Fed Account Access for Nonbanks: An Analysis of the Policy Implications and Potential Risks to the U.S. Financial System

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Background

On May 5, 2021, the Federal Reserve issued for public comment a set of proposed guidelines intended to govern how Federal Reserve Banks would review and assess account applications by institutions with novel charters.

The proposed guidelines are in part a reflection of the ongoing efforts by Big Tech and FinTech firms to engage in banking activities without being subject to bank regulation and supervision. Federal and state authorities have begun creating novel types of charters that permit various forms of lending, deposit-taking and payments activities, while avoiding most federal bank regulation and supervision (notably, the BHC Act). Once armed with novel charters, these firms will seek accounts at Federal Reserve Banks in order to, among other things, gain direct access to the Fed's payment systems (i.e., without the requirement to partner with a regulated bank).

The key elements of the proposal are outlined below; however, serious policy questions remain unaddressed. BPI developed the following series of posts and analysis in an effort to address some of the complexities and implications that would be introduced by allowing nonbanks Fed accounts access.

The posts cover a range of topics, including:

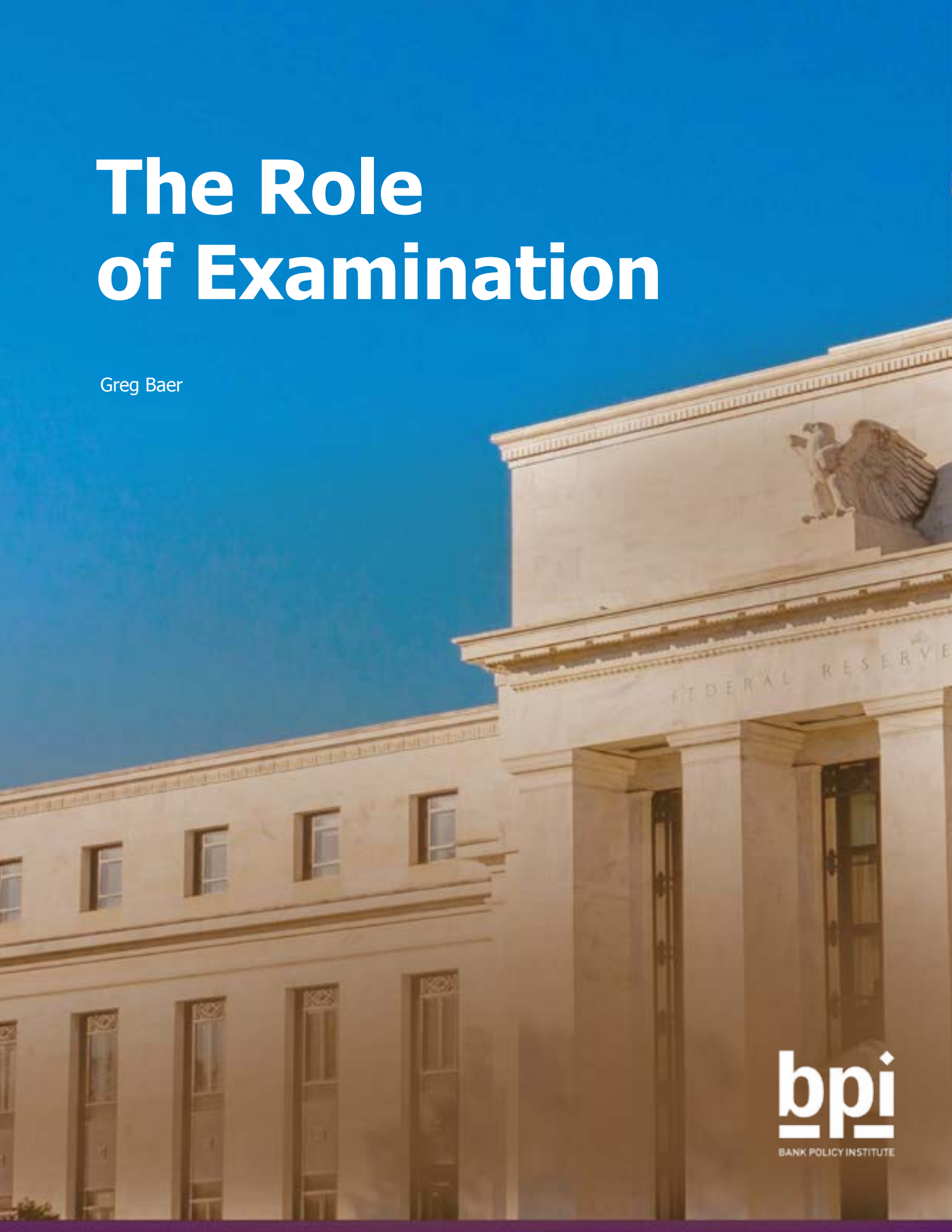
- Whether institutions with novel charters are legally eligible to apply for Fed accounts;
- Whether these institutions should be subject to examination for AML/KYC/CFT, sanctions and operational risk compliance, and whether they should adhere to obligations under the Community Reinvestment Act;
- Whether these accounts should be eligible to earn interest; and
- Whether these institutions might present undue financial stability and monetary policy risks.

KEY ELEMENTS OF THE FED'S PROPOSED GUIDELINES

- The proposed guidelines are intended to reflect the Board's policy goals of safety and soundness of the banking system, monetary policy implementation, financial stability, consumer protection and a safe, inclusive and innovative payment system.
- Reserve Banks will evaluate how applicants meet six principles. Each principle identifies risk factors, which are used in supervision and regulation of federally insured institutions, that will be considered by the Reserve Banks.
    - The institution must be legally eligible to maintain an account at a Reserve Bank.
    - The account should not present undue credit, operational, settlement, cyber or other risks to the Reserve Bank.
    - The account should not create undue credit, liquidity, operational, settlement, cyber or other risks to the payment system.
    - The account should not create undue risk to the stability of the financial system.
    - The account should not create undue risk to the overall economy by facilitating activities such as money laundering, terrorism financing, fraud, cybercrimes or other illicit activity.
    - The account should not adversely affect the Federal Reserve's ability to implement monetary policy.
- The Board acknowledges that assessments of applications from non-federally-insured institutions may require more extensive due diligence.

The Role of Examination

Greg Baer



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The Role of Examination

Last month, the Federal Reserve released proposed guidelines governing whether, and on what terms, FinTechs with novel and nontraditional charters should be able to access the Fed's payment system via an account at a Federal Reserve Bank. Under the proposal, access would be determined by each Federal Reserve Bank based on guidelines established by the Board. The proposal requires the Reserve Banks to ensure at the time of application that the nonbank has established a series of policies, but does not require any future examination – whether by the Fed itself or the chartering authority – to ensure continuing compliance with the guidelines.

The proposal raises the question of why we examine banks – that is, traditional FDIC-insured banks. Historically, three primary rationales were (1) to prevent a risk to the Deposit Insurance Fund, and ultimately the taxpayer; (2) to prevent excessive risk taking that could be produced by deposit insurance, as an obvious example of moral hazard; (3) to ensure compliance with consumer protection laws. Post the Global Financial Crisis, a fourth rationale was added: to protect financial stability. (For the banking agencies, the third was largely removed in 2010, as all authority to examine, regulate and enforce the consumer financial protection laws was transferred to the CFPB for all banks with more than $10 billion in assets).

