Submitted via e-mail to
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July 12, 2021

Ann E. Misback
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

RE: Proposed Guidelines for Evaluating Account and Services Requests (Docket No. OP-1747)

Dear Ms. Misback:

Payward, Inc. d/b/a Kraken ("Kraken") is pleased to submit this set of comments in response to the Board of Governors of the Federal Reserve System ("Board") notice and request for comment "Proposed Guidelines for Evaluating Account and Services Requests"[1] ("Proposed Guidelines"). Kraken operates an online platform that provides a number of digital asset services to its worldwide customer base, including exchange, staking, custody, and futures trading. An independently operated Kraken affiliate, Payward Financial, Inc. d/b/a Kraken Bank ("Kraken Bank"), obtained the country's first special purpose depository institution ("SPDI") bank charter from the State of Wyoming in September 2020. In October 2020, Kraken Bank applied for a master account with the Federal Reserve Bank of Kansas City. That application remains pending.

A Federal Reserve master account is essential for financial institutions to gain direct access to the Federal Reserve's payment services, and Kraken applauds the Board's goal of issuing guidelines intended to "ensure that Reserve Banks evaluate a transparent and consistent set of factors when reviewing requests for accounts and services."[2] Clarity from the Board regarding the master account application process is long overdue.[3]

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[1] 86 Fed. Reg. 25,865 (May 11, 2021).

[2] Proposed Guidelines at 25,866.

[3] In an April 2017 speech—over four years ago—Board Governor Lael Brainard noted that technology-focused bank charters raised "interpretive and policy issues for the Federal Reserve regarding whether charter recipients would become Federal Reserve members or have access to Federal Reserve accounts and services, such as direct access to payment systems." Lael Brainard, *Where Do Banks Fit in the Fintech Stack?*, Speech to the Northwestern Kellogg Public-Private Interface Conference on "New Developments in Consumer Finance: Research & Practice" (April 28, 2017), *available at* https://www.federalreserve.gov/newsevents/speech/brainard20170428a.htm.

The Proposed Guidelines, however, create *opacity* in the master account application process, not clarity. The Proposed Guidelines set forth six principles that the Board directs Reserve Banks to use in evaluating master account applications. The six principles as drafted are broad, leave wide discretion to individual Reserve Banks, and provide little meaningful guidance to a depository institution seeking master account access as to the likelihood of its application being approved. In their current ambiguous formulation, the six principles will not serve as reliable guidance for evaluation. They will serve as hollow justifications for denial. Given their vagueness, these denials could be based on any number of grounds that are just as likely to be politically-driven as prudential. Even then, there are no assurances that Reserve Banks will apply the factors consistently.

Worse, the six principles create *inconsistency* by establishing a two-track system for applicants seeking master accounts: the Proposed Guidelines subject state-supervised financial institutions without a federal regulator to a more extensive due diligence process than federally-supervised financial institutions. This two-track system is contrary to explicit Congressional intent and the plain text of the Federal Reserve Act, which requires that access to Federal Reserve payment services be offered on a nondiscriminatory basis to *all* depository institutions. This is also antithetical to the Federal Reserve's "longstanding commitment to providing efficient, secure, accessible payments."[4] It creates unnecessary barriers that slow innovation, hinder the ability of financial institutions to bring new and unique financial products to the marketplace, and cause those products to be more expensive. Allowing all legally eligible financial institutions to obtain a Federal Reserve master account and access the payment system directly will deliver a materially stronger, more resilient, flexible, equitable, and innovative U.S. payment system with products and services that better meet consumer needs in a 21st century economy.

I. The Proposed Guidelines create an uneven playing field between federally-supervised and state-supervised financial institutions, contradicting Congressional intent

The Proposed Guidelines, despite their egalitarian aspirations, in practice enshrine a two-track system. One easy, fast-tracked, rubber-stamp system for certain federally-supervised banks, and one more difficult system for state-chartered institutions without a federal regulator. The Board admits as much in its own description of them:

> [g]iven that the proposed guidelines utilize factors broadly applied to federally-insured institutions, the Board anticipates the application of the guidelines to access requests by

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[4] Federal Reserve Bank of Kansas City, "From Then to FedNow: Payments Innovation and the Federal Reserve" (December 18, 2020), *available at* https://www.kansascityfed.org/research/policy-perspectives/payments-innovation-and-the-federal-reserve/

