July 12, 2021

VIA ELECTRONIC SUBMISSION

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

Re: SIFMA Comment on Proposed Guidelines for Evaluating Account and Services Requests (Docket No. OP–1747)

Dear Sirs and Madams:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to submit this letter to the Board of Governors of the Federal Reserve System (the "Board") on the notice regarding proposed guidelines ("Proposed Guidelines") to evaluate requests for accounts and services at Federal Reserve Banks ("Reserve Banks").[2]

SIFMA welcomes the Proposed Guidelines and the Board's efforts to increase transparency and consistency in evaluating requests for master accounts and access to Reserve Banks' financial services. Consistent with SIFMA's membership and organizational focus, our comments in this letter focus on the capital markets issues presented by the Proposed Guidelines and, in particular, the potential negative effects that migration of deposits to Reserve Bank balances could have on core funding and capital markets activities and on the Board's ability to effectively implement monetary policy. As we describe below, pass-through investment entities ("PTIEs"), at present, appear to pose these risks most acutely, although other novel and special purpose charter types also may raise similar concerns.

The Proposed Guidelines raise a number of other important concerns regarding the provision of payment system access to novel and special purpose charters. In fact, allowing new, less-regulated institutions access to the Federal Reserve's payments system has been a long-standing concern of Congress as well as the Board.[3]

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1 SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation, and business policy affecting retail and institutional investors, equity and fixed income markets, and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA").

2 86 Fed. Reg. 25865 (May 11, 2021).

3 For example, one of Congress's primary motives for passing the Competitive Equality Banking Act of 1987 was protecting the payments system from certain types of non-traditional banks because such institutions could be less creditworthy and less able to make qualified credit assessments of their customers than traditional banks. *See* S. Rep. 100-19, 100th Cong., 1st Sess. 10-11 (Mar. 19, 1987) ("The payments

Executive Summary

As explained below, SIFMA:

- Supports the Board effecting its goals of promoting financial stability and facilitating the effective implementation of monetary policy by providing Reserve Banks a transparent and consistent set of guidelines to use to review and evaluate access requests;
- Respectfully requests that the final guidelines explain the Board's concerns in further detail, as doing so should further the Board's financial stability and monetary policy goals and, through the enhanced detail and transparency, promote effective and resilient capital markets; and
- Respectfully requests that the final guidelines recommend that a Reserve Bank deny a PTIE account access unless the applicant proves to the satisfaction of the Reserve Bank and the Board that granting account access to PTIEs would not negatively affect the Board's financial stability and monetary policy goals.

Background

The Proposed Guidelines explain the attractiveness of safe, high-quality liquid balances held in Reserve Bank accounts, particularly during times of financial stress. Some firms have sought charters for uninsured, special purpose depository institutions, to take deposits from institutional investors and invest all or substantially all of those funds in balances at Reserve Banks. These types of institutions are sometimes referred to as pass-through investment entities, because they effectively serve as a pass-through from institutional investors to Reserve Banks. And although PTIEs present these concerns most acutely, other novel and special purpose charter types also may raise similar concerns either now or in the future. Reserve Bank accounts used for these purposes present significant risks to financial stability and the effectiveness and resiliency of capital markets and also may be detrimental to the Board's monetary policy objectives.

For example, if investors that typically provide short-term funding to private financial and nonfinancial firms and state and local governments were to rapidly withdraw such funding in times of stress to deposit these assets at a PTIE or another institution, this dynamic could disrupt the financial system, amplifying systemic stress and having deleterious effects on the efficient functioning of capital markets.

Section 4 of the Proposed Guidelines would require a review of the potential to create undue risk to U.S. financial stability. For instance, section 4.e of the Proposed Guidelines provides that Reserve Banks should consider the extent to which an institution's (or group of like institutions') access to a Reserve Bank account could affect the movement of deposit balances across U.S. financial institutions and harm U.S. financial stability due to such movement of deposits. Likewise, section 6 would require a review of whether an account could adversely affect the Board's ability to implement monetary policy. Section 6.c of the Proposed Guidelines, in particular, instructs Reserve Banks to consider how an institution's access to an account could affect the Board's ability to implement monetary policy in normal times as well as times of stress, such as by affecting the level and variability of demand for and supply of reserves, the level and volatility of key policy interest rates, the structure of key short-term funding markets, and the overall size of the consolidated balance sheet of the Reserve Banks.

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system (which involves wire transfers, book-entry securities transfers, automated clearing house services, and check-collection services, among other things) is highly complex and interdependent, and its effective functioning requires a high degree of trust among the participants. ... These cash and securities transfers create multi-billion dollar overdrafts (which, so long as they are settled before the end of the day, are known as 'daylight overdrafts'). The main safeguard against the rippling effects of a default are the creditworthiness of the bank making the transfer and its willingness to make an independent credit judgment about its customers.").

