Supplemental Notice - Proposed Guidelines for Evaluating Account and Services Requests

COMMENT LETTER

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April 22, 2022
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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. OP-1747

Re: Supplemental Notice - Proposed Guidelines for Evaluating Account and Services Requests

Dear Ms. Misback,

The Conference of State Bank Supervisors ("CSBS" or "state bank regulators") appreciates the opportunity to comment on the Supplemental Notice of Proposed Guidelines for Evaluating Account and Services Requests (the "supplemental notice" or "supplement") issued by the Federal Reserve Board (the "Board"). The proposed guidelines, initially released during May 2021, are to be used by the Federal Reserve Banks (the "Reserve Banks") in evaluating requests for access to master accounts and services. The supplemental notice includes a new section that would establish a three-tier review framework, with the level of scrutiny for different types of eligible institutions increasing from streamlined at the lowest tier (1) to strictest at the highest (3).

State regulators recognize and appreciate the Board's stated goal of providing additional clarity on the level of due diligence and scrutiny applied to requests by eligible state and federal institutions for Reserve Bank accounts and services. As detailed below, however, the supplement is problematic as proposed. While the supplemental notice purportedly seeks to clarify, it would instead introduce new areas of uncertainty, regulatory opaqueness, and potential regulatory arbitrage. Most distressing, the proposed Tiers 2 and 3 would introduce a clear bias in favor of federally chartered institutions, would create an uneven playing field between federally chartered entities and their state counterparts and holding companies, and would undermine the dual banking system.

CSBS urges the Board to reconsider the proposed tiering framework. The Board should ensure that access to Reserve Bank accounts and services be afforded to eligible institutions on an equitable and impartial basis, regardless of whether they are state chartered or federally chartered.

Proposed Tier 1 is equitable and not problematic

A less intensive and more streamlined review would be reserved for Tier 1 entities, consisting of eligible institutions that are federally insured. Tier 1 would include both state-chartered and federally chartered institutions. State bank regulators concur that federally insured institutions, regardless of chartering authority, are subject to a well-known, standard, and comprehensive set of banking regulations by virtue of their status as insured depositories, and merit streamlined and equal treatment.

Proposed Tier 2 is unclear, inequitable and problematic

Tier 2 would consist of eligible institutions that are not federally insured but that are subject to prudential supervision by a federal banking agency (by statute) and whose holding company, if any, is subject to Federal Reserve oversight (by statute or commitments). The supplement would impose an intermediate level of review on these entities.

The parenthetical "by statute" relative to institutions lacks an explanation. The Board should clarify that the supplemental notice would include in Tier 2 those non-federally insured state-chartered entities that are members of the Federal Reserve System.1 CSBS is concerned Tier 2 would include charters that a federal banking agency may contend are based on statutory authority, which has been disputed, and that are instead simply creative interpretations of existing law (e.g., the Office of the Comptroller of Currency's "fintech charter"). Clarity on these points would be beneficial and is necessary for transparency.

Tier 2 would include institutions, such as trust companies, that are not federally insured but are chartered and supervised by the Office of the Comptroller of the Currency (the "OCC"). The supplemental notice baldly asserts that these OCC institutions are subject to a similar set of regulations as federally insured institutions. This deference to the OCC reflects an unfortunate and perhaps unintended bias in favor of federally chartered entities. This federal preference clearly belies a misplaced view that no non-federally insured state-chartered entity is subject to a similar set of prudential regulations as federally insured institutions and similar supervision (including examination) as federally regulated entities. This is fundamentally wrong and undermines the underpinnings of the dual banking system. Non-federally insured state charters exist that are subject to robust prudential standards including capital and asset requirements and limitations, customer protection requirements (including asset segregation to disclosure), restrictions on activities on the entity and its affiliates, and other matters. These standards are frequently published and transparent, unlike the amorphous ad hoc standards applied via operating agreement that the OCC has championed. Rather than relying on sweeping and unfounded assumptions regarding the relative robustness of federal versus state regimes for non-federally insured entities, there should be an objective evaluation of the actual, substantive prudential requirements applicable to such institutions relative to the principles laid out by the Board and described in the account access guidelines. The evaluation of account access and services requests cannot be meaningful, let alone equitable and impartial, if the application of prudential requirements is assumed based on the identity of the chartering authority.