> federally-insured institutions would be fairly straightforward in most cases. Reserve Bank assessments of access requests from non-federally-insured institutions, however, may require more extensive due diligence.[5]

By holding the Reserve Banks to these guidelines and formalizing this two-track system, the Board is implying, erroneously, that federally-supervised financial institutions are better supervised and less risky than state-supervised financial institutions that are not subject to FDIC supervision. This is directly violative of the precepts underlying the dual banking system that has been a hallmark of banking in the United States since Alexander Hamilton founded the First Bank of the United States.[6] These different standards are also contrary to applicable law and the Congressional mandate for the Reserve Banks to make master account access and payment services available to *all* depository institutions on a non-discriminatory basis. Implementing these standards would, with little fanfare and even less statutory support, abandon the Board's foundational policy of equitable access.[7]

A. More extensive diligence for certain state charters disrupts the dual banking system, interferes with state sovereignty, and slows innovation

The Board requiring state-chartered depository institutions with innovative charters to undergo "more extensive diligence," will significantly slow the master account application review process. This is tantamount to removing the depository institution's choice of charter. Given the rapid developments in financial technology, it defies logic that any depository institution would choose a charter that it knows will make it more difficult and more costly for it to obtain a master account and access to payment services.

Choice of banking charter is the foundation of our dual banking system. The dual banking system "provides an important check and balance on arbitrary or capricious regulation."[8] And as the Office of the Comptroller of the Currency observed in describing the importance of dual banking: "Each component of the dual banking system makes different, positive contributions to the overall strength of the U.S. banking system, and efforts to dilute the unique characteristics of

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[5] Proposed Guidelines at 25,866.

[6] The Office of the Comptroller of the Currency, *National Banks and the Dual Banking System* (September 2003) at 3.

[7] "Since its inception, driven by its long-standing policy commitment to promote nationwide access, the Federal Reserve has extended access to depository institutions of all sizes on fair and equitable terms . . ." "FedNow Service Frequently Asked Questions," FAQ 14, *available at* https://www.federalreserve.gov/paymentsystems/fednow_faq.htm.

[8] Christian A. Johnson, *Wild Card Statutes, Parity, and National Banks - The Renascence of State Banking Powers*, 26 Loy. U. Chi. L.J. 351, 362 (1995).

one component of the system undermine the collective strength that comes from the diverse contributions of the two systems."[9]

The "more extensive diligence" requirement would interfere with a state's sovereignty over the parameters of its own bank charters. If the Proposed Guidelines are enacted as drafted, states will likely feel pressure to require their charter to include federal supervision in order to avoid a prolonged review by the Reserve Banks of master account access applications and thereby ensure the competitiveness of their state charters. The Board and the Reserve Banks cannot place such pressure on the states and replace the judgement of elected state legislatures with their own regarding the best ways to innovate. States have long been known as "laboratories for innovation and change"[10] in banking and financial services, and should be allowed to innovate on their own terms. The Board should provide assurances to states that have passed, or are considering passing, laws authorizing an innovative banking charter that lack of federal supervision will not slow the review process.

Finally, at a time when demand for access to electronic payment systems is rapidly increasing,[11] the Board should welcome innovative bank charters obtaining a master account and payment services, not place roadblocks to these charters. Since the Department of Justice declared the Federal Reserve's ACH system an "essential facility" for purposes of antitrust law (leading to the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980), the role of competition in improving payment services has been evident. In the words of the Federal Reserve's Faster Payment Task Force, "achieving the desired faster payments system means fostering competition in a way that enables innovative solutions to enter the market."[12]

B. More extensive diligence is contrary to Congressional mandate and the Federal Reserve Act requirements for non-discriminatory access

By establishing different due diligence criteria for different categories of charters, the Board is acting outside the bounds of its statutory authority and Congress's express intent to ensure non-discriminatory access to Federal Reserve services. Under the Federal Reserve Act, Reserve Banks are required to provide payment services and a master account, to all

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[9] The Office of the Comptroller of the Currency, *National Banks and the Dual Banking System*, at 10.

