

FEDERAL RESERVE SYSTEM

[Docket No. OP-1877]

Request for Information and Comment on Reserve Bank Payment Account Prototype

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for information and comment.

SUMMARY: The Board of Governors of the Federal Reserve System (Board) seeks public input on a special purpose Reserve Bank account prototype (a Payment Account) tailored to the risks and needs of institutions focused on payments innovation. A Payment Account holder would be expected to use its account for the express purpose of clearing and settling the institution's payment activity. Payment Accounts would be designed to pose limited risk to the Federal Reserve Banks (Reserve Banks) and the overall payment system, and Reserve Banks would generally conduct a streamlined review of requests for these accounts. Any institution that is legally eligible for Federal Reserve accounts or services (accounts and services) under the Federal Reserve Act would be eligible to request a Payment Account from a Reserve Bank. The Payment Account prototype does not seek to expand or otherwise change legal eligibility for access to accounts and services.

DATES: Comments must be received on or before [INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT:

Jason Hinkle, Associate Director, Zineb York, Manager, or Maggie Bota, Senior Financial Institution Policy Analyst, Division of Reserve Bank Operations and Payment Systems;

Matthew Malloy, Chief, Division of Monetary Affairs, or Corinne Milliken Van Ness, Senior Counsel, Legal Division, Board of the Federal Reserve System: (202) 452-3000. For users of text telephone systems (TTY) or any TTY-based Telecommunications Relay Services, please call 711 from any telephone, anywhere in the United States.

ADDRESSES: You may submit comments, identified by Docket No. OP-1877 by any of the following methods:

- *Agency Website:* <https://www.federalreserve.gov/apps/proposals/>. Follow the instructions for submitting comments, including attachments. ***Preferred Method.***
- *Mail:* Benjamin W. McDonough, Deputy Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW, Washington, DC 20551.
- *Hand Delivery/Courier:* Same as mailing address.
- *Other Means:* publiccomments@frb.gov. You must include the docket number in the subject line of the message.

Comments received are subject to public disclosure. In general, comments received will be made available on the Board's website at <https://www.federalreserve.gov/apps/proposals/> without change and will not be modified to remove personal or business information including confidential, contact, or other identifying information. Comments should not include any information such as confidential information that would be not appropriate for public disclosure. Public comments may also be viewed electronically or in person in Room M-4365A, 2001 C St. NW, Washington, DC 20551, between 9 a.m. and 5 p.m. during Federal business weekdays.

SUPPLEMENTARY INFORMATION:

I. Background

The payments landscape continues to evolve rapidly as technological progress, statutory developments, and other factors drive the introduction of innovative approaches to banking functions. These innovations necessitate adaptation throughout the financial sector, including the institutions and infrastructure that support a safe and efficient payment system.

On August 15, 2022, after a public comment process, the Board adopted guidelines (Account Access Guidelines or Guidelines) for Reserve Banks to utilize in evaluating requests for access to accounts and services (access requests). The Guidelines establish a transparent, risk-based, and consistent set of factors for Reserve Banks to use in reviewing access requests from legally-eligible institutions.^{1,2,3} The Guidelines incorporate a tiering framework under which access requests from certain types of entities (e.g., non-federally insured institutions) are subject to greater due diligence and scrutiny than access requests from other types of entities (e.g., federally-insured institutions).

Over the last three years, the business models of institutions submitting access requests have continued to evolve. For example, several institutions have explained that they are interested in access to accounts and services in order to reduce costs to their customers while

¹ 87 FR 51099 (Aug. 19, 2022).

² Information on the Federal Reserve Banks' financial services, including a list of such services, can be found at <https://www.frbsservices.org>.

³ The Guidelines do not apply to accounts provided under fiscal agency authority or to accounts authorized pursuant to the Board's Regulation N (12 CFR part 214), joint account requests, or account requests from designated financial market utilities, since existing rules or policies already set out the considerations involved in granting these types of accounts.

increasing payment processing speed, often through new technologies. Some of these institutions have requested either a state or federal banking charter and a few have initiated requests for Reserve Bank accounts and services.

