition of interest payments is included in the proposal, to insure that “hot money” does not enter or leave the Federal Reserve’s balance sheet. In normal times this restriction alone should be adequate; even given the likely magnitude of the Payment Account balances. With this restriction, the stringent balance limits proposed are likely to be overkill, although some backstop in readiness during low-interest rate environments is understandable.

Additional Considerations

Historically, financial instability in the US has frequently arisen when regulatory costs have induced institutions outside the regulatory sphere to offer close substitutes for services provided by regulated institutions. Currently, the biggest threat to financial stability from payments innovation arises from the move of customer activity to unregulated and risky products. If these products provide greater convenience and lower costs than similar regulated products, consumers will discount the systemic risks that would arise from a provider’s temptation to mingle credit risk with payments operations.

As we have noted, the ability to obtain Payment Accounts with the Federal Reserve can be a carrot for payment service providers, inducing them to abide by safety standards. A second potential carrot will be the ability of regulated providers to advertise that their funds are directed through the Federal Reserve payments rails. The Federal Reserve can encourage the development of a “bright line” between payment solutions that use and those that do not use Fed accounts.

The proposal provides a practical solution for bringing institutions providing stablecoins and other payments solutions into the banking system. In the long run, it will be important to readjust the classification and regulation of banking institutions by their activities. Relevant standards for payments service providers are different than those for credit institutions, and regulatory requirements will need to adapt to take those differences into account.

Conclusion

The skinny account proposal addresses the realities of the modern payments landscape while remaining true to longstanding principles of equitable access and financial stability. The framework offers important public benefits: improved financial stability through regulatory incorporation of systemically important payment activities, reduced concentration risk in the payment system, and alignment with the public utility philosophy established by the Monetary Control Act of 1980.

However, the ultimate success of the framework depends on whether it can attract its intended beneficiaries, particularly stablecoin issuers. The challenge lies in calibrating the design to make the value proposition compelling enough to justify the substantial regulatory burdens of

obtaining and maintaining bank charters. Given that skinny account holders would still need to maintain extensive commercial banking relationships for reserve custody, the operational efficiencies of direct Fed access for issuance and redemption flows alone may not be sufficient to motivate charter acquisition.

Thoughtful design choices regarding balance limits, capital requirements, charter application processes, and activity permissions will be essential to ensuring the business case for entering the banking system is compelling. When properly calibrated, skinny accounts can align public benefits with private incentives: payment innovators gain competitive advantages through direct Fed access that justify accepting regulatory oversight, while policymakers gain better visibility into systemic payment flows and a more resilient financial infrastructure.

¹ This motivation was widely considered to be behind the Bank of England’s push to increase the number of banks that directly participate in their CHAPS payment system following the run on Northern Rock, a large UK bank that conducted payments through a correspondent, in 2007. BoE (2025) reports that the “simplification of participant onboarding processes and requirements supported a doubling of CHAPS direct participants between 2008 and 2025.” <https://www.bankofengland.co.uk/paper/2024/dp/response-reviewing-access-to-rtgs-accounts-for-settlement>

² If balance limits were set significantly higher, allowing stablecoin issuers to hold larger portions of their backing assets directly at the Federal Reserve, this could shift reserves away from traditional commercial banks toward institutions that do not engage in credit creation, a potentially important change in the allocation of bank reserves across the financial system. However, it is unclear whether such a shift would meaningfully affect the total amount of credit creation that occurs, given that the overall level of reserves in the banking system would remain unchanged and credit creation is primarily constrained by capital requirements, lending standards, and loan demand rather than reserve availability under current monetary policy frameworks. Indeed, to the extent that, as some observers have argued, the development of cryptocurrencies have put undue pressure on safe securities in their role as collateral, allowing these entities to hold more backing assets as Federal Reserve balances would be a desirable outcome.

³ Some progress on introducing what we might call “skinny” bank charters has been made in states where they have introduced special bank charters for merchant acquirers. Georgia has a limited-purpose state bank charter called a Merchant Acquirer Limited Purpose Bank designed for payment companies that do not want to be full-service banks. Such charter holders are the natural candidates for Payments Accounts, and encouragement of this innovation would be complementary to the introduction of payments accounts.

⁴ Two important historical examples of innovations leading to such concerns were the spread of money market mutual funds and the rise of the Eurodollar market.

Answers to specific questions:

1. Would the design of the Payment Account prototype support payment activities of eligible institutions?

Yes, but with limitations. The design would streamline issuance and redemption operations for institutions like stablecoin issuers, enabling real-time settlement and eliminating intermediary costs. However, balance limits mean institutions would still need extensive commercial bank relationships for reserve custody.

2. What payment activities or use cases would a Payment Account best facilitate (or be unable to facilitate)?

Best facilitated: Direct customer issuance and redemption operations for stablecoins via Fedwire and FedNow.

Unable to facilitate: Correspondent banking services (explicitly forbidden), FedACH transactions (excluded), and holding large reserve balances due to overnight limits. Each of these powers would be of value to some potentially important and legitimate segment of the payments market.

3. What barriers to innovation in payments would a Payment Account eliminate or alleviate?

They would reduce network externality disadvantages for newcomers, eliminate dependency on correspondent banking relationships, reduce counterparty risk, lower transaction costs, and create a more level playing field for payment service providers competing with established banks.

4. Would the design of the Payment Account prototype potentially increase the range of risks to the payment system identified in the Guidelines? If so, in what ways?

On balance we believe Payment Accounts would reduce risks by improving regulatory visibility, and reducing concentration risk by distributing payment flows across more direct participants.

5. Are there adjustments to the proposed formula for setting the balance limit that the Board should consider if it decides to establish a Payment Account?

The success of a Payment Account in attracting stablecoin issuers may require more generous balance limits calibrated to actual operational and reserve needs.

6. What are the benefits and drawbacks of paying no interest on overnight balances in a Payment Account?

The prohibition on interest payments ensures that “hot money” does not enter or leave the Federal Reserve's balance sheet. This prohibition is intended to prevent unpredictable fluctuations in Payment Account balances driven by institutions chasing interest rate returns. We believe that concerns about the Fed's continued ability to implement monetary policy are overblown, but that in any event this restriction is more than adequate protection.

Given the no-interest restriction, we believe the proposed balance limits are overly stringent. Without interest payments, there is little incentive for institutions to park excess funds in Payment Accounts, so tight overnight balance limits may not be needed.

8. Are there additional features or limits that the Board should consider in the design of the Payment Account prototype?

The long-term success of Payment Accounts will depend on complementary changes in the regulatory landscape: expedited and less burdensome charter application processes for payment-focused institutions, tailored capital and liquidity requirements that recognize the distinct risk profile of payment operations versus traditional banking, and clear regulatory guidance on permissible stablecoin-related activities that reduce compliance uncertainty.