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Federal Reserve Bank Account Access

Updated Guidelines Suggest a Three-Tiered Framework for Evaluating Different Types of Institutions for Access to Federal Reserve Bank Accounts

On March 1, 2022, the Board of Governors of the Federal Reserve System (the "Federal Reserve") issued a supplemental notice requesting comments on an updated proposed framework for the regional Federal Reserve Banks to use in evaluating requests by "eligible" institutions to establish accounts at, and obtain other financial services provided by, the Federal Reserve Banks.[1] These accounts and services are core components of the U.S. payments system.

The Federal Reserve issued an initial version of the proposed guidelines in May 2021. As we described in our May 6, 2021 memorandum to clients, the proposed guidelines would provide the Federal Reserve Banks with "a structured, transparent, and detailed framework for evaluating access requests" by eligible institutions.[2] The initial proposal included six broad "principles," to be evaluated on a case-by-case basis, that would "support consistency in approach and decision-making" across Federal Reserve Banks, while maintaining their "discretionary authority to grant or deny requests."[3] The Federal Reserve received a variety of comments on the initial proposal—including from institutions with "traditional charters," such as banks and credit unions, and their trade associations, as well as from institutions with "novel charters," such as cryptocurrency custody banks and their trade associations. These comments included a range of suggestions as to how the principles should apply based on the type of requesting institution.[4] After consideration of these comments, the Federal Reserve is re-proposing an updated version of the guidelines that leaves the six principles largely unchanged, but adds a new "three-tiered review framework" to "provide additional clarity regarding the review process for different types of institutions."[5]

In the notice accompanying the updated proposed guidelines, the Federal Reserve reiterates that the guidelines "were designed primarily as a risk management framework" and therefore would focus on risks of access to Federal Reserve Bank accounts or services, and not on any "net benefits to the financial system" that could arise from granting access to any particular applicant.[6] The updated proposed guidelines explicitly confirm that the Federal Reserve would "expect[] the Reserve Banks to collaborate on reviews of account and service requests, as well as ongoing monitoring of accountholders, to ensure that the guidelines are implemented in a consistent and timely manner." The updated proposed guidelines also reiterate that "legal eligibility does not bestow a right to obtain an account and services." Rather, the guidelines are intended to "promote consistent outcomes across Reserve Banks" when reviewing access requests, given decisions regarding individual access requests remain at the discretion of the individual Federal Reserve Banks. Further, consistent with the initial proposal, the updated proposed guidelines would inform whether and to what extent a Federal Reserve Bank would impose conditions on an institution's access—for example, limits on the interest paid on an account or a maximum balance.[7]

The three-tiered framework that would be added in the updated proposed guidelines generally would determine "the level of due diligence and scrutiny to be applied by Reserve Banks to different types of institutions." Although institutions in a higher tier would face greater due diligence and scrutiny than institutions in a lower tier, no eligible institution would be categorically excluded from access to an account: a Federal Bank would have "the authority to grant or deny an access request by an institution in any of the three proposed tiers," based on the application of the principles summarized below.[8] The three tiers would be the following:

- ***Tier 1.*** This tier would include eligible institutions that are federally insured. These institutions would generally be subject to a "less intensive and more streamlined review" because they are subject to a "standard, strict, and comprehensive set of federal banking regulations," and for most institutions, detailed regulatory and financial information would be "readily available, often in public form." These institutions may, however, receive additional attention in cases where the application of the guidelines identities potentially higher risk profiles.[9]
- ***Tier 2.*** This tier would include eligible institutions that are not federally insured, but that are themselves subject by statute to prudential supervision by a federal banking agency, and whose holding company, if any, is subject to Federal Reserve oversight, whether by statute or commitments.[10] These institutions would generally receive an "intermediate level of review," because they are subject to a set of regulations that is "similar, but not identical" to the regulations applicable to federally insured institutions, and therefore may present greater risks, and detailed regulatory and financial information may be less available or unavailable in public form.[11]
- ***Tier 3.*** This tier would include eligible institutions that are neither federally insured nor subject to federal prudential supervision at the institution or holding company level. These institutions would generally receive the "strictest level of review" because they may be subject to a supervisory or regulatory framework that is "substantially different from, and less rigorous than" the regulatory framework applicable to federally insured institutions, and detailed regulatory and financial information may not exist or may be unavailable.[12]

As noted above, the updated proposed guidelines do not substantially change the six principles the Federal Reserve Banks would apply in evaluating access requests. Those principles would be the following:

- ***Eligibility.*** Under the first principle, a Federal Reserve Bank would determine whether an institution requesting access to an account or services is eligible for such access under the Federal Reserve Act or another statute, and whether the institution has a "well-founded clear, transparent, and enforceable legal basis for its operations."[13]