Over the same period, many eligible uninsured institutions have requested or expressed interest in requesting a master account and have expressed concern about the length of time that Reserve Banks take to review their access requests and the likelihood of denial. Institutions focused primarily on payment activities may only desire access to a subset of Federal Reserve services through a Reserve Bank account. While recognizing that decisions on access requests are made at the discretion of the individual Reserve Banks, the Board is exploring whether a tailored, special purpose Payment Account could meet these institutions' needs while mitigating material risks identified in the Guidelines.

II. Payment Account Prototype

The Board is requesting feedback on a Payment Account prototype. In designing the Payment Account prototype, the Board has considered the risks identified in the Guidelines (i.e., risks to the Reserve Banks, to the overall payment system, to financial stability, to the overall economy as a result of illicit activities, and to the implementation of monetary policy). In addition, the Board considered features that could limit Payment Accounts' impact on the Federal Reserve's balance sheet. As explained further below, Payment Accounts would be subject to a common set of risk-mitigating features. For example, to reduce credit risk to the Reserve Banks, a Payment Account holder would only have access to Federal Reserve payment services that have automated controls to prevent the accountholder from incurring an overdraft. In addition, a Payment Account holder would not be eligible for discount window access. The

Reserve Banks would retain their discretion to impose additional restrictions and risk controls on a Payment Account on a case-by-case basis.

A Payment Account would be separate and distinct from a full-service Reserve Bank master account (Master Account).⁴ If the Federal Reserve decides that the Reserve Banks will offer a Payment Account, the Board would propose necessary changes to existing guidance and regulations, including the Guidelines and Regulation D.

III. Payment Account Term Sheet

A. Account Description

- a. A Payment Account would be a special purpose account with a Reserve Bank that holds limited overnight balances of a legally-eligible institution for the express purpose of clearing and settling the institution's payments.⁵ The Reserve Bank would permit a Payment Account holder to maintain only a limited balance in the account at the close of business; these end-of-day balances would be intended only to provide liquidity for payment activity at the beginning of the next business day. A Payment Account would be a separate and distinct type of account from a Reserve Bank master account (a Master Account), which generally does not have a limit imposed on overnight

⁴ Some of the Payment Account features and risk controls could be the same as utilized for a Master Account and are included in this document for completeness.

⁵ A Payment Account would be technology-agnostic and would not be designed to promote any particular payment product or service.

balances.^{6,7} The Board would explore reporting the balances maintained in Payment Accounts separate from balances maintained in Master Accounts on the Reserve Banks' financial reporting. The Reserve Banks would retain their discretion to impose additional restrictions and risk controls on a Payment Account on a case-by-case basis.

B. Eligibility

- a. Any institution that satisfies the legal eligibility requirements for an account under the Federal Reserve Act would be eligible to request a Payment Account. Generally, institutions would be limited to maintaining one account with a Reserve Bank, either a Payment Account or a Master Account.⁸ The Payment Account prototype would not make any changes to legal eligibility for access to accounts and services.

C. Overnight Balance Limit

- a. A Payment Account would be subject to an overnight balance limit, meaning that a Payment Account holder would need to reduce the balance of the account below a specified limit at the Federal Reserve's close of business.⁹ During the Federal Reserve business day, a Payment Account holder would be

⁶ As with existing Master Accounts, overnight overdrafts would not be permitted in Payment Accounts.

⁷ A Payment Account would be a separate and distinct type of account from a Reserve Bank Joint Account.

⁸ A Payment Account holder would not be eligible to be a participant in an Excess Balance Account.

⁹ The business day of Federal Reserve Financial Services is defined in the Federal Reserve Policy on Payment System Risk and begins immediately after the close of business of the Fedwire Funds Service on days when the Fedwire Funds Service is open and the close of the FedNow Service on all other days (which, in both cases, is generally 7:00 PM ET).

allowed to maintain a balance in a Payment Account above the overnight limit to fund payments settling in the account. The Reserve Banks would establish a compliance program to enforce the overnight balance limit, which could include, among other options, counseling, penalty fees, and service restrictions.