Today, *regulation* focuses on the first and second rationale, primarily in the form of prudential regulations including limits on risk-taking and extremely stringent capital and liquidity requirements. For an uninsured bank (particularly one that takes no deposits), where taxpayers are not at risk and there is no moral hazard, there clearly is diminished need for such regulation.

Bank *examination*, however, today is not focused exclusively or perhaps even primarily on safety and soundness – that is, on financial risks that could cause material losses that imperil the solvency of the institution and cause it to fail at a cost to the FDIC Deposit Insurance Fund. Consider:

- First, the largest examination and corresponding bank compliance effort is focused on policies for anti-money laundering and countering the financing of terrorism. These are not safety and soundness concerns; Congress obviously did not enact the Bank Secrecy Act and the USA Patriot Act in order to prevent banks from losing money but rather to enlist them in aiding law enforcement and national security. The same motivation applies if bad actors choose to finance illegal activity through uninsured banks or FinTechs. Thus, there appears no case to be made for examining an uninsured bank or FinTech processing payments any differently from an insured bank processing payments.
- Second, a related, major examination and compliance focus is enforcement of U.S. sanctions. (One could argue it should not be an examination focus, as the federal banking agencies have never been granted any examination, regulatory or

enforcement authority by statute, but at least for now, they proceed as if they have.) So, again, Congress or the President clearly do not impose economic sanctions on foreign enemies in order to prevent banks from losing money and depleting the Deposit Insurance Fund, but rather to promote the nation's national security. Thus, there appears no case to be made for examining an uninsured bank or FinTech processing payments any differently from an insured bank processing payments.

- Third, the fastest-growing examination and compliance focus is on operational risk, which generally means cyber risk. The concern is that bad actors – whether they be basement-dwelling miscreants or dedicated state actors – will disrupt the payment system either by denying service or destroying or disrupting data, and also potentially prey on businesses or consumers whose data they obtain. Once again, the concern here is not primarily a risk to the Deposit Insurance Fund. Rather, the overwhelming concerns are disruption of the payment system, a loss of privacy, potential consumer economic harm through fraud and a potential diminishment in economic commerce. Thus, there appears no case to be made for examining an uninsured bank or FinTech processing payments any differently from an insured bank processing payments.

These three examples are not three minor elements of how banks are examined. They constitute a large percentage (and perhaps a majority) of examination time and compliance department budgets.

Thus, if the Fed believes that these issues are important and benefit from examination, then any access to the payments system should be conditioned on uninsured banks being examined by their supervisory or chartering agency in *a substantially equivalent way* as the federal banking agencies examine insured banks.

There is clear precedent for such a step. Under the International Banking Act and the Fed's Regulation K, when the Board considers an application by a foreign bank to establish a U.S. branch, it must consider whether the foreign bank and any foreign bank parent are subject to comprehensive supervision on a consolidated basis by their home country supervisor.[1] In assessing this supervisory standard, the Board considers the extent to which home country supervisors (i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports or otherwise; (iii) obtain information on the dealings and relationships between the bank and its affiliates, both foreign and domestic; (iv) receive from the bank financial reports that are consolidated on a worldwide basis, or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; and (v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis.[2]

Alternatively such examination could be conducted by the Fed itself, as a condition for access to its systems. Again, there is precedent here, as the Fed currently conducts rigorous on-site examination of the RTP system operated by The Clearing House as a condition for its

maintaining a joint account at the Fed. Further, a nonbank FinTech that grew to become a significant player could become subject to Fed regulation and examination under Title VIII of the Dodd-Frank Act.[3]

There is an additional reason to equalize examination in this area. If one does believe both that AML, sanctions and cyber issues are important, then a failure to examine for them in the same way regardless of charter would create a substantial arbitrage opportunity for those looking to launder money, finance terrorism, evade U.S. sanctions or launch a cyberattack against the nation's critical financial infrastructure. So, all the more reason for parity.

[1] 12 U.S.C. § 3105(d)(2); 12 CFR 211.24(c)(1).
[2] *See, e.g.,* FRB Order No. 2021- 06 at 2 (May 24, 2021).
[3] Title VIII among other things provides for expanded Federal Reserve supervision and regulation of payment, clearing, and settlement systems designated as systemically significant by the Financial Stability Oversight Council.

Putting the Horse before the Cart: The First Rule of Granting Fed Accounts is Clarifying Who is Legally Eligible to Apply

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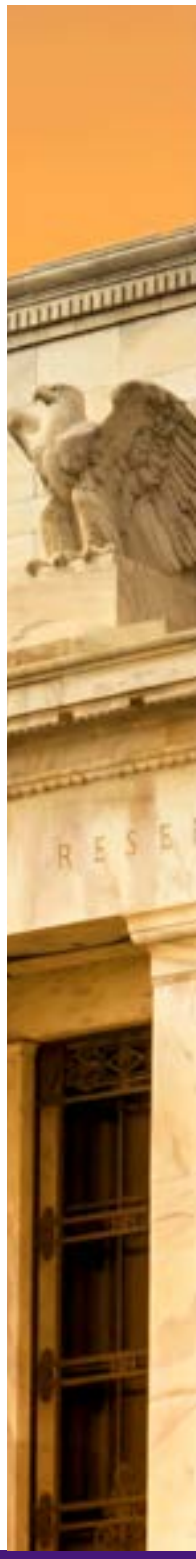
Putting the Horse before the Cart: The First Rule of Granting Fed Accounts is Clarifying Who is Legally Eligible to Apply

The Federal Reserve has issued for comment a set of proposed guidelines on access to Federal Reserve master accounts and Reserve Bank financial services by companies with novel charters.[1] A key threshold question is which entities are legally eligible to apply for a Federal Reserve account. In its proposed guidelines, the Federal Reserve acknowledged that this question requires an answer but decided that now was not the time.[2] This note attempts to identify the relevant law on legal eligibility and identify areas of possible ambiguity requiring clarification.



CURRENT ELIGIBILITY

The Federal Reserve's Operating Circular 1 identifies the institutions that are currently eligible for a master account and services:[3] member banks, commercial banks, mutual savings banks, federal savings banks, savings and loan associations, credit unions, a U.S. branch or agency of a foreign bank and an Edge or agreement corporation. The Operating Circular also includes "other entities authorized to have a Master Account at a Reserve Bank," such as U.S. government agencies and government-sponsored enterprises.

