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Banks demand high bar for fintech access to Fed services

Kate Berry

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Banks want the Federal Reserve to create tough standards for evaluating whether fintech firms with narrow-purpose banking charters should be given access to the payments system and other central bank services.

Bank trade groups sent letters to the Fed on Monday in response to guidelines it proposed in May that would grant such fintech firms access to Fed accounts and services. The proposal contains six principles for the 12 Federal Reserve banks to consider when evaluating applications by fintech firms. The Fed asked for public comment by Monday on what standards should be used when vetting such requests.

The banking groups generally expressed support for the Fed's proposal but also said it is too broad and that any company granted access to the payments system should be subject to the same strict regulatory requirements as traditional financial institutions. The groups contend that fintechs with narrow-purpose charters pose a safety-and-soundness risk and should be denied access.

"We urge the board to outline specific capital, liquidity, risk management and public reporting requirements necessary for master account access, and any additional parameters for eligible entities whose business models may present enhanced risks to the payment system," the American Bankers Association, the Consumer Bankers Association and the National Association of Federally-Insured Credit Unions said in a joint letter. "Given the potential risks they pose, we believe entities that are not subject to such standards and oversight should not have access to the payments system."

The Office of the Comptroller of the Currency has recently approved trust charters for cryptocurrency firms; such companies are not federally insured. The agency also has designed a special-purpose fintech charter that is mired in a legal dispute. A key unresolved question is whether firms lacking Federal Deposit Insurance Corp. backing will be granted access to the Fed's payments system.

Many fintechs currently use traditional banks as their agents to indirectly access the Fed's wholesale settlement services. Some commenters said this arrangement obliges fintechs to rely on rival payment service providers that they also compete with, while increasing costs.

"To the extent that fintechs are able to gain the same direct access to the Fed's wholesale purchases that ordinary banks enjoy, they can operate more efficiently, and compete more effectively with those banks in providing alternative retail products and services," wrote George Selgin, a senior fellow and director of the Cato Institute's center for monetary and financial alternatives.

The Fed has said in the past that it is committed to supporting "responsible innovation," both by the firms it regulates directly and in the financial market generally.

The bank trade groups said the Fed should establish an evaluation committee to review all applicants and require that entities meet robust safety-and-soundness standards currently required of federally insured or other regulated institutions. Entities granted access to the payments system also should be subject to ongoing federal and state supervision along with call report or other periodic financial reporting requirements.

"Each payment system participant must be subject to robust safety-and-soundness, regulation and supervision, on an ongoing basis, to protect all payment system participants and the payment system itself," the ABA, CBA and NAFCU said.

Two other trade groups — the Bank Policy Institute and Independent Community Bankers of America — said in a separate letter that the Fed needed to clarify the legal standards for eligibility.

Applicants must be legally eligible under the Federal Reserve Act, which generally grants eligibility to depository institutions, according to the Fed's proposal. But it also appeared to allow entry to certain nontraditional charters, an issue banks want clarified.

"The key question to be considered in any application is the risk profile and business model of the applicant," the BPI and ICBA said in their letter. "We strongly encourage the Board to assess whether novel charters meet the definition of 'national bank' and 'depository institution' for purposes of the Federal Reserve Act."

The trade groups also want the Fed's proposal to explain specifically how the 12 Federal Reserve banks will examine, audit and monitor applicants for compliance with the proposed guidelines, both as part of the initial application and on an ongoing basis.

"In the context of novel charters, the Reserve banks should conduct a significantly greater degree of due diligence, examination and monitoring to ensure that applicants satisfy the guidelines," the BPI and ICBA said in their letter.