- i. The Board is considering setting the overnight balance limit at the lesser of \$500 million or 10% of the Payment Account holder's total assets.¹⁰
 - ii. The Reserve Bank could have the ability to adjust the overnight balance limit, temporarily or permanently, on a case-by-case basis. In some cases, the Reserve Bank would be expected to consult with the Board on such an adjustment.
- b. As noted above, a Payment Account would be designed only to facilitate the clearing and settlement of the Payment Account holder's payment activity, and this feature would be intended to encourage a Payment Account holder to limit overnight balances in their account.

D. No Interest on Overnight Balances

- a. A Payment Account holder would not receive interest on balances held at a Reserve Bank.
- b. As noted above, a Payment Account would be designed only to facilitate the

¹⁰ The institution's total assets would be determined by its most recent report to its primary banking regulator or equivalent.

clearing and settlement of the Payment Account holder's payment activity.

This feature, along with the overnight balance limit, would be intended to encourage a Payment Account holder to limit overnight balances in their account.

E. No Access to the Discount Window

- a. A Payment Account holder would not be permitted to access credit from the discount window.
- b. This feature would be intended to reduce the credit risk that a Payment Account holder could pose to the Reserve Bank.

F. No Access to Reserve Bank Intraday Credit

- a. A Reserve Bank provides intraday credit, also known as a daylight overdraft, when an institution's Federal Reserve account is in a negative position during the business day. An institution with a Payment Account would not be permitted to incur daylight overdrafts. Payments would need to be prefunded and as noted below, payments that would cause an overdraft in a Payment Account would be rejected.
- b. This feature would be intended to reduce the credit risk that a Payment Account could pose to the Reserve Bank.

G. Services Available

- a. The following services (collectively, the permitted services) would be

available for an institution to request to settle in a Payment Account:¹²

- i. The Fedwire[®] Funds Service;
 - ii. The National Settlement Service;
 - iii. The FedNow[®] Service; and
 - iv. The Fedwire[®] Securities Service for Free Transfers only.^{13, 14}
- b. This feature would be intended to reduce the credit risk that a Payment Account could pose to the Reserve Bank. Limiting Payment Accounts to these services would reduce credit risk to the Reserve Banks since each of these services have automated solutions that can reject transactions that would cause daylight overdrafts. As noted above, Payment Account holders would not be permitted to incur daylight overdrafts.

H. Services Not Available

- a. Any services not listed above (collectively, the excluded services) would not be available in connection with a Payment Account, including:
- i. FedACH[®] Services;
 - ii. Check Services;

¹¹ A Payment Account holder could request access to additional Reserve Bank financial services provided that those transactions settle in the master account of the institution's correspondent bank. Such a request would be evaluated by the Reserve Bank under the Guidelines.

¹² A description of the Federal Reserve payment services is available at www.frb services.org.

¹³ Free Transfers, as defined in the Reserve Banks' Operating Circular 7 (Fedwire Securities Service), are transfers of securities that do not result in a debit or a credit to a Master Account other than a transaction fee. Free transfers are commonly referred to as transfers free of payment.

¹⁴ "Fedwire" and "FedNow" are service marks of the Federal Reserve Banks. A list of marks related to financial services products that are offered to financial institutions by the Federal Reserve Banks is available at <https://www.frb services.org>.

iii. FedCash[®]; and

iv. The Fedwire[®] Securities Service for Transfer Against Payment.¹⁵

- b. This feature would be intended to reduce the credit risk that a Payment Account could pose to the Reserve Bank. These services would not be available because they do not currently have automated solutions that can reject transactions that would cause daylight overdrafts. As noted above, Payment Account holders would not be permitted to incur daylight overdrafts.