The Federal Reserve's authority to provide an account and services derives from the Federal Reserve Act. Section 13 of the Act authorizes each of the 12 Federal Reserve Banks to accept deposits from "member banks, or other depository institutions" and to accept deposits from "any nonmember bank or trust company or other depository institution" "solely for the purposes of exchange or of collection."[4] At the time section 13 was enacted, only member banks were eligible to obtain an account and services.[5] Over time, the Act has been amended to include nonmember banks and trust companies, and also "other depository institutions." The addition of "other depository institution" was made in 1980 in order to expand the universe of institutions to which the Federal Reserve Act's reserve requirements apply to include not only Federal Reserve member banks, but also any other bank that accepted deposits.[6]

ELIGIBILITY OF NOVEL CHARTERS THAT TAKE DEPOSITS

If an entity with a novel charter accepts deposits, is it legally eligible? It depends on this question: what is a "depository institution"?

Section 19 of the FRA defines "depository institution" for this purpose as including various banking entities that are insured either by the FDIC, but also any of these entities that is "eligible to make an application to become" insured under section 5 of the Federal Deposit Insurance Act (FDI Act).[7] The FDI Act provides that an institution

must be "engaged in the business of receiving deposits other than trust funds" in order to make an application to become insured.[8] Through its regulations, the FDIC has further interpreted this phrase by stating that "a depository institution shall be 'engaged in the business of receiving deposits other than trust funds' only if it maintains one or more non-trust deposit accounts in the minimum aggregate amount of $500,000."[9] It therefore appears that the definition of "depository institution" in the Federal Reserve Act applies to institutions that accept a minimal amount of deposits, even if they are not insured by the FDIC.

Several novel institutions and charter types have been designed to accept uninsured deposits and therefore would appear to be a "depository institution" under the FRA and legally eligible to apply for a master account and services.

ELIGIBILITY OF NOVEL CHARTERS THAT DON'T TAKE DEPOSITS

So what about entities with novel charters that do not accept deposits; are they eligible? It is much less clear.

The OCC has announced plans for two such novel charters; each would permit some variation of payments or lending, but both would prohibit deposit-taking.[10] The OCC has not approved any of these charters yet; in fact, no applications have even been filed. However, any eventual applicant likely would seek a Fed account in connection with the novel charter. Because institutions that do not take deposits would not qualify as "depository institutions" or "other depository institutions," they would need to qualify for eligibility in another way.[11]

It is possible that such institutions could claim that they are "national banks" under the Federal Reserve Act, which are by definition also Fed "member banks."[12] Member banks are legally eligible for Fed accounts under section 13 of the Act.

So, are these institutions "national banks" under the Federal Reserve Act? The Act does not define "national bank" except to say that it is "synonymous with national banking association."[13] The Act does not define "national banking association" or even "banking association." The Act defines a "bank" in relevant part as "a State bank, banking association, and trust company, except where national banks are specifically referred to."[14]

Thus, the statute is not a model of clarity on this point, and so it is likely to be a matter of first impression for the Fed to decide. Certainly, the OCC labels these entities as "national banks" under the National Bank Act, but that is not determinative here. The relevant federal law (the one that requires national banks to be member banks) is the Federal Reserve Act, which means the Federal Reserve and not the OCC is responsible for interpreting and resolving any unclear or ambiguous terms.

Stepping back, we would posit that these kinds of OCC entities are better thought of as

"national payments companies" or "national lending companies," or both, but not "national banks." And the Federal Reserve Act does not contemplate allowing national payments or lending companies to have Fed accounts. Here, it is worth noting that if one these OCC entities had a state license, it would not be a "bank" license but rather would be a money transmitter license or a lending license. Thus, just because these entities would have a federal charter from the OCC does not mean they should presumptively be deemed "national banks" under the Federal Reserve Act and entitled to Fed accounts.

FEDERAL RESERVE AUTHORITY TO PROVIDE MASTER ACCOUNTS AND SERVICES

The FRA does not explicitly authorize a Federal Reserve Bank to provide services, but rather implies that authority in section 11A. That section requires the Federal Reserve to establish pricing principles and a schedule of fees for the services offered by the Reserve Banks. It also provides that "Federal Reserve bank services covered by the fee schedule shall be available to nonmember depository institutions…" -- thus implying that services are available to both member banks and nonmember banks.

In addition to the lack of explicit authorization to provide services, the Federal Reserve Act does not require a Federal Reserve Bank to provide an account to an applicant. The statute states that a Reserve Bank "may receive from any of its member banks, or other depository institutions,…deposits of current funds…" The use of the word "may" indicates that each Reserve Bank retains discretion as to whether to accept deposits from an institution, which means it also has discretion as to whether to provide an account. The Federal Reserve has also come to this conclusion. In recent litigation with an applicant for a Master Account, the Federal Reserve Bank of New York said that section 13 of the FRA "permits Federal Reserve Banks to reject deposits – and thus deposit account requests – from depository institutions."[15] The Federal Reserve has reiterated this view in its proposed guidelines, stating that it "believes it is important to make clear that legal eligibility does not bestow a right to obtain an account and services."[16]

CONCLUSION

Whether or not the Federal Reserve determines that novel charter types and novel institutions are technically "eligible" to apply for a Federal Reserve master account or for access to Reserve Bank services, none of the 12 Reserve Banks is required to provide such accounts and services. There are strong considerations both with respect to risk to the system and policy concerns that must be considered before the Federal Reserve permits these institutions to access the system. The Federal Reserve has taken an important first step in proposing a set of the standards that must be met before an institution is permitted to open a master account or access Reserve Bank services. The continued safety and integrity of the payment and financial system depends on careful examination of these institutions to ensure they meet those standards, and the Reserve Banks should not compromise on those standards.

[1] 86 Fed. Reg. 25865 (May 11, 2021).
[2] "[The] Board is considering whether it may in the future be useful to clarify the interpretation of legal eligibility under the Federal Reserve Act for a Federal Reserve account and services." 86 Fed. Reg. at 25866.
[3] Federal Reserve Banks Operating Circular 1, Effective February 1, 2013, available at https://www.frbservices.org/assets/resources/rules-regulations/020113-operating-circular-1.pdf
[4] 12 U.S.C. § 342.
[5] "Member banks" are those that are members of the Federal Reserve System and includes both state-chartered institutions that elect to become members and national banks.
[6] Depository Institution Deregulation and Monetary Control Act, section 105(a), PL 96-221, 94 Stat. 132, 139-140.
[7] 12 U.S.C. § 461(b)(1)(A).
[8] 12 U.S.C. § 1815(a).
[9] 12 CFR 303.14(a).
[10] The first novel charter is the Special Purpose National Bank charter for FinTech companies, which would permit these companies to engage in lending and payments, but not accept deposits. The OCC has not chartered any companies under the special purpose national bank charter, largely because the OCC's authority to issue the SPNB charter has been tied up in litigation in federal court for the past five years. Recently the U.S. Court of Appeals for the Second Circuit ruled that any legal challenges to the SPNB charter aren't ripe because the OCC hasn't approved any such charters. The Second Circuit dismissed the claims on procedural grounds without prejudice to the underlying merits of the challenge. See Lacewell v Office of the Comptroller of the Currency, No. 19-4271 (2d Cir. Jun. 3, 2021). The second novel charter is a national payments bank charter, which would permit companies to engage in payments, but not deposit-taking or lending. For a description of this charter, see https://bankingjournal.aba.com/2020/06/podcast-occs-brooks-plans-to-unveil-payments-charter-1-0-this-fall/
[11] The Federal Reserve Act does not directly contemplate eligibility for any kind of non-depository institutions, as these OCC institutions would be. Moreover, they wouldn't appear to qualify as commercial banks, mutual savings banks, federal savings banks, savings and loan associations, credit unions, a U.S. branch or agency of a foreign bank or an Edge or agreement corporation.
[12] The Federal Reserve Act requires that national banks be members of the Federal Reserve System. See 12 U.S.C. § 222.
[13] 12 U.S.C. § 221.
[14] 12 U.S.C. § 221.
[15] TNB USA Inc. v Federal Reserve Bank of New York, Memorandum of Law in Support of Defendant Federal Reserve Bank of New York's Motion to Dismiss, U.S. District Court, Southern District of New York, Civ. No. 18 Civ. 7978, Mar 8, 2019.
[16] 86 Fed. Reg. 25865, 25867 (May 11, 2021).

