Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through

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Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1599; RIN 7100-AE98

Re: Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire.

Dear Sir or Madam,

The Conference of State Bank Supervisors (the "CSBS" or "state bank regulators")[1] appreciate the opportunity to comment on the Notice of Proposed Rulemaking issued by the Federal Reserve Board (the "Board"), titled "Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire" (the "proposed rule"). State bank regulators appreciate the Board's effort to align certain provisions in Regulation J with recent amendments to Regulation CC, Availability of Funds and Collection of Checks, to reflect the virtually all-electronic check collection and return environment.

However, state bank regulators write to request clarity as to the impact of certain proposed revisions with respect to access to the Federal Reserve payments systems. In the proposed rule, the Board has proposed revising the definition of "sender" in Regulation J to expand the list of entities eligible to function as senders to include "a member bank, as defined in Section 1 of the Federal Reserve Act." State bank regulators request clarity as to the legal basis, policy rationale and impact of the proposed revision to the definition of sender.

Currently, Regulation J defines "sender" to include, in relevant part, "depository institutions" as defined in Section 19 of the Federal Reserve Act ("FRA"), which—with respect to commercial banks, savings banks and savings and loan associations—only

includes institutions which are “engaged in the business of receiving deposits, other than trust funds” as defined in the Federal Deposit Insurance Act (the “FDIA”).[2] Given that the definition of depository institution only includes institutions eligible to obtain deposit insurance, and given that state banks and national banks are required to actually obtain deposit insurance as a condition of obtaining membership in the Federal Reserve System (“FRS”),[3] revising the definition of sender to include member banks would seemingly be redundant unless the Board intends for member nondepository trust companies to be eligible to function as senders under Regulation J.[4]

State bank regulators request that the Board clarify whether the revision to the definition of “sender” in Subpart A of Regulation J would expand the types of institutions that may directly participate as a sender in the Fedwire services subject to Subpart B of Regulation J. If the definition of sender is being revised to expand direct access to the Fedwire Funds service or any other Federal Reserve financial services, state bank regulators request that the Board clarify what types of institutions would be afforded access through the proposed revision, for instance, whether member nondepository trust companies would now qualify.[5]

Revising the definition of sender to capture member nondepository trust companies would prompt concerns regarding payments system risk and extension of the federal safety net, and competitive equality with respect to access to Federal Reserve financial services. State bank regulators note that eligibility for master accounts and direct access to the Federal Reserve payments system has generally been limited to depository institutions (which, by their very nature, have a deep well of reservable, insured deposits) so as to limit the need to provide intraday credit to such institutions and thereby expose the Reserve Banks, and by extension the federal government and taxpayers, to the associated credit risks.

Notwithstanding these important policy considerations, state bank regulators believe that if direct access to the Federal Reserve payments systems is to be expanded to nondepository trust companies that obtain membership in the FRS, then FRS membership and direct payments system access should be afforded to such institutions in an equitable and impartial manner, regardless of whether they are state-chartered or federally chartered. State regulators are concerned that, despite the mandates of the FRA, the FRS has seemed to treat membership and direct payments system access as rights to which federally-chartered trust companies are entitled while simultaneously treating membership and access as privileges which state-chartered trust companies must earn.[6]

Differences in state and federal regulatory requirements aside, state regulators believe that the regulatory scrutiny applied to state-chartered nondepository trust companies is not categorically different than that applied to federally-chartered nondepository trust companies, and thus the former should not automatically be designated “high-risk” on this basis.[7] State regulators encourage the Board not only to issue clear, objective criteria to guide nondepository trust companies seeking membership in the FRS, but also ensure that accounts and financial services are made available to such institutions on an equitable and impartial basis as is required by the FRA.

Sincerely,

John Ryan President & CEO

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[1] CSBS is the nationwide organization of state banking and financial regulators from all 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. CSBS supports the state banking agencies by serving as a forum for policy and supervisory process development, by facilitating regulatory coordination on a state-to-state and state-to-federal basis, and by facilitating state implementation of policy through training, educational programs, and exam resource development.

[2] See 12 U.S.C. § 461(b)(1)(A); see also 12 U.S.C. §§ 1813 (defining insured bank), 1815 (specifying that a depository institution must be engaged in the business of receiving deposits to be eligible to apply for deposit insurance). Note that by incorporating the FRA definition of “depository institution”, the current list of institutions that qualify as “senders” under Regulation J mirrors the current list of institutions permitted to maintain a master account and thereby obtain direct access to Federal Reserve financial services.

[3] Compare 12 U.S.C. § 222 (“Every national bank in any State shall . . . become a member bank of the Federal Reserve System . . . and shall thereupon be an insured bank under the [FDIA] and failure to do so shall subject such bank” to forfeiture of its charter.) with 12 U.S.C. § 329 (“ . . . no [state] bank engaged in the business of receiving deposits other than trust funds . . . shall be admitted to membership unless it is, or has been, approved for deposit insurance under the [FDIA]”).

[4] For the purposes of this letter, we assume that the proposed revision to the definition of “sender” in Regulation J would expand access only to nondepository trust companies since the FRA defines a “member bank” to mean a “bank or trust company which has become a member of one of the reserve banks created by this Act”. See 12 U.S.C. § 221.

[5] *We recognize that the proposed revision to the definition of "sender" in Regulation J would mirror the definition of "financial institution" in Operating Circular (OC) 1, the Federal Reserve circular governing the terms under which a master account may be opened. Nevertheless, we request clarity as to the legal basis and policy rationale for the current definition of "financial institution" in OC 1 for the same reasons that we request clarity with respect to the revised definition of "sender" in Regulation J. Clarity on this matter is also needed in light of a potentially inconsistent description of the scope of access and participation in the Fedwire Funds Service Disclosure under the Principles for Financial Market Infrastructures framework. See Fedwire Funds Service Disclosure, Principle 18 (December 27, 2017).*

[6] *Congress did not intend for membership in the Federal Reserve system to be automatic for uninsured nondepository trust companies, whether state-chartered or federally-chartered. Rather, Congress only intended for membership to automatic for full-service national banks which, as a necessary consequence of the character of their full-service charter, engage in the business of receiving deposits other than trust funds, as defined in the FDIA. When, after receiving express, specific chartering authority from Congress, the Office of the Comptroller of the Currency ("OCC") has chartered nondepository trust companies, those companies, like state-chartered nondepository trust companies, have not been legally entitled to membership in the FRS because they lack the requisite legal capacity to obtain deposit insurance as required by the Federal Reserve Act. See 12 U.S.C. § 222.*

[7] *See Guidance for Federal Reserve Financial Services Applicants That Are Deemed High Risk by the Federal Reserve Bank of New York, available at: https://frbservices.org/assets/forms/accounting/guidance-high-risk-new- york.pdf.*

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