National Community Reinvestment Coalition (NCRC)

National Consumer Law Center (NCLC) (on behalf of its low income clients)

Center for Responsible Lending (CRL)

Comment to Board of Governors of the Federal Reserve System on the Proposed Guidelines for Evaluating Account and Service Requests

July 12, 2021

Submitted electronically to regs.comments@federalreserve.gov

Ann E Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Proposed Guidelines for Evaluating Account and Service Requests

Dear Ms. Misback:

Thank you for the opportunity to comment on the Board of Governors of the Federal Reserve System's (the Board) request for comment on proposed guidelines to evaluate requests for accounts and services at the Federal Reserve Banks.

The National Community Reinvestment Coalition (NCRC) consists of more than 600 community-based organizations, fighting for economic justice for almost 30 years. Our mission is to create opportunities for people and communities to build and maintain wealth. NCRC members include community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, fair housing and civil rights groups, minority and women-owned business associations, and housing counselors from across the nation. NCRC and its members work to create wealth-building opportunities by eliminating discriminatory lending practices, which have historically contributed to economic inequality.

Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitative practices, help financially stressed families build and retain wealth, and advance economic fairness.

The Center for Responsible Lending (CRL) is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions. For 40 years, Self-Help has created asset-building opportunities for low-income individuals, rural communities, women, and families of color. In total, Self-Help has provided over $9 billion in financing to 172,000 homebuyers, small businesses, and nonprofit organizations and serves more than 185,000 mostly low-income families through 65 credit union branches in North Carolina, California, Florida, Illinois, South Carolina, Virginia, Washington and Wisconsin.

I. Overview of the comment

We acknowledge that setting clear guidelines for admitting financial institutions to the Federal Reserve payments services and providing other financial services is necessary given the proliferation of novel charters available at the state level and continued efforts of non-depositories to gain national banking charters. Creating consistency across Reserve Banks will ensure those policy decisions are made explicitly rather than by setting policy through the one-off approval of precedent-setting applications. We hope that this consistency will help protect the stability of financial institutions, the nation's payments systems, the Federal Reserve System and the economy.

However, as the Board notes, this request for comment only outlines the criteria for approving or denying requests for accounts and services and does not delineate what firms are eligible to make an application in the first place. We believe that approving these guidelines without clarifying to what firms they apply is a critical oversight.

If these criteria are applied loosely, we believe that uninsured or risky financial institutions could gain access to one of the primary benefits of a banking charter while avoiding obligations under the Community Reinvestment Act (CRA), a key anti-redlining law. Moreover, providing access to Fed payment services would also increase the attractiveness of uninsured or risky bank charters that may carry with them preemption rights that allow the companies to ignore important state consumer protection laws without being subject to the full obigations and oversight of traditional banks. We provide three examples of recent novel charters that would create unacceptable risks that the proposed guidance was designed to prevent, summarized in Table 1.

Table 1. The proposed guidance would provide benefits to novel charter holders without commensurate obligations

Charter type		Charter benefits			Charter Obligations		
		Deposit Insurance	Preemption	Federal Reserve Accounts and Services	Supervision of Parent Company	Community Reinvestment Act	State Usury Laws and Other Consumer Protection Laws[1]
Novel charter	Synthetic national fintech charter[2]	No	Yes	Unknown	No[3]	No	No
Novel charter	Industrial Loan Company charters	Yes	Yes	Yes	No	Yes	No
Novel charter	State fintech charters[4]	Unknown[5]	Possibly some[6]	Unknown	No	No	Generally yes[7]
Standard charter	Insured state-chartered banks and national banks	Yes	Yes	Yes	Yes	Yes	No
Standard charter	Insured credit unions	Yes	Some[8]	Yes	Yes	No	Some[9]

[1] This column refers to whether the institution may ignore the usury laws of the consumer's state and instead export its home state interest rate cap (or lack of a cap). In addition, national banks and state banks also enjoy preemption of some other state consumer protection laws. The Riegle-Neal Act provides that a branch of an out-of-state, state-chartered bank can ignore the branch (host) state laws regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches if such laws are preempted as to a branch in the host state of an out-of-State national bank. 12 U.S.C. § 1831a(j)(1).

[2] The term "synthetic national fintech charter" refers to an entity chartered as a national bank that does not take insured deposits but that has a partnership with a separately chartered depository financial institution that enables it to offer insured deposit accounts.

[3] If approved as proposed, the synthetic national fintech charter application submitted by Figure Techologies would not be subject to supervision under the Bank Holding Company Act. A prior version of this comment listed this as subject to the BHCA.

[4] State fintech charters refers to the charters such as those established in Nebraska and Wyoming and discussed in more detail in III(B)3 that do not take demand deposits (or, in some cases, any deposits) and that generally will not have deposit insurance but might be eligible to apply.

[5] Fintech charters that do not take deposits will not have deposit insurance. Charters that hold reserves in dollars may be eligible under state law to apply for deposit insurance but it is unclear whether it would be granted. See subsequent discussion on demand deposits and deposit insurance.