Finally, to qualify under the proposed Tier 2, the holding company of a Tier 2 institution, if any, must be subject to oversight by the Federal Reserve either by statute (i.e., the Bank Holding Company Act) or by "commitment." A brief footnote in the supplemental notice provides that the Board would expect holding companies of Tier 2 entities to comply with similar requirements as holding companies subject to the Bank Holding Company Act. However, the supplement does not specify which sections and requirements of that Act would apply, and does not provide the process and substance required for a holding company to clear this "commitment" hurdle. This is both surprising and unacceptable, given the very significant benefits that may flow to an entity whose holding company successfully navigates to an acceptable level of "commitment" (whatever that may be). As a matter of fairness and transparency, the Board should clarify the form and substance of Federal Reserve oversight by commitment, including the "similar requirements" that would apply as well as the consequences – other than presumably denying access – for the violation of such commitments.

Proposed Tier 3 is inequitable and problematic

The proposed Tier 3, subject to the strictest level of review, would consist of institutions that are not federally insured and that are not subject to federal prudential supervision at the institution and holding company level. Tier 3 would only include state-chartered institutions. This is patently inequitable.

Without foundation, the supplemental notice asserts that state-chartered institutions "may be subject to a supervisory or regulatory framework that is substantially different from, and less rigorous than, the supervisory and regulatory framework that applies to federally-insured institutions." To reiterate, there should be an objective evaluation of the actual, substantive requirements applicable to such institutions relative to the principles laid out by the Board and described in the account access guidelines.

Tier 3 excludes the option of Federal Reserve oversight by "commitments" for the holding companies of state-supervised institutions. Unlike the favorable treatment that would be extended to the parent companies of non-federally insured entities chartered by the OCC under the proposed Tier 2 – which are permitted to enter into presumably unpublished "commitments" through the course of some undefined and unknown process – the parent companies of non-federally insured state institutions would be eligible for no such benefit. This disparate treatment, and clear bias in favor of federal charters, is arbitrary and unfair on its face.

Taken together, Tier 2 and Tier 3 insinuate that the supervisory and regulatory scrutiny applied to eligible state-supervised institutions is substandard. While regulatory scrutiny should certainly be a factor in assessing the risk of providing Federal Reserve accounts and services to an eligible institution, the assessment of such scrutiny should be based on an objective evaluation. States have chartered non- federally insured institutions for many years with clear statutory authority and robust standards and subjected these institutions to close supervision including risk management expectations appropriate for their activities. It is not necessary to disparage these efforts.

State regulators truly value their partnership with the Federal Reserve. State regulators work cooperatively with their Reserve Bank colleagues on a continual – often daily – basis. However, the obvious inequity of the proposed Tier 2 and Tier 3 distinctions for state entities would undermine that partnership and the dual banking system by contending that federal regulation and supervision are more robust and thorough than state regulation and supervision. The evaluation of account access and service requests cannot be equitable and impartial when the application and robustness of prudential requirements is arbitrarily based on the identity of the chartering authority, rather than the substance of the actual, applicable supervisory regimen – whether state or federal.

Access to Federal Reserve accounts and services should be available to all eligible institutions on an equitable and impartial basis consistent with applicable law. It is incumbent on the Board and Reserve Banks to provide consistent and equitable treatment in evaluating access requests. The evaluation of the effectiveness of the risk management framework, governance arrangements, and rules pertaining to a particular institution should involve an objective assessment of the actual substance of those risk mitigants. Such frameworks should not merely be assumed to be effective based on arbitrary constructs regarding the oversight provided by an institution's chartering or supervisory authority.

CSBS has consistently maintained that access to Federal Reserve accounts and services should be prudently restricted to eligible institutions, but granted on an equitable and impartial basis. Competitive equality with respect to access to Federal Reserve account and services is fundamental to the preservation of our dual banking system. We look forward to continuing to collaborate with the Board and the Federal Reserve Banks to achieve our shared supervisory mandates to maintain a strong and resilient banking system that facilitates responsible financial innovation.

Sincerely,

John Ryan
President & CEO

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