FinTechs and Big Tech Should Honor Obligations to Meet the Finance Needs of All Americans, Not Just the Rich, Privileged and Digitally Connected

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FinTechs and Big Tech Should Honor Obligations to Meet the Finance Needs of All Americans, Not Just the Rich, Privileged and Digitally Connected

Traditionally, insured banks have been the only financial institutions subject to the Community Reinvestment Act, as they uniquely benefited from the Federal Reserve's discount window and access to its payment system. For FinTech and Big Tech firms seeking at least the latter right, there no longer seems to be a basis for absolving them of a corresponding responsibility – particularly when doing so would have significant benefits for low- and moderate-income individuals.

Moreover, FinTech and Big Tech companies seeking to provide banking products and services often tout their ability to reach underserved communities and individuals, leading some critics to wonder if the FinTechs and Big Techs aren't just engaged in "inclusion washing" – the practice of touting financial inclusion credentials without justification to gain political support.[1] A simple and effective way to ensure that practices by FinTechs and Big Techs are consistent with their rhetoric would be to subject them to the CRA.

THE CRA

Congress passed the Community Reinvestment Act in 1977 as a way to ensure that U.S. banks met the credit needs of the communities in which they operated, including low- and moderate-income neighborhoods and underserved geographic areas. A main goal in passing this legislation was to combat discriminatory lending practices such as redlining, which excluded entire poor and minority neighborhoods from the banking system and limited their access to credit. Under the Act, a bank that fails to meet its CRA obligations faces consequences, including a prohibition on business expansion until the deficiencies are resolved, and public shaming in the form of a public rating.[2] Millions of poorer and underserved Americans have benefited from the CRA over the past 40+ years.

Senator William Proxmire, the main author of the CRA, justified CRA requirements as a fair exchange for the economic benefits enjoyed by depository institutions by grant of their banking charters. Among the economic benefits Senator Proxmire identified were access to low-cost credit through the Federal Reserve Banks and access to the Federal Reserve's payments system.[3]

The stakes are significant, as a migration of activity outside of the banking system may diminish the effectiveness of the CRA. The CFPB has found that the share of loans originated by independent mortgage companies has increased in recent years, with these companies originating 54.5 percent of all reported loans in 2019.[4] But, while

these institutions are able to reap the financial benefits of providing credit to the consumers, not much is required of them in return.

As the number of nonbank financial institutions in the market increases, there is increased risk that consumers in low- and moderate-income communities, whom the CRA was designed to serve, may once more have limited access to credit or otherwise be subject to discriminatory or predatory lending practices. Of course, many nontraditional institutions that engage in lending activities often claim financial inclusion as part of their mission, so formal obligations to validate those claims should be welcome.

MECHANISMS TO EXPAND CRA TO FINTECHS/BIG TECH

Members of Congress have recognized this imbalance in the lending market. A group of legislators recently reintroduced the American Housing and Economic Mobility Act, which would apply the CRA to nonbank mortgage lenders. And in recent remarks before the National Community Reinvestment Coalition, Federal Reserve Chairman Jerome Powell acknowledged that lending was continuing to move outside the regulated banking sector and that he would support subjecting non-depository institutions to requirements under the CRA.[5]

Access to Federal Reserve master accounts for nontraditional financial institutions presents another route to maintain the relevance of the CRA. The Federal Reserve recently issued a set of proposed guidelines that would establish standards for evaluating applications for Federal Reserve master accounts and access to Reserve Bank financial services.[6] Access to a master account and services would confer upon these institutions the economic benefits identified by Senator Proxmire.

While federal legislative change is certainly the best and most effective way to extend community lending obligations to nonbanks, there are alternative approaches that could achieve some similar benefits. Here are a few:

- **Individual state licensing.** Individual states may take action to ensure that nonbank lenders have similar obligations as banks to serve the needs of their community. In addition to application to banks and credit unions, the state of Massachusetts has required state-licensed mortgage companies to comply with community reinvestment requirements since 2008.[7] The Massachusetts law evaluates a mortgage company's lending and services, similar to the CRA. Earlier this year, Illinois also enacted its own version of the CRA that applies to

banks, credit unions and state-licensed mortgage companies. Illinois will assess a set of factors, including activities to ascertain needs of communities, origination of mortgage loans and efforts to resolve delinquencies. Massachusetts and Illinois have provided templates that may be adopted by other states and applied more broadly to include any institution that engages in lending activities.

- **Licensing agencies.** Leaving aside BPI's broader concerns with the OCC's proposed Special Purpose National Bank charter, the OCC did propose to require that applications for that charter include a description of the applicant's commitment to financial inclusion. The agency's goal with this requirement was to ensure that any institution applying for the charter would make financial services available to all customers and that customers would be treated fairly. The agency did not leave that term open to interpretation, but included in its proposed charter handbook detailed guidance on what this should include.[8] This commitment should address the following: the institution's products, services and activities; anticipated markets and communities, including underserved populations or communities, including low- and moderate-income customers; and goals, milestones, commitment measures and metrics. State licensing agencies that offer novel, bank-like charters can use this example to set financial inclusion expectations or requirements for their chartered institutions.

- **Conditions to access Fed accounts.** It is particularly important to consider nonbanks' obligations to their communities as they're seeking access to the ultimate payments pipeline: the Federal Reserve's payments system. Novel charters allow nonbanks to participate in the business of banking while avoiding the constraints and costs of the regulatory and supervisory framework that is applied to traditional commercial banks by a federal banking agency. In addition to making sure underserved communities continue to have access to financial services, nontraditional institutions offering these services and seeking Federal Reserve master accounts should also have similar obligations if they are to reap the benefits of a master account.

  In its proposed guidelines, the Federal Reserve has identified several policy goals that are reflected in the proposal, which include the need to protect consumers and to promote a safe, efficient, inclusive and innovative payment system.[9] In addition to the consideration of the compliance with consumer protection laws as identified in the proposed guidelines, the ability for historically underserved populations to access financial services should also be considered. The proposed guidelines have also acknowledged that Reserve Bank assessments of requests from non-federally-insured institutions, such as these nontraditional financial institutions, may require more extensive due diligence. Because there is currently no formal requirement for nontraditional financial institutions to comply with the CRA or similar requirements, the institution's plans to ensure the needs of the communities in which they operate should be a part of this more extensive due diligence. Without a demonstrated commitment to its community, a master account and access to services should not be granted.