[6] Institutions that are not insured depository institutions are not eligible for interest rate exportation, but a fintech state charter might be eligible if it secures insurance. It is unclear whether state charters that take deposits but are not insured would be eligible for other types of preemption.

[7] Fintech charters that do not have deposits or deposit insurance are covered by state usury laws and other state laws. It is not clear whether any state laws would be preempted as to fintech charters that take deposits but do not have deposit insurance.

[8] Both federal and state insured credit unions are entitled to exercise interest rate exportation, which preempts the consumer's state usury laws. But preemption is less extensive in other areas than for credit unions than for banks.

We propose two immediate actions the Federal Reserve can take to address these issues: (1) restrict access to accounts and services to insured depositories and (2) going forward, restrict access to those institutions with parent companies that are subject to the Bank Holding Company Act.

In addition, we urge the Board to work with consumer, community and civil rights organizations, as well as industry and Congress, to ensure that financial institutions that benefit from banking charters and Federal Reserve Bank accounts and services are subject to the commensurate obligations to affirmatively serve the banking needs of the communities where they do business and to ensure that their products are responsible and affordable. Finally, until it has clearly outlined the standards for eligibility, we urge the Board to delay the adoption and implementation of these guidelines.

This comment addresses the following issues:

1. The proposed guidelines for evaluating account and services requests for depository institutions will create needed consistency, with some revisions. However, the Board relies on Section 19(b) of the Federal Reserve Act (FRA) to define depository institutions, which could include institutions chartered under many novel charter options at the state and federal level, including uninsured depositories.

2. By relying on this definition of a depository institution and giving those institutions the same payment services access that insured depository institutions have, the Board will encourage future applicants to seek novel charters. If those applications are approved, the Board will have expanded one of the primary benefits of a bank charter to a new class of institutions without developing a commensurate set of obligations or a clear duty-to-serve mandate. The Board would also enhance the attractiveness of charters that lack full bank obligations but enable evasion of important state consumer protection laws, especially freedom from usury caps, making those novel charters more attractive to institutions that offer high-cost lending and other problematic services.

3. There are three types of novel charters that the Board should address in its final guidance, and each raises unique risks to the payments system, the Federal Reserve system and the economy.

4. There is considerable evidence that these novel charters will increase in number, suggesting that the Board may be underestimating both the number of applications from institutions availing themselves of these charter options, as well as the risks that an increased number of these institutions pose to the payments system, the Federal Reserve system, vulnerable consumers and communities, and the economy.

5. The Board should revise the definition of a depository institution in its final guidance to limit prospective applications to only those institutions that accept insured deposits and those institutions with parent companies supervised under the Bank Holding Company Act.

6. Separately, the Board should review the implications of expanding access to Federal Reserve account and payments systems as part of the broader set of government-sanctioned competitive advantages that are available to chartered institutions.

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[9] See footnote 5. Federal credit unions operate under a national usury cap, and some state credit unions also operate under a home state usury cap even if they can export that rate to other states.

II. The ability to access accounts and services at Federal Reserve Banks is an important benefit of a bank charter

A. State and national banks have a government-sanctioned competitive advantage over nonbanks

Recipients of bank charters receive several primary benefits that provide them with considerable competitive advantages over nonbank financial institutions. State and national banks have the ability to accept deposits and apply for deposit insurance, which protects their customers from losses related to insolvency and ensures consumer confidence. Consumers have a high degree of confidence in holding money and transacting with an insured depository. As a result, most Americans choose to hold at least one account at an insured depository. National banks and insured state banks have the ability to export the interest rates of their home state and to ignore the consumer protection laws of states outside their home state in some other areas as well. In either case, banks have the ability to lend and transact business based on a uniform set of requirements, usually without comparable federal consumer protection requirements, giving them a considerable competitive advantage over nonbank financial institutions that must maintain licenses and comply with the consumer protection laws in each state in which they do business. A third primary benefit of traditional bank charters is the ability to apply for Federal Reserve Bank master accounts and access to the Federal Reserve payments systems.

When regulators modify the eligibility requirements necessary to access any one of these benefits, we believe it is incumbent on them to consider the implications for all other interrelated benefits and associated obligations.

B. Access to Federal Reserve accounts and payments services conveys benefits to those institutions approved for accounts

Banks that are approved for these benefits can use the FedWire system to send and receive payments, directly access the Federal Reserve Automated Clearinghouse (FedACH) system, access custody and settlement services, gain access to the planned FedNow real-time payments network and obtain intraday overdraft credit. Likewise, Federal Reserve member banks elect the directors of the Federal Reserve Banks and, as such, help set the nation's monetary policy.[10]

III. The proposed guidelines create consistency among applicants but are silent on what firms can apply

A. The proposed guidelines for evaluating account and services requests will create needed consistency among applicants, but the proposed definition of depository institution fails to capture new participants and novel charters

We applaud the Board's effort to provide Reserve Banks with a clear set of account access guidelines to evaluate requests for accounts and services. The proposal addresses this goal in two important ways. First, it requires that applicant institutions be eligible to apply under the FRA and have a well-founded, clear, transparent, and enforceable legal basis for their operations.[11] In addition, the proposal provides a framework for evaluating risk to the Federal Reserve Banks, the payments system, the U.S. financial

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[10] *The Federal Reserve System: Purposes and Functions*. Tenth Edition. Board of Governors of the Federal Reserve System, 2016.https://www.federalreserve.gov/aboutthefed/files/pf_complete.pdf , pg 6..