- ***Risks to Federal Reserve Banks and the payment system.*** Under the second and third principles, a Federal Reserve Bank would assess any credit, liquidity, operational, settlement, cyber or other risks that access to an account or services could pose to itself or to the overall payment system. A Federal Reserve Bank would evaluate, among other things, an institution's risk management and governance, compliance with regulatory and supervisory requirements, financial condition, liquidity, operational capacity and reliability, and settlement processes.
- ***Risks to financial stability.*** Under the fourth principle, a Federal Reserve Bank would assess risks that access to an account or services by the institution or "a group of like institutions" could pose to U.S. financial stability, including through the transmission of liquidity or other strains in times of financial or economic stress. A Federal Reserve Bank would take into account that there may be a "particularly large" risk of "significant deposit inflows" into an institution that holds mostly central bank balances and is not subject to capital requirements similar to those that apply to federally insured institutions; such an institution could more easily expand its balance sheet during times of stress, allowing investors to deposit funds into the institution, instead of providing short-term funding to financial and non-financial firms and state and local governments, "greatly amplifying stress."[14]
- ***Facilitation of illicit activity.*** Under the fifth principle, a Federal Reserve Bank would assess risks to the overall economy that could arise if access to an account or services facilitates illicit activity, such as money laundering, sanctions violations, fraud or cybercrime. A Federal Reserve Bank would be required to determine that the institution has an AML program that satisfies the "pillars" generally required of bank AML programs.[15] The updated proposed guidelines buttressed this principle by stating that a Federal Reserve Bank evaluating an institution's application would also confirm that the institution has an appropriate program to support compliance with sanctions administered by the Office of Foreign Assets Control ("OFAC").[16]
- ***Monetary policy effects.*** Under the sixth principle, a Federal Reserve Bank would assess the effect that access to an account or services by the institution or a "group of like institutions" could have on the Federal Reserve's ability to implement monetary policy.

The addition of the three-tiered framework for evaluating applications from different types of entities makes clear that the Federal Reserve Banks will be required to apply strict scrutiny to entities that are not already subject to some level of federal banking regulation. However, the proposal leaves open the door to account access for those eligible state-chartered institutions that can demonstrate their ability to satisfy all six principles.

Comments on the updated proposed guidelines are due by April 22, 2022.

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ENDNOTES

1 Board of Governors of the Federal Reserve System, Guidelines for Evaluating Account and Services Requests. 87 Fed. Reg. 12,957 (Mar. 8, 2022), *available at* https://www.govinfo.gov/content/pkg/FR-2022-03-08/pdf/2022-04897.pdf.

2 Board of Governors of the Federal Reserve System, Proposed Guidelines for Evaluating Account and Services Requests, 86 Fed. Reg. 25,865, 25,866 (May 11, 2021), *available at* https://www.govinfo.gov/content/pkg/FR-2021-05-11/pdf/2021-09873.pdf.

3 *Id.* at 25,866.

4 Staff Memorandum to the Board of Governors of the Federal Reserve System re: Proposed Guidelines to Evaluate Requests for Accounts and Services at Federal Reserve Banks (Feb. 16, 2022), *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20220301a2.pdf.

5 87 Fed. Reg. at 12,958.

6 *Id.* at 12,958 n.2.

7 *Id.* at 12,959.

8 87 Fed. Reg. at 12,962.

9 *Id.*

10 The Federal Reserve would expect holding companies of Tier 2 entities to comply with similar requirements to those that apply to holding companies subject to the Bank Holding Company Act of 1956, as amended. *Id.* at 12,958 n.5.

11 *Id.* at 12,962.

12 *Id.*

13 *Id.* at 12,959. This principle corresponds to the first of the Principles for Financial Market Infrastructures, the internationally accepted standards for payment systems and other financial market utilities, and the Federal Reserve's Regulation HH, 12 C.F.R. § 234.3(a)(1), which applies to systemically important payment systems in the United States. *See* Principle 1, Committee on Payment and Settlement Systems & Technical Committee of the International Organization of Securities Commissions, *Principles for Financial Market Infrastructures* (Apr. 2012), *available at* https://www.bis.org/cpmi/publ/d101a.pdf.

14 87 Fed. Reg. at 12,961.

15 *See, e.g.*, 31 C.F.R. § 1020.210(a).

16 OFAC has published a framework addressing what it considers to be the five essential components of a risk-based sanctions compliance program. *See* Department of the Treasury, Office of Foreign Assets Control, A Framework for OFAC Compliance Commitments (May 2, 2019), *available at* https://home.treasury.gov/system/files/126/framework_ofac_cc.pdf. For further information on this framework, see our memorandum to clients, "OFAC Issues Compliance Commitments Framework: OFAC's Framework Provides 'Best Practices' Guidance; Identifies Five Essential Components of a Sanctions Compliance Program and Outlines Ten Root Causes of Apparent Violations of OFAC Sanctions Programs" (May 10, 2019), *available at* https://www.sullcrom.com/ofac-issues-compliance-commitments-framework.

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