

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date: January 23, 2023
To: Board of Governors
From: Staff¹
Subject: Policy Statement on Section 9(13) of the Federal Reserve Act

Actions Requested: Staff requests that the Board approve the attached policy statement interpreting section 9(13) of the Federal Reserve Act (Act) for publication in the Federal Register. Staff also requests authority to make technical, non-substantive changes to the draft policy statement prior to publication in the Federal Register.

Executive Summary:

- The legal frameworks applicable to national banks, insured state banks, and uninsured state banks can result in differences in the scope of permissible activities depending on the type of entity. In particular, section 24 of the Federal Deposit Insurance Act (FDIA) prohibits insured state banks from engaging as principal in any activity that is not permissible for national banks, unless otherwise authorized by federal statute or the Federal Deposit Insurance Corporation (FDIC). By its terms, section 24 of the FDIA does not apply directly to uninsured state banks.
- The Board has the discretionary authority under section 9(13) of the Act to limit the activities of any state member bank (SMB), insured or uninsured, to those that are permissible for a national bank in a manner consistent with section 24 of the FDIA. To promote a level playing field among banks conducting the same activities, and to clarify how the Board would approach the permissibility of activities conducted by uninsured state member banks, staff is recommending the Board issue a policy statement that would interpret section 9(13) of the Act to align the permissibility frameworks for both uninsured and insured state member banks.
- Specifically, the proposed policy statement would provide that the Board will presumptively exercise its authority to limit state member banks to engaging as principal in only those activities that are permissible for national banks—in each case, subject to the terms, conditions, and limitations placed on national banks with respect to the activity—unless those activities are permissible for state banks by federal law.
- In light of inquiries the Board has received regarding the permissibility of crypto-asset-related activities, the preamble to the draft policy statement would provide examples as to how the Board would presumptively apply section 9(13) of the Act. In particular, the preamble would provide that the Board would presumptively prohibit SMBs from holding most crypto-assets as principal, and also would provide that any SMB seeking to issue a dollar token would need to demonstrate, to the satisfaction of Federal Reserve supervisors, that the bank has controls in place to conduct the activity in a safe and sound manner, and to receive a Federal Reserve supervisory nonobjection before commencing such activity.

¹ Mark VanDer Weide, Reena Sahni, Asad Kudiya, Andrew Hartlage, Kelley O'Mara, and Katherine Di Lucido (Legal Division); Michael Gibson, Molly Mahar, and Kavita Jain (Division of Supervision and Regulation).

- The proposed policy statement also would reiterate to SMBs that legal permissibility is a necessary, but not sufficient, condition to establish that an SMB may engage in a particular activity, and that an SMB must at all times conduct its business and exercise its powers with due regard to safety and soundness.

Background:

In recent years, the Board has received a number of inquiries, notices, and proposals from supervised SMBs and applicants for membership regarding potential engagement in novel and unprecedented activities, including those involving crypto-assets. Section 24 of the FDIA generally prohibits insured state banks from engaging as principal in any activity that is not permissible for national banks, unless authorized by federal statute or the FDIC.² By its terms, this provision does not apply directly to uninsured SMBs. The Board has discretion under section 9(13) of the Act, however, to limit the activities of a state member bank and its subsidiaries to those activities that are permissible for a national bank in a manner consistent with section 24 of the FDIA.³ The Board generally has supported the principle that the same bank activity, presenting the same risks, should be subject to the same regulatory framework, regardless of which agency supervises the bank. This principle of equal treatment helps to level the competitive playing field among banks with different charters and different federal supervisors and to mitigate the risks of regulatory arbitrage.

Discussion:

The proposed policy statement would interpret section 9(13) of the Act, which vests the Board with the authority to prohibit or otherwise restrict SMBs and their subsidiaries from engaging as principal in any activity that is not permissible for a national bank, unless the activity is permissible for state banks under federal law. The policy statement also would set out a rebuttable presumption that the Board will exercise its discretion under section 9(13) of the Act to limit SMBs to engaging as principal in only those activities that are permissible for national banks—in each case, subject to the terms, conditions, and limitations placed on national banks with respect to the activity—unless those activities are permissible for state banks under federal

² 12 U.S.C. 1831a(a); 12 CFR part 362.

³ 12 U.S.C. 330 (as amended by Federal Deposit Insurance Corporation Improvement Act of 1991 § 303(b), Pub. L. 102-242, 105 Stat. 2236, 2353).

law.⁴ An SMB may rebut this presumption if it (i) presents a clear and compelling rationale for the Board to allow the proposed deviation in regulatory treatment among federally supervised banks; and (ii) has robust plans for managing the risks of the proposed activity in accordance with principles of safe and sound banking.

In certain instances, the Office of the Comptroller of the Currency (OCC) has imposed terms, limitations, or conditions on the permissibility of an activity for a national bank. In a case where the OCC has placed additional terms, limitations, or conditions on the permissibility of a national bank activity, the proposed policy statement would provide that an SMB may only engage in the activity if the SMB adheres to the terms, conditions, and limitations placed on national banks by the OCC with respect to the activity. For example, if the OCC conditions permissibility on a national bank demonstrating, to the satisfaction of its supervisory office, that the bank has controls in place to conduct the activity in a safe and sound manner, and receiving a written nonobjection from OCC supervisory staff before engaging in a particular activity, then the activity would not be permissible for an SMB unless the bank makes the same demonstration and receives a written nonobjection from Federal Reserve supervisory staff before commencing such activity.

The proposed policy statement also would reiterate to SMBs that legal permissibility is a necessary, but not sufficient, condition to establish that an SMB may engage in a particular activity, and that an SMB must at all times conduct its business and exercise its powers with due regard to safety and soundness. For instance, an SMB should have in place internal controls and information systems that are appropriate in light of the nature, scope, and risks of its activities. With respect to any novel and unprecedented activities, such as those associated with crypto-assets or use of distributed ledger technology, the proposed policy statement would note that it is particularly important for an SMB (i) to have in place appropriate systems to monitor and control risks, including liquidity, credit, market, operational, and compliance risks; and (ii) to be able to explain and demonstrate an effective control environment related to such activities.

⁴ Staff expects that, in these circumstances, insured state banks will likely be prohibited from engaging in the activity under section 24 of the FDIA, as well. 12 U.S.C. § 1831a(a); 12 CFR part 362. The goal of the statement is to align the Board's process in assessing permissibility with that of the FDIC under section 24 of the FDIA. See, e.g., FDIC FIL-54-2014: Filing and Documentation Procedures for State Banks Engaging, Directly or Indirectly, in Activities or Investments that are Permissible for National Banks (November 19, 2014).

The preamble to the proposed policy statement would discuss how the Board, under section 9(13) of the Act, would presumptively prohibit SMBs from engaging in an activity for which the Board has not identified any authority permitting national banks to engage in it, such as holding most crypto-assets as principal. The preamble also would explain how the Board would expect an SMB seeking to engage as principal in an activity that is conditionally permissible for national banks, such as issuing dollar tokens (sometimes referred to as stablecoins), to receive a supervisory nonobjection from Federal Reserve supervisors before commencing such activity, in line with the condition that the OCC has placed on national banks.

Staff Recommendation

Staff recommends that the Board approve publication of the proposed policy statement in the Federal Register. Staff also recommends that the Board authorize staff to make technical, non-substantive changes to the proposed policy statement prior to publication in the Federal Register.

Attachment