[11] Proposed Guidelines for Evaluating Account and Services Requests, 86 Fed. Reg. 25866 (May 11, 2021)

system, and for preventing the use of accounts and services to facilitate money laundering, cybercrimes, and other illicit activities.[12]

1. The proposed scope of depository institutions includes uninsured depository institutions

The proposal does not provide any additional clarity on the interpretation of legal eligibility beyond the requirements in II(1)a—a point which the Board recognizes.[13] In II(1), the Board notes that applicants must be legally eligible under the FRA to apply for account access, and in II(1)a, the Board continues that only entities that are member banks or meet the definition of depository institutions under Section 19(b) of the FRA are eligible.[14] This subsection defines depository institutions as insured banks, mutual savings banks, savings banks, credit unions, or institutions eligible to make deposit insurance applications.[15] The following subsection, however, makes it clear that uninsured depositories may also be considered. In addition, the proposed definition affords eligibility to those institutions eligible to apply for deposit insurance—criteria that, in light of the creation of novel charters at the state level, create considerable uncertainty as to the intended scope of the definition.

2. The proposed definition of depository institutions includes a growing number of novel charters

The Board anticipates that the application of these guidelines will be straightforward for some recent novel charters, such as those that propose to take insured deposits. However, it also notes that more extensive due diligence may be required for non-insured institutions.[16] While the proposed definition may be straightforward for insured and chartered depository institutions, a growing number of novel charter types, both federal and state, suggests that the Board may be underestimating both the number and complexity of the applications. This suggests a need for both a careful review of the likely applicants and consideration of the broader public policy implications of this definition.

B. Recent novel charters and novel charter applications highlight the ambiguity in the proposed definition of depository institution

The Board's definition of a depository institution in the proposed guidance is overly broad and ambiguous and could encourage applications from synthetic national fintech charters, a large and growing number of ILCs and state-authorized novel banking charters organized as cryptocurrency custody banks, digital asset depositories, and other uninsured financial institutions. These examples are not one-off examples; they are a growing class of depository institutions. As a result, the proposed definition of depository institution is inadequate to ensure that most applications "will be fairly straightforward to address." Likewise, the activities of many of these institutions may fall well outside the range of activities of typical federally-insured institutions, making the due diligence necessary to implement the proposed account access guidelines onerous or impossible.

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[12] Id.

[13] Id.

[14] Codifed at 12 USC § 461 - Reserve requirements

[15] 12 U.S.C. § 1815(a)

[16] Proposed Guidelines, 86 Fed. Reg. 25867

1. The proposed application for a national bank charter from Figure Bank would create a synthetic fintech charter not anticipated by the Board definition of depository institution

On November 6, 2020, the Office of the Comptroller of the Currency (OCC) published an application for a national bank charter from Figure Technologies, Inc. and Figure Bank (Figure). Figure indicated that it would apply to the Federal Reserve for membership but would not seek deposit insurance.

Figure is a nonbank financial technology company operating in 50 states and the District of Columbia under applicable state licensure privileges and state regulations. Figure originates home equity lines of credit, transmits payments, provides funding to commercial businesses, and manages a marketplace lending platform. Figure uses Provenance, its proprietary blockchain system, to facilitate its operations. Figure also acts as the program manager for a transaction account which is offered in partnership with a separate chartered financial institution.

The structure of the proposed bank raises considerable concern since it follows the unsuccessful effort of the OCC to develop a nonbank so-called fintech charter.[17] The OCC fintech charter would convey the benefits of a national bank, such as access to payments networks and the preemption of state consumer protection and other laws without assigning the recognized obligations of full national banks, such as compliance with the Community Reinvestment Act. Figure opted against a non-depository charter, likely to try to avoid the risk that the charter would be invalidated by the then-pending case in the Second Circuit, *Lacewell v Office of the Comptroller of Currency*, which sought to block the creation of a non-depository charter,[18] though the Figure charter has been challenged on similar grounds.[19] By accepting uninsured deposits at the bank itself and offering insured deposit accounts through a banking-as-a-service partner, the Figure application essentially proposes the creation of a synthetic fintech charter. Likewise, since the bank itself would not hold insured deposits, it would have no obligation under the CRA. While the benefits of preemption are not available to uninsured state-chartered banks, by affiliating itself with an insured bank, Figure can gain the benefits of preemption when it wants them and avoid the obligations of insured depositories when it does not.