[1] "Financial Inclusion Is a Top Selling Point for Fintech Backers, but the Target Groups Aren't as Interested." Morning Consult, 12 Mar. 2021, morningconsult.com/2021/03/11/fintech-inclusion-regulation-poll/
[2] Litan, Robert E, et al, United States Department of the Treasury, "The Community Reinvestment Act after Financial Modernization: A Baseline Report," April 2000, available at https://www.treasury.gov/press-center/press-releases/Documents/crareport.pdf
[3] Id at p. 44.
[4] This data is derived from the reports of closed-end applications and originations made by financial institutions in 2019. See Consumer Financial Protection Bureau, Data Point 2019: Mortgage Market Activity and Trends, June 2020, available at https://files.consumerfinance.gov/f/documents/cfpb_2019-mortgage-market-activity-trends_report.pdf
[5] Kiernan, Paul and Andrew Ackerman, "Powell Says Low-Income Lending Rules Should Apply to All Firms Offering Consumer Credit," The Wall Street Journal, May 3, 2021, available at: https://www.wsj.com/articles/powell-highlights-slower-recovery-for-low-wage-and-minority-workers-11620065926
[6] 86 Fed. Reg. 25865 (May 11, 2021).
[7] 209 CMR 54.00, available at https://www.mass.gov/regulations/209-CMR-5400-mortgage-lender-community-investment
[8] Comptroller's Licensing Manual Supplement: Considering Charter Applications From Financial Technology Companies, available at https://www.occ.gov/publications-and-resources/publications/comptrollers-licensing-manual/files/considering-charter-apps-from-fin-tech-companies.html
[9] 86 Fed. Reg. at 25866.

When Consistency is Not Foolish–A More Sensible Approach To Granting Fed Accounts and Paying Interest on Reserves

Bill Nelson & Paige Paridon

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When Consistency is Not Foolish–A More Sensible Approach To Granting Fed Accounts and Paying Interest on Reserves

Last month, the Federal Reserve Board published proposed guidelines to be used by Federal Reserve Banks in evaluating requests for Federal Reserve accounts by institutions with novel charters, including uninsured deposit-taking institutions (UDIs) like narrow banks and non-deposit-taking FinTech payments companies. The proposal is available here, and a BPI primer on the issue is available here.

The proposal aims to ensure a consistent approach across the System for reviewing account applications. Indeed, one of the Board's primary functions is to establish regulations governing Reserve Bank behavior, and the Board and Reserve Banks have longstanding processes to ensure that the Banks implement the Board's regulations and policies in a uniform manner.[1] However, somewhat curiously, the proposal makes no mention of any of those processes; nor does it contemplate any other process for ensuring that its guidelines would be uniformly applied in practice. Further, some parts of the proposal actually seem to undercut the goal of consistency. In this post, we recommend that the Board clearly articulate mechanisms to ensure consistent outcomes around account access, as the proposal seems to intend.

A MORE COHERENT FRAMEWORK TO ENSURE CONSISTENT OUTCOMES

As noted, one of the Board's key statutory functions is to oversee Reserve Bank operations.[2] Section 13(1) of the Federal Reserve Act provides that "Any Federal reserve bank **may** receive from any of its member banks, or other depository institutions . . . deposits of current funds in lawful money," leaving open the question of the conditions for such receipt.[3] The Board's proposal seeks to ensure that "Reserve Banks apply a consistent set of guidelines when reviewing . . . access requests to promote consistent outcomes across Reserve Banks and to facilitate equitable treatment across institutions."[4] Further, the proposal provides that "the evaluation of an institution's access request should also consider whether the request has the potential to set a precedent that could affect the Federal Reserve's ability to achieve its policy goals now or in the future."[5] The Board explains further that the uniform applicability of "the proposed guidelines would reduce the potential for forum shopping across Reserve Banks and mitigate the risk that individual decisions by Reserve Banks could create de facto System policy for a particular business model or risk profile."[6] However, the proposal contains no mechanism to ensure the uniform applicability sought.

Historically, the Board, working with the Reserve Banks, has established consistent rules for actions taken by Reserve Banks and numerous procedures for ensuring compliance with those rules. In certain instances, the Board has delegated oversight

responsibility to the Director of The Division of Reserve Bank Operations and Payment Systems (RBOPS) (or the Director's designee).[7] RBOPS generally "oversees the policies and operations of the Federal Reserve Banks as providers of financial services to depository institutions and as providers of fiscal agency services to the U.S. Treasury and other government agencies."[8] For example, RBOPS conducts audits of Reserve Bank operations, including compliance with Board regulations concerning payment, accounts and services, and the Federal Reserve's Policy on Payment System Risk.[9] Presumably, the granting of accounts would fall under those audits, although no such audits are mentioned in the proposal.

The Federal Reserve uses a similar mechanism to ensure consistency in discount window lending. In that context, the Federal Reserve Banks make three different types of discount window loans – primary credit, secondary credit and seasonal credit loans.[10] Every two weeks, pursuant to its authority under the Federal Reserve Act, the Board establishes the interest rates that will be charged on the three types of loans based on proposals from the Reserve Banks.[11]

The Board also establishes, under this same authority, the rules governing who qualifies for which type of loan.[12] As noted, for example, a bank must be in "generally sound financial condition" to qualify for primary credit.[13] A bank can receive a seasonal credit loan if its seasonal need "will persist for at least four weeks."[14] And so on.

Pursuant to these regulations established by the Board, each Reserve Bank must decide if an applicant qualifies for the type of credit for which it has applied, and the Reserve Bank then makes the lending decision.[15] There is a System committee – the Subcommittee on Credit Risk Management, or "SCRM" – where representatives from the Reserve Banks ensure that each Reserve Bank is applying the rules uniformly.[16] Board staff from RBOPS and the Monetary Affairs Divisions observe these meetings. In addition, the Board conducts regular audits of each Reserve Bank's lending rules and practices to ensure that the Bank is following Regulation A.[17]

Thus, it is somewhat of a mystery why the proposal does not mention any of these established and well-tested practices – or any other mechanism – to review or monitor application decisions throughout the system to ensure consistency of application. The Board should, at a minimum, make clear that it will leverage its existing tools – or create new ones – to review application decisions across the System. For example, the access decisions presumably would fall under RBOPS' authority to monitor the Reserve Banks' compliance with Board regulations and policies. The SCRM or another similar committee composed of representatives from each of the Reserve Banks and the Board could review account access decisions to ensure consistency in application of the Board's access rules across the System.