[10] *Id.*

[11] According to one survey of global bank and payment executives conducted by Accenture, nearly 420 billion transactions worth $7 trillion are expected to shift from cash to cards and digital payments by 2023, and 75%of surveyed bank executives say that the pandemic has increased the urgency of their plans to modernize payment systems. "Payments modernization: Playing the long game" (November 2020), *available at*
https://www.accenture.com/us-en/insights/banking/payments-modernization-playing-long-game.

[12] Faster Payments Task Force, "Challenges and Opportunities," *available at* https://fasterpaymentstaskforce.org/challenges-and-opportunities/.

"depository institutions" and other eligible financial institutions on a non-discriminatory basis. The expansion of master account and payment services eligibility to all depository institutions on a non-discriminatory basis was a significant part of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA"),[13] a sweeping set of banking reforms that was the result of a multi-year effort to update monetary policy by addressing the decline in Federal Reserve membership and fostering private sector competition in the payments system.[14]

The Board and the Reserve Banks provide various payment services under the authority granted in Section 13(1) of the Federal Reserve Act.[15] As amended by Section 105 of the DIDMCA, Section 13(1) of the Federal Reserve Act states that Reserve Banks "may receive from any of its member banks, *or other depository institutions*, and from the United States, deposits of current funds in lawful money" as well as Federal reserve notes, check, and other specified forms of payment.[16] Section 11A, also added to the Federal Reserve Act by the same Section 105 of the DIDMCA, states that all payment and settlement services listed on the Federal Reserve fee schedule ("covered services") "*shall* be available to nonmember depository institutions" and priced the same as for member banks.[17] Section 103 of the DIDMCA added the definition of "depository institution" as used in both Section 13 and Section 11A as, in relevant part, "any insured bank as defined in Section 3 of the Federal Deposit Insurance Act *or any bank which is eligible to make application [sic] to become an insured bank*."[18] This language contains no authorization—nor even any suggestion of congressional intent—to discriminate between state and federal, or insured and uninsured banks.

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[13] P.L. 96-221 (March 31, 1980).

[14] Bill Medley, *Highways of Commerce: Central Banking and The U.S. Payments System,* (Federal Reserve Bank of Kansas City, 2014) at 87.

[15] "The Federal Reserve has long provided payment services under authority of the Federal Reserve Act (See e.g., Federal Reserve Act section 13(1) . . .)." Federal Reserve Board, "Potential Federal Reserve Actions To Support Interbank Settlement of Faster Payments, Request for Comments," 83 Fed. Reg. 57,351, fn. 8 (November 15, 2018).

[16] 12 U.S.C. § 342 (emphasis added); DIDMCA Section 105.

[17] 12 U.S.C. § 248a(c)(2) (emphasis added). "Covered services" are (1) currency and coin services; (2) check clearing and collection services; (3) wire transfer services; (4) automated clearinghouse services; (5) settlement services; (6) securities safekeeping services; (7) Federal Reserve float; and (8) any new services which the Federal Reserve System offers, including but not limited to payment services to effectuate the electronic transfer of funds. 12 U.S.C. § 248a(b).

[18] 12 U.S.C. § 461(b) (emphasis added); DIDMCA Section 103.

Looking at the changes as a whole,[19] along with Congress's general intent in enacting the DIDMCA, it is apparent that: (1) Congress intended for Federal Reserve payment services to be available to both member and nonmember depository institutions; (2) nonmember depository institutions are not required to be insured in order to receive payment services, and (3) because a master account is necessary for a depository institution to receive payment services, master accounts must be made available on a nondiscriminatory basis to all "depository institutions." To put it another way, the DIDMCA "took the central bank out of the business of second guessing the chartering authority's original assessments about whether a financial institution can open its doors."[20]

In sum, the Board's conclusion that applying the Proposed Guidelines to federally-insured institutions would be "fairly straightforward" while application to non-federally-insured institutions would likely require "more extensive due diligence" contradicts the Board's congressional mandate. The Board and the Reserve Banks do not have the legal authority to create a higher standard for a bank to obtain a master account and payment services based on the type of charter or whether it has deposit insurance.