In its comment on the application, NCRC and others argued that the OCC did not have the authority to approve this type of synthetic fintech charter since national banks were required to hold deposits and that those deposits were required to be insured.[20]

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[17] "Exploring Special Purpose National Bank Charters for Fintech Companies." Washington, D.C.: Office of the Comptroller of the Currency, December 2016. https://www.occ.gov/topics/supervision-and-examination/responsible-innovation/comments/pub-special-purpose-nat-bank-charters-fintech.pdf.

[18] After the Figure application, the Second Circuit ruled that the case was not ripe, without ruling on the merits. See *Lacewell v. Office of the Comptroller of the Currency,* No. 19-4271 (2d Cir. 2021).

[19] See *Conference of State Bank Supervisors v. Office of the Comptroller of the Currency, et al.*, No. 1:20-cv-03797-DLF (D.C. 2020).

[20] See National Community Reinvestment Coalition, National Consumer Law Center, and Center for Responsible Lending. "Comment to the Office of the Comptroller of the Currency Opposing the Application of Figure Technologies to Form a National Bank," December 7, 2020. https://ncrc.org/ncrc-two-other-consumer-groups-send-comment-letter-opposing-figures-application-for-a-national-bank-charter/.

Figure's application also states that it will apply to be a member of the Federal Reserve without insured deposits. However, all national banks must become members of the Federal Reserve and be insured, as required under the FRA[21], and the Federal Deposit Insurance Act (FDIA).[22] The FRA states:

> "Every national bank in any State shall, upon commencing business or within ninety days after admission into the Union of the State in which it is located, become a member bank of the Federal Reserve System by subscribing and paying for stock in the Federal Reserve bank of its district in accordance with the provisions of this chapter and shall thereupon be an insured bank under the Federal Deposit Insurance Act,[23] and failure to do so shall subject such bank to the penalty provided by Section 501a of this title." 12 U.S.C. § 222.

Thus, under the FRA, every national bank must be a member of the Federal Reserve, and it must also carry insurance. In 501a, the FRA includes the penalty for not having insurance, stating, "If a nationally-chartered institution fails to become or maintain membership in the Federal Reserve, then it must forfeit its charter."[24]

The example of the application for a national bank charter submitted by Figure Technologies and its intent to apply for Federal Reserve membership demonstrate both the intent of some financial technologies firms to gain access to the benefits of Federal Reserve accounts and payments services, as well as the ambiguity that similarly-structured applications would create if they applied for account access under the proposed guidelines.

2. **ILCs accepting insured deposits are difficult to supervise and will increase the number of applications substantially**

In 2020, the Federal Deposit Insurance Corporation (FDIC) announced a final rule to clarify its treatment of applications related to state-chartered industrial loan companies (ILCs). The release of the final rule anticipated an increase in applications for ILC deposit insurance, particularly from financial technology firms.[25] Responding to many of these applications, NCRC noted that these firms posed a considerable risk to the financial system, including anti-trust concerns and the inability to supervise the parent company for privacy, fair lending, or safety and soundness.[26] Many of these same concerns have been raised by the Government Accountability Office.[27]

[21] 12 U.S.C. § 222

[22] 12 U.S.C. § 1811

[23] Id.

[24] 12 U.S.C. § 501a.

[25] See, for example "Comment on Brex's Charter Application." Washington, DC: National Community Reinvestment Coalition, March 15, 2021. https://ncrc.org/download/92001/ and "Consumer and Community Groups Urge FDIC to Deny Insurance Application for Rakuten ILC." Washington, DC: National Community Reinvestment Coalition, February 19, 2021. https://ncrc.org/ncrc-consumer-and-community-groups-urge-fdic-to-deny-insurance-application-for-rakuten-ilc/.

[26] For further discussion on the risks associated with ILCs, see "NCRC, Consumer and Community Groups Urge FDIC to Deny Insurance Application for Rakuten ILC." Washington, DC: National Community Reinvestment Coalition, February 19, 2021. https://ncrc.org/ncrc-consumer-and-community-groups-urge-fdic-to-deny-insurance-application-for-rakuten-ilc/.

[27] "Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority." Washington, DC: Government Accounting Office, September 15, 2005. https://www.gao.gov/assets/gao-05-621.pdf.

An application for access to Federal Reserve accounts and payments services would, in many cases, require additional due diligence, given the limited ability of the FDIC to examine the parent company for safety and soundness. As such, future evaluations of an application under the proposed guidelines would be difficult to evaluate for risks to the payments system and the Federal Reserve system. Given the number of applications pending, and the anticipated volume of applications from fintech firms seeking to preempt state law and gain the competitive advantage that access to payments networks conveys, we expect that the evaluation of these applications will be neither straightforward nor rare.