The Final Guidelines Should Continue to Require Evaluation of, and Also Elaborate Upon, Potential Negative Effects Caused by the Migration of Deposits to Reserve Bank Balances

For the reasons described below, we agree with these considerations and believe they should be given significant weight during the review of an application for a master account.

As the Board noted in a 2019 advance notice of proposed rulemaking (the "2019 ANPR"), PTIEs could reduce liquidity in the general collateral repurchase market and otherwise raise funding costs for businesses and households.[4]

- PTIEs' pass-through access to Reserve Bank accounts would be attractive to lenders in the overnight general collateral repo market due to the high-quality, liquid nature of Reserve Bank balances.[5]
- If such repo lenders were to shift their funds to a Reserve Bank account, through a PTIE, then the demand for (and supply of) repo lending likely would decrease, which could make it more costly for securities dealers to finance inventories of Treasury securities.[6] This result likely would harm a core underpinning of capital markets.
- The Board also noted that a decline in the robustness of the repo market could have implications for the success of using the Secured Overnight Financing Rate ("SOFR") to replace the London Interbank Offered Rate ("LIBOR"), because SOFR is based on the Treasury repo market.[7]
- To summarize the concern presented by this possibility, the Board said: "Such a development could impair the liquidity of the repo market, making it harder for banks to monetize Treasury securities in times of stress" and could raise the "overall cost of Treasury borrowing".[8]
- The 2019 ANPR also notes that shifting investments away from commercial banks could raise bank funding costs as well as the cost of credit to households and businesses.[9]

Further, "if lenders in the federal funds market shifted much of their overnight investment to deposits" at PTIEs, "the federal funds rate could become volatile" and the FOMC may have to "change its policy target on relatively short notice".[10] There may also be spillover effects in markets linked to the federal funds rate.[11] In addition, if a sufficient number of institutional cash investors shifted their money to PTIEs and away from traditional overnight money markets, "the reference rates derived from those markets, such as the overnight bank funding rate, could also become volatile".[12]

Ultimately, the Board noted in the 2019 ANPR that it believes the potential negative impact of PTIEs on monetary policy implementation and financial stability outweighs the benefits of

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4 84 Fed. Reg. 8829, 8830 (Mar. 12, 2019).

5 *Id.*

6 *Id*.

7 *Id.*

8 *Id.*

9 *Id.*

10 *Id.*

11 *Id.*

12 *Id.*

Reserve Banks paying interest on excess reserves ("IOER") to PTIEs.[13] Likewise, and further, due to the aforementioned concerns, we believe that PTIE access to accounts and services of Reserve Banks in general poses significantly more risk than benefit.

We believe that the Board should include the above-described financial stability and monetary policy considerations at 4.e and 6.c of the Proposed Guidelines in the final guidelines. In addition, given that the Board and Reserve Banks already have significant experience with PTIEs and have given significant consideration to the issue of providing PTIEs with account access, we believe that the Board may be more prescriptive with respect to PTIEs in the final guidelines and should more clearly caution Reserve Banks against granting PTIEs access. Specifically, we request that the final guidelines recommend that a Reserve Bank deny a PTIE account access unless the applicant proves to the satisfaction of the Reserve Bank and the Board that granting account access to PTIEs would not negatively affect the Board's financial stability and monetary policy goals, as described above. Such a rebuttable presumption should better protect Reserve Bank reserves and the stability of key interest rates and short-term funding markets.

Conclusion

We agree that financial stability and monetary policy concerns should be evaluated as part of the review of any access request, and thus, we recommend that the final guidelines explain in more detail, including through illustrative, non-exhaustive examples, the potential risks to which they refer, such as the Board did in the 2019 ANPR. In addition, we respectfully request that the final guidelines recommend that a Reserve Bank deny a PTIE account access unless the applicant proves to the satisfaction of the Reserve Bank and the Board that granting account access to PTIEs would not negatively affect the Board's financial stability and monetary policy goals. Providing clearer direction and additional detail should better ensure a common understanding among the Board, Reserve Banks and the public, providing greater transparency and consistency in evaluation of master account applications and, in turn, helping to ensure that U.S. capital markets remain resilient, competitive, and well positioned to drive innovation and growth.

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SIFMA greatly appreciates the Board's consideration of these comments and would be pleased to discuss any of these views in greater detail if that would assist the Board's deliberations. Please feel free to contact me at (202) 962-7452 if you would like to discuss further.

Sincerely,

Peter J. Ryan
Managing Director, Head of International Capital Markets and Prudential Policy

cc: Carter McDowell
Managing Director, Associate General Counsel

David Portilla and Will Giles, Cravath, Swaine & Moore LLP

[13] *Id.* at 8831.