



Financial Services Management

Payment-System Access

Cite

FRB, Supplemental Notice and Request for Comment,
Guidelines for Evaluating Account and Services Requests

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<https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20220301a1.pdf>

Impact Assessment

- Despite the Fed's effort to clarify payment-system access, its criteria and process would remain opaque.
- As a result, structural reform could come via idiosyncratic Reserve Bank decisions, not express and transparent federal-policy action.
- Payment-system access for major nonbanks or even commercial companies might be possible under the new definition of eligible charters.
- Significant competitive disparities could result along with heightened regulatory arbitrage.

Overview

Following considerable controversy surrounding how Federal Reserve Banks grant master accounts,¹ the FRB has proposed a somewhat more explicit set of guidelines than provided in its initial notice seeking views on expanding payment-system access.² The first proposal laid out the Fed's policy goals for granting access but said only that insured depositories would get the most straightforward review and other institutions would be subject to more detailed scrutiny. The Fed has now reissued that proposal and differentiated applicants into three classes, getting the lightest to the strictest review. Still, the criteria to be used in each case, the extent to which Reserve Banks would set them in comparable ways, and how long the process might last is not specified nor is there an appeals process that would permit applicants to correct identified flaws and resubmit their request. As a result, the currently wide variability for different institutions in different parts of the country might well continue, altering the de facto structure of the financial system.

¹ See *Client Report FEDERALRESERVE69*, February 3, 2022.

² See **PAYMENT23**, *Financial Services Management*, June 7, 2021.

Impact

The initial proposal, which is substantively repeated in this revision, laid out factors Reserve Banks would need to consider in granting access to master accounts and related services. This perhaps better delineated Reserve-Bank discretion, but it did not significantly limit it given the broad nature (e.g., safety and soundness) of its goals and the often-subjective nature of judgments related to them. The opinions of other regulators about the extent to which an applicant company met the Board's principles would have to be considered by Reserve Banks, but "only to the extent possible," further preserving Reserve Bank discretion and perhaps even increasing the odds of inter-agency disputes.

The three-tier process for Reserve Bank deliberations does not substantively alter this approach. Indeed, it also seems to allow the FRB and/or Reserve banks (this is not made clear) additional discretion to consider nonbank holding companies to be the equivalent of BHCs in terms of safety-and-soundness if a parent company commits to abide by Fed standards. When this would occur and under what terms or transparency is also not made clear, perhaps allowing companies that own entities seeking payment-system access to satisfy one or more Reserve Banks regarding regulation even if the activities the parent company conducts (e.g., commerce) differ markedly from those allowed to a BHC. It may be that this option is intended for foreign banking organizations or certain other forms of financial services companies under parent-company standards that backstop legal commitments, but how this will work and how the Fed will judge a parent-company's commitment is left unsaid.

The proposal also does not address other ways in which payment-system determinations could vary widely across the country with significant implications for the entire U.S. market, in which payment-system access is not limited to any individual Reserve Bank district. There are twelve Reserve Bank districts, allowing for many different approaches and a patchwork of standards. This will likely lead to clusters of charters in favorable Reserve Bank districts competing with like-kind companies hoping to set up shop elsewhere in the U.S. not granted this franchise-critical privilege. Significant structural change to the payment system might thus occur without the clear approval of the Federal Reserve or the policy transparency necessary to inform Congressional judgment about the extent to which non-traditional or riskier banks warrant payment-system access.

This revised proposal thus fails to address consistency and chartering concerns raised in the initial proposal. Indeed, nor does it clearly answer numerous procedural questions. For example, it does not set any time limits on when a Reserve Bank must advise a master-account applicant of its decision. Waits can often be crushingly long for innovative ventures; for example, a narrow bank focused on holding reserves at the central bank has been on hold for at least four years.³ Because applicants for payment-system access are almost by definition start-up ventures, these delays may threaten charter viability. This may impede innovation unless one or another Reserve Bank acts, but the extent to which such innovation is accompanied by effective payment-system, consumer-, and systemic risk buffers would prove uncertain.

³ See **CHARTER25**, *Financial Services Management*, March 18, 2019.

What's Next

This proposal was released on March 1, shortly before Chairman Powell provided semi-annual monetary policy testimony to Congress. This sparked questions by Sen. Rounds (R-SD) about its timing given the controversies surrounding Sarah Bloom Raskin's nomination, but Mr. Powell rebutted suggestions that there is any linkage. Comments are due by April 15.

Analysis

As noted, the bulk of this proposal is identical to the initial one although it now includes a section laying out an application-review process. The initial proposal suggested that access review would generally be straightforward for insured depositories and more complex for others; the new proposal has the following three-tier approach to Reserve Bank review:

A. Tier I

This would govern insured depositories and would generally be relatively simple unless an IDI is identified as posing higher risk. The proposal does not specify what risks might trigger additional review, how this would proceed, or how long it would take.

B. Tier II

This would govern institutions that are not insured but are covered under a statutory set of prudential standards by a federal banking agency or BHCs under FRB supervision under law or "commitment." Holding companies not under statutory FRB control would thus be eligible if the company involved agreed to apply to Fed-comparable standards. These entities would receive an "intermediate" level of review.

C. Tier III

This would cover institutions eligible for payment-system access that do not fall under either tier I or II. These review standards would be the strictest, but again how Reserve Banks would proceed, the extent to which different Reserve Banks would view standards in the same light, or how long this might take is not spelled out.