THE PROPOSAL'S DELEGATION OF DECISIONS ON THE IORB RATE UNDERCUTS THE PROPOSAL'S GOAL OF CONSISTENCY

Not only does the proposal fail to mention a mechanism to ensure consistency of application, it appears to cede to individual Reserve Banks the Board's statutory authority to establish the interest rate that Reserve Banks would pay to any particular accountholder.[18] The proposal states:

> "If the Reserve Bank decides to grant an access request, it may impose (at the time of account opening, granting access to service, or any time thereafter) obligations relating to, or conditions or limitations on, use of the account or services as necessary to limit operational, credit, legal, or other risks posed to the Reserve Banks, the payment system, financial stability or the implementation of monetary policy or to address other considerations.[5]"

> "The conditions imposed could include, but are not limited to, paying a different rate of interest on balances held in the account, limiting the amount of balances on which interest is paid, or establishing a cap on the amount of balances held in the account."

Thus, under the proposed guidelines, if a Reserve Bank decides to provide an applicant an account, that individual Reserve Bank apparently could impose as a condition that it will pay a different interest rate – that the Reserve Bank itself would set – to the applicant than to other accountholders.

This is striking for a number of reasons. First, by statute, the Board sets the interest rate the Reserve Banks pay on reserve balances (the IORB rate). Section 19 of the Federal Reserve Act provides that the Board may prescribe regulations concerning the payment of interest on balances at a Reserve Bank.[19] There is no comparable authority provided to Reserve Banks under section 13 of the Federal Reserve Act, "Powers of Federal Reserve Banks."[20] Further, while the Board may delegate some functions to the Reserve Banks, it may not delegate those related to rulemaking or principally to monetary and credit policies.[21] Thus, it is not within the Board's authority to delegate this function, as it is related to (a) rulemaking, and (b) "principally to" monetary policy.[22] The Board has explained that the "The interest rate on required reserves (IORR rate) is determined by the Board and is intended to eliminate effectively the implicit tax that reserve requirements used to impose on depository institutions. The interest rate on excess reserves (IOER rate) is also determined by the Board *and gives the Federal Reserve an additional tool for the conduct of monetary policy . . . the Federal Reserve intends to move the federal funds rate into the target range set by the FOMC primarily by adjusting the IOER rate."*[23]

Second, as noted, even if arguably it were within the Reserve Bank's authorities to set the IORB rate for certain types of accounts (for example, if the Board declined to establish regulations governing the payment of interest on reserves and the Reserve Banks interpreted silence as

tacit authorization to set the rate of interest paid on reserves), or it were able to delegate this function, doing so would undermine one of the key goals of the proposal to ensure consistency across the System. Indeed, inconsistency would be likely, as the proposal includes no mechanism by which the Board and Reserve Banks would agree to common rates.

Third, delegation of interest rate setting would be inconsistent with the Board's 2019 Advance Notice of Proposed Rulemaking for evaluating master account requests from narrow banks or "pass-through investment entities" (or PTIEs, as the Board calls them) (available here). The Board requested comment on whether Reserve Banks should pay PTIEs a different rate of interest on their excess reserves than they pay to other banks. That earlier proposal asks:

> If the Board were to determine to pay a lower IOER rate to PTIEs, how should the Board define those eligible institutions to which a lower IOER rate should be paid?
>
> If the Board were to determine to pay a lower IOER rate to PTIEs, what approach should the Board adopt for setting the lower rate?

Note that there was no ambiguity over the fact that the Board would set the interest rate.[24]

Why might the Board have chosen such open-ended language about interest rates in the account access proposal? It seems unlikely that the final arrangement the Board establishes to handle account requests by UDIs would leave Reserve Banks such discretion in practice. One explanation could be that there is disagreement across the System over how these cases should be handled, with some in the System objecting to the idea that UDIs might earn a different rate of interest, and the Board wanted to put a marker down covering the possibility. If that's the reason, it is all the more important that the Board establish—or use existing—mechanisms to ensure consistent implementation of the guidelines that it establishes.

In order to ensure consistent application of the guidelines—including with respect to interest rates—the Board would need to go further than it has in the proposal, which merely sets forth factors to be considered. The Board should establish guidelines that the Reserve Banks must consider and subject those decisions to centralized review and monitoring, at least for nontraditional applicants, including PTIEs. For example, the Board could establish in the guidelines at least three potential outcomes for applications for accounts: rejection, the granting of a "limited" account, and the granting of a "regular" account. A regular account would be the same as the accounts currently provided to federally insured depository institutions. A limited account would receive a lower rate of interest, or no interest, as established by the Board for all such accounts, and perhaps a cap on use, also set by the Board. The Board also could define criteria that must be met in order to be granted either a limited or regular account. Reserve Banks could then decide whether to reject an application or grant a regular or limited account based on the Board's criteria. The Board could then ensure that its existing mechanisms are used, or new mechanisms created, to ensure consistency across the System.