3. Some state novel charters grant those depository institutions the ability to apply for Federal Reserve membership

In June of 2021, the state of Nebraska enacted the Financial Innovation Act, which, among other provisions, authorized the creation of a digital asset depository (DAD). The act allows DADs to hold digital assets, provide custody services, issue stablecoins, use independent node verification networks and stablecoins for payments activities, and facilitate digital asset business services.[28] DADs are prohibited from accepting demand deposits or making loans in US currency. The Financial Innovation Act does not preclude DADs from making an application for FDIC insurance and, curiously, notes that DADs are eligible to apply for Federal Reserve membership.[29]

In 2019, the state of Wyoming enacted the Special Purpose Depository Institutions Act which authorized the creation of special purpose depository institutions (SPDIs). The Act allows Wyoming banks that receive deposits to engage in activities related to cryptocurrencies. The Wyoming Division of Banking is the primary regulator, and deposit accounts are not required to carry FDIC insurance.[30] However, the law provides that SPDIs are eligible to apply for Federal Reserve membership.[31]

Continued efforts by state legislatures to create novel charters provide additional evidence that the Board's definition of a depository institution in the proposed guidance is overly broad and ambiguous and could encourage applications from cryptocurrency custody banks, digital asset depositories, and other uninsured financial institutions. Given that these entities are solely state-regulated, it is unlikely the Federal Reserve would be able to conduct the due diligence necessary to adequately assess the risks to the payments network, the Federal Reserve system and the economy.

C. There is evidence that opening up the payments system to novel charter financial institutions will increase the risk to the payments system, contrary to the goals of the proposed guidelines

The recent failures of Wirecard and Greensill Capital in Germany highlight the importance of prudential oversight of financial technology firms and the risks of allowing non-traditional banks to gain access to payments and other systems.

In 2006, the technology firm Wirecard acquired a German bank and gained access to credit card payments and issuing networks. By 2017 the bank was furnishing "more than 40 alternative payments methods" and "over 100 transaction currencies," handling over $140 billion of payments annually. However, the bank's

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[28] Nebraska Legislature, *Financial Innovation Act,* LB649. 107th legislature, 1st session (2021) available at https://nebraskalegislature.gov/bills/view_bill.php?DocumentID=44186

[29] Id.

[30] See Wyo. Stat. §13-12-116 *et seq,* and Wyo. Stat. §13-12-108. Required disclosures.

[31] Wyo. Stat. §13-12-103(b)(vi)

reported overseas deposits of €12.4 billion did not exist, and evidence surfaced that bank officials frequently authorized fraudulent transactions to accounts that they controlled. The resulting collapse of Germany's "largest fintech" was a significant embarrassment for German financial regulators and political figures with close ties to the firm.[32]

In 2014, the United Kingdom-based Greensill Capital acquired a German bank and began operating as Greensill Bank. The bank specialized in factoring to high-risk, smaller and newer firms. The bank's ability to expand access to credit for small businesses was widely praised at the time and called "one of Britain's many fintech success stories."[33] However, the firm eventually failed when its invoice-backed bonds failed to provide the short-term liquidity that Greensill had promised to its investors. Moreover, the losses were magnified considerably since many of Greensill's loans were made to major investors in the firm.[34]

In both cases, regulators failed to act quickly enough to avert widespread losses. This inaction was largely attributed to their lack of consolidated supervisory authority over the banks' parent companies. In each instance, the regulators lacked the necessary tools to monitor and address risky practices or prevent loans and fraudulent payment transfers to the banks' parent companies or other firms that benefited the parent company.

Without ensuring the type of consolidated supervision required of insured depositories, the Board risks encouraging or even approving firms similar to Wirecard or Greensill. By doing so, the Reserve Banks would be unable to prevent the risks to the payments network, the Federal Reserve system and the economy that the proposed guidance is designed to prevent.

D. The broad definition of a depository institution in the proposed guidelines has public policy implications and could erode well-established duty-to-serve obligations assigned to chartered financial institutions

The broad definition of depository institution used in the proposed guidance has several unintended consequences: (1) it facilitates the conveyance of a benefit to firms structured in a way to avoid a duty-to-serve obligation, (2) it encourages, rather than prevents evasions of those obligations along with evasion of state consumer protection laws, and (3) it encourages charter arbitrage that will result in reduced commitments to CRA-eligible activities and lower consumer protections.

1. The proposed definition of depository institution provides a competitive advantage to banks without deposit insurance and an obligation under the Community Reinvestment Act

If the OCC approves the application of Figure Technologies to form an uninsured national bank, it encourages the formation of new banks organized along similar lines. Structured in this manner, a national bank would have direct access to the payments networks, a powerful competitive advantage. But without deposit insurance, the bank would be exempt from any obligations under the Community Reinvestment Act.[35]

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[32] Wilmarth, Arthur. "Wirecard and Greensill Scandals Confirm Dangers of Mixing Banking and Commerce." *Banking & Financial Services Policy Report No. 5*, Banking & Financial Services Policy Report No. 5, forthcoming 2021. https://scholarship.law.gwu.edu/faculty_publications/1548. pg. 9

[33] Id. pg. 13.

[34] Id pg. 15.