I. Account Usage Restrictions

- a. A Payment Account would be designed as a special purpose account for the express purpose of clearing and settling the institution's payment activity. Accordingly, a Payment Account holder would not be permitted to act as a correspondent bank, and a Payment Account could not be used to settle transactions for respondent institutions.¹⁶ This feature would be intended to reduce the range of risks a Payment Account could pose to the Reserve Bank and the overall payment system.
- b. In addition, consistent with the Reserve Banks' current practice for Master

¹⁵ Transfer Against Payment, as defined in the Reserve Banks' Operating Circular 7 (Fedwire Securities Service), is a transfer that is affected with a credit to the account of the sender and a debit to the account of the receiver for the amount of the payment.

¹⁶ A Correspondent is a financial institution: (1) that has authorized a Reserve Bank to settle Debit and Credit Transaction Activity to its Master Account for a Respondent or for any financial institution for which the Respondent acts as Correspondent; or (2) that maintains required reserve balances for one or more financial institutions in its Master Account. *See* Section 2.2 of Operating Circular (OC) 1. A Respondent is: (1) a financial institution that settles Debit and Credit Transaction Activity for some or all its Reserve Bank transactions in the Master Account of a Correspondent; or (2) a financial institution that maintains its required reserve balances in the Master Account of a Correspondent. *See* Section 2.2 of OC 1.

Accounts, the Reserve Banks would not recognize third-party interests in Payment Accounts. Like Master Account balances, the Reserve Banks would treat all balances in a Payment Account solely as obligations to the account holder.

J. Other Risk Controls

- a. In addition to the foregoing risk mitigants, the Reserve Banks would apply the following risk controls to a Payment Account:¹⁷
 - i. Outgoing transactions that would result in an overdraft in the account would be rejected. This feature is intended to reduce the potential credit risk a Payment Account could pose to the Reserve Bank. As noted above, Payment Account holders would not be permitted to incur daylight overdrafts.
- b. The Board is exploring additional risk controls and conditions for a Payment Account. These controls could take the form of, among other things, account agreement conditions, attestation requirements, consent to reviews, or periodic reporting requirements. These controls could cover areas of risks to the Reserve Bank and payment system (such as operational or cyber risks), or risks associated with illicit financing (such as Anti-Money Laundering (AML) risk mitigation).

K. Payment Account Request Process

¹⁷ Some of these risk controls may also apply to Master Accounts.

- a. An eligible institution would request a Payment Account from the relevant Reserve Bank. The relevant Reserve Bank would have the discretion to approve or deny the request. Similar to requests for Master Accounts, Reserve Banks would be expected to review a request for a Payment Account under the Guidelines.
- b. Consistent with a Payment Account's lower risk profile, the Board anticipates that a request for a Payment Account would generally receive a more streamlined review than a request for a Master Account from a comparable institution. As a result, a Reserve Bank would generally be expected to complete its review of an institution's request for a Payment Account within 90 calendar days of receiving all documentation requested by the Reserve Bank.¹⁸
- c. As noted above, the Reserve Banks would retain their discretion to impose additional restrictions and risk controls on a Payment Account on a case-by-case basis.

IV. Request for Information

The Board requests public input on all aspects of the Payment Account prototype, and in particular the Board seeks responses to the following questions:

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

¹⁸ Additional due diligence may be required in some circumstances, which could require a moderate amount of additional time for the Reserve Bank to review the request, and the Reserve Bank would be expected to consult with the Board on such an adjustment. The Board may set a limit on the additional review time. Thus, the 90-day review might be extended in some cases.

eligible institutions?

2. What payment activities or use cases would a Payment Account best facilitate (or be unable to facilitate)?
3. What barriers to innovation in payments would a Payment Account eliminate or alleviate?
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?
5. What are the benefits and challenges of imposing an overnight balance limit on a Payment Account? 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?
6. What are the benefits and drawbacks of paying no interest on overnight balances in a Payment Account?
7. How might the Federal Reserve condition access to a Payment Account on the applicant having an acceptable AML, Bank Secrecy Act (BSA) and Countering the Financing of Terrorism (CFT) compliance programs and, more generally, how can the Federal Reserve best constrain AML/BSA/CFT risks associated with a Payment Account?

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

By order of the Board of Governors of the Federal Reserve System.

Benjamin W. McDonough,
Deputy Secretary of the Board.