[1] Section 11(j) of the Federal Reserve Act authorizes the Board to "exercise general supervision over said Federal reserve banks." 12 USC § 248(j).
[2] *Id.*
[3] 12 USC U.S.C. § 342 (emphasis added).
[4] 86 Fed. Reg. 25,865, 25,866 (May 11, 2021).
[5] 86 Fed. Reg. at 25,867.
[6] 86 Fed. Reg. at 25,866.
[7] *See* Board of Governors of the Federal Reserve, Office of Inspector General: "Opportunities Exist to Enhance the Onsite Reviews of the Reserve Banks' Wholesale Financial Services," Audit Report 2014-FMIC-B-014 (September 30, 2014) at 4, available at: Opportunities Exist to Enhance the Onsite Reviews of the Reserve Banks' Wholesale Financial Services (federalreserve.gov).
[8] The Fed - Reserve Bank Operations and Payment Systems (federalreserve.gov). See also Audit Report 2014-FMIC-B-014 at 4 (Stating that "RBOPS is responsible for the oversight of Reserve Bank operations, including overseeing and monitoring various aspects of wholesale financial services . . . The FMI Oversight group within RBOPS supports the Board in meeting its statutory responsibilities under [section 11(j) of] the Federal Reserve Act for oversight of the Reserve Banks' wholesale financial services, as well as under Title VIII of the Dodd-Frank Act for supervision of the private-sector FMUs designated as systemically important" (internal citations omitted).
[9] *See, e.g.,* Federal Reserve 2019 Annual Report, "Oversight of Federal Reserve Banks," available at: The Fed - Publications: Annual Report (federalreserve.gov). ("The Board's reviews of the Reserve Banks include a wide range of oversight activities, conducted primarily by its Division of Reserve Bank Operations and Payment Systems . . . The oversight program identifies the most strategically important Reserve Bank current and emerging risks and defines specific approaches to achieve a comprehensive evaluation of the Reserve Banks' controls, operations, and management effectiveness."). See also "Federal Reserve Policy on Payment System Risk," Amended as of March 19, 2021, available at: Federal Reserve Policy on Payment System Risk. This policy states that "Through this policy, the Board expects financial system participants, including private-sector FMIs and the Reserve Banks, to reduce and control settlement and other systemic risks arising in FMIs, consistent with the smooth operation of the financial system. This policy is also designed to govern the provision of intraday balances and credit while controlling the Reserve Banks' risk by (1) making financial system participants and FMIs aware of the types of basic risks that may arise in the payment, clearing, settlement, or recording process; (2) setting explicit risk-management expectations; (3) promoting appropriate transparency by FMIs to help inform participants and the public; and (4) establishing the policy conditions governing the provision of Federal Reserve intraday credit to eligible account holders." Policy on Payment System Risk at 4. See also Audit Report 2014-FMIC-B-014 for an example of the Reserve Bank oversight and monitoring RBOPS conducts.
[10] See 12 CFR 201.4. Primary credit is for financially sound banks, secondary credit is for other banks and seasonal credit is for community banks with seasonal funding needs.
[11] Section 13(8) of the Federal Reserve Act provides that "All such advances shall be made at rates to be established by such Federal reserve banks, such rates to be subject to the review and determination of the Board of Governors of the Federal Reserve System." See, e.g., "Minutes of the Board of Governors discount rate meetings," February 8, 2021, available at: Minutes of the Board's discount rate meetings from February 8 through March 17, 2021 (federalreserve.gov) ("Subject to review and determination by the Board of Governors, the directors of the Federal Reserve Banks of Boston, New York, Cleveland, Chicago, St. Louis, Minneapolis, Kansas City, and San Francisco had voted on January 28, 2021, and the directors of the Federal Reserve Banks of Philadelphia, Richmond, Atlanta, and Dallas had voted on February 4, to establish the primary credit rate at the existing level of 0.25 percent").
[12] *See id*. The Board has promulgated Regulation A, entitled "Extensions of Credit by Federal Reserve Banks, pursuant to sections 10A, 10B, 11(i), 11(j), 13, 13A, 14(d), and 19 of the Federal Reserve Act (12 U.S.C. 248(i)-(j), 343 et seq., 347a, 347b, 347c, 348 et seq., 357, 374, 374a, and 461). See 12 CFR 201 et seq.
[13] 12 CFR 201.4(a).
[14] 12 CFR 201.4(c)(2).
[15] 12 CFR 201.3, 201.4.
[16] *See, e.g.,* Amy Kytonen, Vice President, Supervision, Regulation, and Credit "Credit risk management update: Contributions from the Ninth," (September 18, 2019), available at: Credit risk management update Contributions from the Ninth | Federal Reserve Bank of Minneapolis (minneapolisfed.org) (The Subcommittee on Credit Risk Management "assists Reserve Bank presidents in developing and implementing policies for managing discount window credit, condition monitoring, and payment system risk . . . In a nutshell, SCRM ensures that all things related to managing credit risk are considered nationwide . . . ").
[17] The Board's Division of Monetary Affairs conducts audits of the Federal Reserve Banks for compliance with Regulation A.
[18] *See* 12 U.S.C. 461(b)(12). Specifically, section 19(12) states that: "(A) In General. Balances maintained at a Federal Reserve bank by or on behalf of a depository institution may receive earnings to be paid by the Federal Reserve bank at least once each calendar quarter, at a rate or rates not to exceed the general level of short-term interest rates. (B) Regulations Relating To Payments And Distributions. The Board may prescribe regulations concerning—(i) the payment of earnings in accordance with this paragraph; (ii) the distribution of such earnings to the depository institutions which maintain balances at such banks, or on whose behalf such balances are maintained; and (iii) the responsibilities of depository institutions, Federal Home Loan Banks, and the National Credit Union Administration Central Liquidity Facility with respect to the crediting and distribution of earnings attributable to balances maintained, in accordance with subsection (c)(l)(A), in a Federal Reserve bank by any such entity on behalf of depository institutions."
[19] *Id.*
[20] *See* sections 13(1)-(14) of the Federal Reserve Act.
[21] Section 11(k) of the Federal Reserve Act provides that the Board, by published order or rule, may delegate any of its functions, other than

those related to rulemaking or principally to monetary and credit policies. 12 U.S.C. 248(k).

[22] *Id.*

[23] Federal Reserve Board, "Policy Tools: Interest on Required Reserve Balances and Excess Balances," available at: Federal Reserve Board - Interest on Required Reserve Balances and Excess Balances (emphasis added) (last updated May 18, 2021). The Board issued an interim final rule in 2008 implementing the authority it was provided by Congress in 2006 in the "Financial Services Regulatory Relief Act of 2006" (PL 109–351, Oct. 13, 2006) to pay interest on excess reserves. In adopting the IFR, the Board stated that "The ability to pay interest on balances held at Reserve Banks should help promote efficiency and stability in the banking sector. Paying interest on excess balances will permit the Federal Reserve to expand its balance sheet as necessary to provide sufficient liquidity to support financial stability while implementing the monetary policy that is appropriate in light of the System's macroeconomic objectives of maximum employment and price stability. Paying interest on excess balances should also help to establish a lower bound on the federal funds rate." 73 Fed. Reg. 59482 (Oct. 9, 2008).

[24] The ANPR has not advanced since its initial publication.

Financial Stability and Monetary Policy Risks Associated with Granting Accounts to Institutions with Novel Charters

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Financial Stability and Monetary Policy Risks Associated with Granting Accounts to Institutions with Novel Charters

On May 5, the Federal Reserve published proposed guidelines to be used to evaluate requests for accounts by institutions with novel charters, including uninsured deposit-taking institutions like narrow banks and the new Wyoming special purpose depository institution charter for crypto banks. The proposal is available here and a BPI primer on the issues is available here.

Among other criteria, the proposed guidelines state that the provision of an account should not "create undue risk to the stability of the U.S. financial system," or "adversely affect the Federal Reserve's ability to implement monetary policy." This note discusses the ways the Fed may be concerned that granting accounts to uninsured deposit-taking institutions with novel charters (UDIs) can create risks to financial stability or interfere with monetary policy implementation.

In short, because they are not federally insured, some UDIs can be subject to destabilizing and contagious depositor *outflows*. And because some UDIs would only maintain reserve balances as assets and reserve balances are attractive in periods of financial stress, they can be subject to destabilizing deposit *inflows*.

FINANCIAL STABILITY

The proposed guidelines state that a Reserve Bank should determine whether access to an account by a UDI by itself or by a group of similar UDIs could "introduce financial stability risk to the U.S. financial system." In particular, the Reserve Bank is instructed to consider

> "…the extent to which, especially in times of financial or economic stress, liquidity or other strains at the institution may be transmitted to other segments of the financial system."

For example, if a FinTech-affiliated UDI advertised its uninsured deposits as essentially riskless because they were backed by "reserves" but it turns out that they weren't riskless (more on that below), then depositors in the UDI, knowing that the first one out the door was most likely to get paid and later ones might not, could all simultaneously seek to withdraw their deposits (they'd certainly have strong incentive to do so). If the UDI had made losses that were not covered by its capital, or if it did not hold a sufficient quantity of highly liquid assets to pay depositors, it would have to close its doors, with any remaining depositors likely receiving only partial returns.