[35] 12 U.S. Code § 2901 - Congressional findings and statement of purpose

a. Preventing evasions of CRA is an important role of the Federal Reserve Board and other bank regulators

The CRA requires banks to meet the conveniences and needs of the communities where they accept deposits, and its implementing regulations establish rules and enforcement procedures for holding them accountable for doing so.[36] As one of the three banking regulators responsible for implementing CRA, the Federal Reserve Board should closely monitor policy changes that could encourage the evasion of CRA by financial institutions.

b. Low- and moderate-income communities rely on the CRA to receive needed loans, grants, services and investments that they would otherwise not receive were it not for the community reinvestment obligations imposed upon banks as a condition of receiving a charter.

Since 1996, CRA-covered banks have issued $1.156 trillion in small business loans in low- and moderate-income (LMI) tracts and $1.179 trillion in community development loans to support affordable housing and economic development projects that benefit LMI communities.[37]

The Department of the Treasury has estimated that the CRA accounts for 20 percent of the growth in lending to LMI communities, and that CRA-regulated lenders are more likely to originate prime loans to LMI borrowers than are lenders not regulated by the CRA.[38] Additionally, research has confirmed that banks with CRA obligations originated more home purchase loans to LMI borrowers and in LMI census tracts and captured more market share in places where they had assessment areas than lenders without CRA obligations.[39]

The benefits of CRA extend beyond access to credit and services and include gains in other community-level socioeconomic factors. By comparing census tracts where incomes were 80 percent of area medians against those at 79 percent, researchers were able to demonstrate similarly positive effects of CRA eligibility on rates of homeownership, property valuations and rental vacancy rates.[40] Similarly, census tracts that had recently become eligible for CRA coverage had greater increases in mean individual incomes relative to non-eligible tracts.[41]

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[36] Office of the Comptroller of the Currency. "Licensing Manual: Charters," October 2019. https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-licensing-manual/files/licensing-booklet-charters.html/.

[37] National Community Reinvestment Coalition. "Treasure CRA," 2020. https://www.ncrc.org/treasureCRA/.

[38] Robert E. Litan, Nicolas Retsinas, Eric Belsky, and Susan White Haag. "The Community Reinvestment Act After Financial Modernization: A Baseline Report." Washington, D.C.: United States Department of the Treasury, April 2000. https://www.treasury.gov/press-center/press-releases/Documents/crareport.pdf.

[39] William Apgar, Eric Belsky, Mark Duda, Yr-Ru Chen, Nicolas Retsinas, Alexander Von Hoffman, Madeleine Pill, Gary Fauth, and Dawn Patric. "The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System." Cambridge, MA: Joint Center for Housing Studies, March 2002. https://www.jchs.harvard.edu/sites/default/files/media/imp/cra02-1.pdf.

[40] Robert B. Avery, Paul S. Calem, and Glenn B. Canner. "The Effects of the Community Reinvestment Act on Local Communities." Washington, D.C.: Board of Governors of the Federal Reserve System, March 20, 2003. https://www.federalreserve.gov/communityaffairs/national/CA_Conf_SusCommDev/pdf/cannerglen.pdf.

[41] John M. Fitzgerald and Samuel P. Vitello. "Impacts of the Community Reinvestment Act on Neighborhood Change and Gentrification." *Housing Policy Debate* 24, no. 2 (March 25, 2014): 446–66.

c. The loss of CRA eligibility harms communities because they lose the benefits that come from lending institutions that would have otherwise had a community reinvestment obligation.

Research from the Federal Reserve Bank of Philadelphia revealed that "the loss of CRA coverage leads to an over 10 percent decrease in [home] purchase originations by CRA-regulated lenders." The study added that while non-depository institutions did make up for some of the unmet demand, the substitution was not of an equivalent proportion. Non-depositories replaced approximately one-half of the supply that had been offered by covered depositories.[42] The most affected by the loss of CRA eligibility were applicants of color and households with incomes greater than the cutoff threshold for LMI income status. The increased market share claimed by non-depository institutions was accompanied by greater use of more costly FHA lending.[43]

In a study conducted in the following year, the same team observed that the number of loans made to small businesses in the same census tracts also fell dramatically, even when the supply of lending to small businesses in nearby areas remained constant.[44]

In recent years, many areas have lost a sizable portion of their branches,[45] which has reduced the number of banks with CRA obligations in those respective areas. Research shows a strong correlation between the loss of branches and a contraction in the supply of credit, with a prolonged effect on the net amount of small business lending, and with higher-than-normal concentrations of those losses in LMI and high-minority neighborhoods.[46]

2. The proposed definition of depository institution provides a competitive advantage to insured ILCs that lack consolidated supervision and those with insufficient CRA plans

In 2020, the FDIC approved applications for deposit insurance from two ILCs, immediately after it enacted a final rule addressing the ILC approval and supervision process in February 2021.[47] As a result, nonbank firms are permitted to gain deposit insurance for ILCs that offer a full range of loan and deposit products that directly compete with banks, without the supervision under the Bank Holding Company Act necessary to adequately assess the risk of a commercial enterprise engaged in banking. For example, while banks and their parent companies and affliates are subject to Federal Reserve capital and liquidity

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[42] Lei Ding and Leonard Nakamura. "'Don't Know What You Got 'Til It's Gone' — The Community Reinvestment Act in a Changing Financial Landscape." Working paper (Federal Reserve Bank of Philadelphia). Philadelphia, Pennsylvania: Federal Reserve Bank of Philadelphia, February 2020. https://doi.org/10.21799/frbp.wp.2020.08.

[43] Id.

[44] Lei Ding, Hyojung Lee, and Raphael Bostic. "Effects of the Community Reinvestment Act (CRA) on Small Business Lending." Working paper (Federal Reserve Bank of Philadelphia). Philadelphia, Pennsylvania: Federal Reserve Bank of Philadelphia, December 2018. https://doi.org/10.21799/frbp.wp.2018.27.

[45] Board of Governors of the Federal Reserve. "Perspectives from Main Street: Bank Branch Access in Rural Communities." Washington, D.C., November 2019. https://www.federalreserve.gov/publications/files/bank-branch-access-in-rural-communities.pdf.

[46] Hoai-Luu Q. Nguyen. "Are Credit Markets Still Local? Evidence from Bank Branch Closings." *American Economic Journal Applied Economics* 11, no. 1 (January 2019): 1–32. https://doi.org/10.1257/app.20170543 and Ding, Lei and Reid, Carolina Katz, The Community Reinvestment Act (CRA) and Bank Branching Patterns (September 10, 2019). FRB of Philadelphia Working Paper No. 19-36, Available at SSRN: https://ssrn.com/abstract=3474360 or http://dx.doi.org/https://doi.org/10.21799/frbp.wp.2019.36

[47] *Parent Companies of Industrial Banks and Industrial Loan Companies* 86 Fed. Reg 10703

regulation and a prohibition on conducting nonfinancial activities, ILCs are not. As a result, ILCs have become a popular vehicle for many non-depository fintechs to gain access to deposit insurance, payments networks and preemption of state laws—competitive advantages they have long sought.

Since these firms are seeking deposit insurance, they are subject to CRA. However, CRA plans for many of these institutions are often insufficient to demonstrate a commitment to the communities in which the firms plan to do business. This problem has been compounded by the fact that many recent ILC applicants proposed to do business primarily online and claimed the location of their headquarters, often Salt Lake City due to Utah's favorable ILC law, as their only assessment area. Efforts to modernize CRA could and should include changes to the designation of assessment areas to prevent this problem. The FDIC's decision to grant deposit insurance to ILCs, however, represented a substantial erosion of the applicability of CRA to financial technology firms and was made without adequate consideration of the impact on the affirmative obligation of depository institutions to serve the communities in which they do business.[48]

Similarly, granting FDIC insurance to ILCs enables them to take advantage of interest rate exportation and preemption of certain consumer protection laws. It is already evident that some ILCs are engaged in high-cost predatory rent-a-bank lending[49]– extending the advantages of preemption of state usury laws even farther beyond the bank itself. The ability to gain this preemption benefit without oversight of the parent company encourages use of ILCs for high-cost lending, and extending the benefits of access to the payment system would further enhance the attractiveness of ILC charters as a means of preempting state consumer protection laws without the oversight of the parent company that traditional banks have.

Granting Federal Reserve account and payments system access to ILCs, given the lack of consolidated supervision, introduces exactly the type of risk the proposed guidance was designed to prevent. Likewise, the growing number of ILC applications and the popularity of the ILC charter among financial technology firms suggest that these applications will become more frequent than the proposed guidance suggests. Finally, conveying one of the three primary benefits of a bank charter to ILCs without addressing the ILC loophole in CRA sets unacceptably low standards rather than the higher standards the proposed guidance is designed to establish.

3. **The proposed definition of a depository institution may provide a competitive advantage to state-chartered fintech charters that introduce unqualifiable risk to the payments system, the Federal Reserve and the economy**

Both Wyoming and Nebraska have already created non-depository, fintech charters designed to offer financial technology firms the benefits of a banking charter with minimal or no federal supervision. By claiming that firms chartered under these new laws have the ability to apply for Federal Reserve membership, and without the deposit insurance requirement that triggers FDIC supervision, institutions with these novel charters will almost certainly introduce unacceptable risk to the payments system, the Federal Reserve system, vulnerable consumers and communities and the economy if allowed to gain this important bank charter benefit. Likewise, without deposit insurance, they would have no CRA obligation,

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[48] For more information on the designation of assessment areas for banks operating primarily online, see "NCRC Comment on Federal Reserve Board's Advance Notice of Proposed Rulemaking Regarding the Community Reinvestment Act - February 2021." Washington, D.C.: National Community Reinvestment Association, February 16, 2021. https://ncrc.org/ncrc-comment-on-federal-reserve-boards-advance-notice-of-proposed-rulemaking-regarding-the-community-reinvestment-act-february-2021/ pg. 35-37.