A run on one UDI is not a systemic risk, but when granting a charter, the Fed has to

consider the implications of granting charters to similar institutions as well. If there were other, similar UDIs, depositors at those UDIs would probably also rapidly withdraw their funds to protect themselves from possible similar trouble. Even if those UDIs were solvent, if they did not have enough cash on hand to meet the runs, they too would have to close their doors. Before halting depositor withdrawals, the UDIs may try to sell their assets at firesale prices, which could put pressure on unrelated institutions that held the same or similar assets.

Essentially the same dynamic could apply to stablecoins issued by UDIs that were advertised as being riskless but proved to be risky. If holders of any one stablecoin were unable to redeem their investments for 100 percent of the face value of the coin, all similar stablecoins would likely experience elevated demand to convert the stablecoin to dollars.

The deposits at a UDI could appear riskless but end up being risky for several reasons. Perhaps the most important reason is that the public has come to expect deposits to be riskless because the deposits they are familiar with are insured and UDI deposits would not be insured. In addition, some UDIs have played on the ambiguity of the word "reserves" to suggest that they are only allowed to invest in deposits at the Federal Reserve when they are actually allowed to invest in risky assets. Case in point: a Wyoming SPDI (crypto bank) can invest not only in central bank reserves, which are riskless and perfectly liquid, but also in certain municipal securities, agency securities, and any assets "determined by the Commissioner to be…permissible under safe and sound banking practices." [12]

These institutions also are permitted to use the word "bank" in their names, even though they are not insured depository institutions, contrary to the public's general understanding of what a bank is. The public may expect an institution that is called a bank to be subject to the same rigorous capital and liquidity standards as federally insured banks. Capital insulates depositors from losses and liquidity ensures the institution can meet deposit withdrawals. For example, federally insured banks are required to hold substantial capital to cover the potential for operational losses but the UDIs known to be seeking charters are not, despite also being subject to operational risk.

Moreover, even if deposits are backed 100 percent by reserve balances, they need not be riskless. Consider, for example, a bank funded 20 percent with deposits, 79.5 percent with debt, and 0.5 percent with equity whose assets are 20 percent reserve balances and 80 percent subprime mortgages. It would satisfy a 100 percent reserve requirement, but the deposits are far from riskless. Reserve requirements help ensure that an institution is *liquid* but not that it is *safe*. Deposits are not collateralized by the reserves. If an UDI defaults, depositors are treated as general creditors and so share in the losses equally with others, like debt holders, vendors and landlords of the institution, in contrast to depositors in FDIC-insured institutions.

The other financial stability worry the Fed describes concerns narrow banks or "pass-through investment entities" (PTIEs), another type of UDI seeking Fed account access. PTIEs invest only in reserve balances and are funded only with uninsured deposits and a tiny sliver of capital. The business model is to earn interest on the reserve balances and pass that interest on to

depositors minus a small amount to cover costs and provide a return on equity.

The Fed's proposal notes that reserve balances are attractive investments during times of financial stress. Only banks are able to invest in reserve balances, but PTIEs essentially allow other institutions to invest in reserve balances as well. As a result, these UDIs can be magnets for flights to quality out of investments in "nonfinancial firms, financial firms, and state and local governments." The massive "dash for cash" that occurred in March 2020 provides a good illustration of how such outflows can be destabilizing. In the event last year, the dash was into (among other things) bank deposits, which rose by nearly $2 trillion and funded banks' $700 billion increase in lending. Had those funds flowed into PTIEs, they would have only funded increased holdings of reserve balances.

MONETARY POLICY

The Fed's monetary policy concerns about granting accounts to UDIs appear to be focused on the implications of PTIEs for reserve balances. On May 13, 2019, the Fed issued an ANPR in which it proposed paying PTIEs a lower interest rate on reserve balances than other account holders (available here). In that proposal, the Board described its specific monetary policy concerns in detail.

The proposal last month states that a Reserve Bank should consider whether granting an account to a UDI or a group of similar UDIs

> "…could affect the level and variability of the demand for and supply of reserves, the level and volatility of key policy interest rates, the structure of key short-term funding markets, and on the overall size of the consolidated balance sheet of the Reserve Bank."

These concerns correspond to those described in the Fed's PTIE proposal from 2019.

First, the Board is concerned that PTIEs may make it difficult for the Fed to shrink its balance sheet if it decided to do so. Investors in other assets such as Treasury bills, commercial paper or certificates of deposit could shift their investments to PTIEs, and the PTIEs would, in turn, deposit those investments at the Federal Reserve as reserve balances. In order to control interest rates, the Fed would need to supply the reserves that are demanded and doing so requires the Fed to maintain a correspondingly large securities portfolio.
Second, currently, the only lenders in the fed funds market are GSEs. GSEs have deposits at the Fed but do not receive interest. Rather than receive zero interest, GSEs lend their extra cash in the fed funds market to banks. The Fed is concerned that if GSEs can invest in PTIEs, they will

stop lending in the fed funds market. Trading volume in the market would fall and volatility in the fed funds rate would increase.

The Fed also indicated that if PTIEs attracted investors away from depository institutions and money market mutual funds, trading volumes in repo markets and the Eurodollar market could also decline, increasing volatility in those markets as well.

ENFORCEMENT

The proposal states that Reserve Banks would need to determine if granting an account to the UDI or to a group of similar UDIs would increase financial stability risks or interfere with monetary policy implementation before granting the account. The Reserve Banks are encouraged to make use of assessments of the financial condition of the institution by state and/or federal supervisors. Notably, the proposal states that the flight-to-quality risk is greater if an institution is not required to meet capital requirements similar to those of a similar institution that receives federal deposit insurance.

If a Reserve Bank concludes that granting an account would create financial stability or monetary policy problems, the Reserve Bank would presumably not grant the account. The Reserve Bank also could determine that financial stability or monetary policy problems could be mitigated by placing restrictions on the UDI's account. In particular, the Reserve Bank could pay a different interest rate, limit the amount in the account on which interest is paid, or put a cap on the amounts in the account.

To avoid the financial stability risk associated with destabilizing and contagious runs out of the accounts, Reserve Banks could seek assurance that the deposits were, in fact, riskless and that the UDI had liquidity needed to meet any outflows. Such assurance could come, for example, from the UDI being required by its charter to only invest in reserve balances and to be subject to capital requirements like normal banks.

To avoid the financial stability and monetary policy risks associated with attracting investors either in normal times or during stress, the Reserve Bank could pay PTIEs a lower interest rate or it could require the PTIEs to maintain the same capital levels as a similar bank that has federal insurance; either change would cause the interest rate a PTIE was able to pay its depositors to fall below other money market rates. The Reserve Bank could also put a cap on the size of each PTIE's account.

[1] Wyoming Administrative Rules, Audit, Dept. of Banking Division, Chapter 20: Special Purpose Depository Institutions. https://docs.google.com/viewer?a=v&pid=sites&srcid=d3lvLmdvdnxiYW5raW5nfGd4OmZlMTYzNDY1NmM3ZjQ2Ng

[2] The list of allowable investments in the Wyoming regulation is ambiguous. As noted, it permits SPDIs to invest in agency and municipal securities but requires the SPDIs to invest only in Level I High Quality Liquid Assets (HQLA). Level 1 HQLA includes only reserve balances and Treasury securities.