[49] *See* Comments of Center for Responsible Lending, National Consumer Law Center (on behalf of its low income clients) et al. to the Federal Deposit Insurance Corporation re Parent Companies of Industrial Banks and Industrial Loan Companies, 12 CFR Part 354, RIN 3064-AF31 (July 1, 2020), https://www.nclc.org/images/pdf/rulemaking/ILC_Comment_FDIC_July-2020.pdf.

providing them with all of the benefits of a bank charter, including preemption of state consumer protection laws, with none of the community reinvestment obligations.

IV. The Federal Reserve can act to reduce the risks associated with providing institutions with novel charters access to Federal Reserve accounts and services and should work with other regulators and Congress where needed

The Federal Reserve has discretion in granting access to its accounts and services.[50] It should use that discretion judiciously when evaluating the risks to the payments system, the Federal Reserve system and the economy posed by the types of institutions discussed in prior sections.

A. Recommendations to clarify eligible depository institutions and prevent charter arbitrage

1. Limit access to accounts and services to insured depositories, taking the risk management criteria in the proposed guidance into consideration

While the proposed guidance lays out some criteria for eligibility, the Federal Reserve has broad authority to reject applications and set the criteria for membership and access to accounts and services. While the proposed guidance states that applicants must be eligible for membership under the FRA or other federal statutes, the pending application of Figure Technologies illustrates one avenue by which financial institutions may seek to gain access without deposit insurance.[51] Likewise, the use of Section 19(b) to define depository institutions would permit uninsured state-chartered institutions to apply.[52]

The Board should limit access to accounts and services to insured depositories. This modification can be made under the Federal Reserve's authority to approve or deny access to accounts and services as discussed in the proposed guidance, by explicitly clarifying that having insured deposits is a pre-requisite for access to accounts and services.[53] While it may be prudent for Congress to modify the definition of "depository institution" in the FRA, the Board should by no means wait for such modification in order to limit risks to the financial system, consumers, communities, and the economy, by establishing this prudent limitation now.

2. Going forward, restrict access to accounts and services to those institutions with parent companies subject to Federal Reserve supervision under the Bank Holding Company Act

The lack of consolidated supervision at foreign firms such as Wirecard and Greensill Bank illustrates the unquantifiable risk that banks owned by commercial firms pose to the payments system, the Federal Reserve system and the economy. As a result, while the six criteria for assessing risks described in the proposed guidance may be sufficient for evaluating prospective applications by depository institutions, they would not provide sufficient authority to examine the parent companies of ILCs for similar or related risks.

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[50] Proposed Guidelines, 86 Fed. Reg. 25867

[51] The OCC has not acted on this application as of June 30, 2021, and the application is subject to litigation. See *Conference of State Bank Supervisors v. Office of the Comptroller of the Currency, et al.*, No. 1:20-cv-03797-DLF (D.C. 2020).

[52] 12 U.S. Code § 461(b)(1)(B)

[53] Proposed Guidelines, 86 Fed. Reg. 25867

While this restriction would address concerns with the proposed guidance, it does not address the full range of concerns with ILCs. Thus, separately, we urge the FDIC to reinstate the moratorium on new ILCs applications, similar to the moratorium included in Dodd-Frank.[54] At the same time, Congress should take the necessary steps to address the ILC supervision, privacy and consumer protection gaps.

B. Coordinate efforts with other federal and state regulators to ensure that the benefits of banking charters are not expanded at the expense of financial institution's duty–to-serve and consumer protection obligations

Access to Federal Reserve accounts and services, deposit insurance, and the ability to preempt state law are important competitive advantages available to financial institutions. Expanding eligibility for these benefits must be weighed carefully against the risks that an individual institution poses. Any action taken must consider the existing balance of benefits and obligations that come with a banking charter. As described in Table 1 above, recently proposed or created novel charters upset this balance, and enable financial institutions to gain many of the benefits of a bank charter with few or none of the obligations.

We urge the Federal Reserve Board to coordinate efforts with other banking regulators and Congress to ensure an appropriate set of benefits and obligations in the final guidance on access to accounts and services and other laws and regulations.

V. Conclusion

Please contact Jesse Van Tol, the National Community Reinvestment Coalition's Chief Executive Officer, NCRC's Vice President of Policy and Research, Tom Feltner, at tfeltner@ncrc.org, Lauren Saunders, Associate Director of the National Consumer Law Center, lsaunders@nclc.org, or Rebecca Borné, Senior Policy Counsel at the Center for Responsible Lending at rebecca.borne@responsiblelending.org for additional information or to discuss these comments in more detail.

Sincerely,

Jesse Van Tol
Chief Executive Officer
National Community Reinvestment Coalition

Lauren Saunders
Associate Director
National Consumer Law Center (on behalf of its low income clients)

Michael Calhoun
President
Center for Responsbile Lending

[54] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 603 (2010)