II. The Proposed Guidelines do not achieve the stated goal of transparency and certainty

The Proposed Guidelines are intended to establish a "more transparent and consistent approach"[21] for Reserve Bank evaluations of requests for master account access. Due to the broad nature of the six principles set forth in the Proposed Guidelines, the wide discretion left to individual Reserve Banks, and the lack of a timeline for review of account applications, the Proposed Guidelines as written do not achieve this goal. In order for review of master account applications to be meaningfully transparent and certain, the Board should (1) establish baseline criteria that, if met, would make it more likely than not that a depository institution would have its

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[19] "Object and Policy of Law is Important to Determine Legislative Intent: To determine legislative intent the court should pay due regard to the object in view by looking first to the whole statute." Congressional Research Service, *Statutory Interpretation: Theories, Tools, and Trends* (Updated April 5, 2018).

[20] Peter Conti-Brown, "The Fed wants to veto state banking authorities. But is that legal?", *available at* https://www.brookings.edu/research/the-fed-wants-to-veto-state-banking-authorities-but-is-that-legal/.

[21] Proposed Guidelines at 25,866.

application for a master account approved in a timely manner,[22] and (2) ensure consistent application of the Proposed Guidelines by individual Reserve Banks.

A. The six principles lack meaningful specificity

The six principles and underlying factors the Board proposes are predominantly high-level, sometimes vague, and leave much room for interpretation. Reserve Banks are directed to "assess," "confirm," and make a "judgment" about various aspects of the depository institution's proposed business and operations, all from a risk management perspective. For example, the Reserve Banks are directed to confirm that the applicant has established "clear and appropriate rules to carry out [its] risk management objectives," but there is no further guidance on what should and should not be considered "clear and appropriate" or how an applicant can effectively demonstrate that its risk framework is indeed "clear and appropriate."

> *Principle 1: Each institution requesting an account or services must be eligible under the Federal Reserve Act or other federal statute to maintain an account at a Reserve Bank and receive Federal Reserve services and should have a well-founded, clear, transparent, and enforceable legal basis for its operations.*[23]

Principle 1 provides the most clarity and transparency, but only to the extent it relies on underlying statutory authority. Entities that are member banks or meet the definition of a depository institution under Section 19(b) of the Federal Reserve Act are legally eligible to obtain Federal Reserve accounts and services. As discussed above, the eligibility standards under the Federal Reserve Act clearly apply to both insured and uninsured depository institutions, as well as state-chartered and federally-chartered depository institutions. *We strongly encourage the Board to modify Principle 1 to clarify the Board's interpretation of eligibility, instead of addressing the issue "in the future" as it indicates it may in the Proposed Guidelines.*[24]

Principle 1 goes on to state that a Reserve Bank should assess the consistency of an institution's activities and services with applicable laws and regulations, as well as consider whether the institution's services would impede compliance by the institution's customers with

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[22] As a model, the Board could look to prior rules and guidelines it has issued for fact-based, case-by-case analyses, such as the Board's "Control and Divestiture Proceedings," 85 Fed. Reg. 12,398 (March 2, 2020). In that final rule, the Board stated: "Board determinations regarding the presence or absence of a controlling influence have taken into account the specific facts and circumstances of each case. Nonetheless, the Board has developed over time a number of factors and thresholds that the Board believes generally are indicative of the ability or inability of a company to exercise a controlling influence over another company." *Id.* (internal citation omitted).

[23] Proposed Guidelines at 25,867.

[24] Proposed Guidelines at 25,866.

U.S. sanctions programs, Bank Secrecy Act and anti-money laundering requirements or regulations, or consumer protection laws and regulations. A financial institution's compliance with all applicable laws is, without question, a key factor in the institution's safety and soundness. However, the phrasing of this part of Proposed Guideline 1 is broad and does not appear to provide meaningful additional transparency or clarity to the current application and assessment process of Reserve Banks, which already incorporates a general risk assessment of the applicant depository institution.[25]

> *Principle 2: Provision of an account and services to an institution should not present or create undue credit, operational, settlement, cyber or other risks to the Reserve Bank.*

Principle 2 outlines a number of factors a Reserve Bank should evaluate to assess the risks presented by the applicant financial institution to the Reserve Bank. The Reserve Bank should, among other things, confirm that the institution has an effective risk management framework and governance arrangements, is in sound financial condition, has an operational risk framework in place designed to ensure operational resiliency against events that may impair the institution's use and settlement of Reserve Bank services, and demonstrate the ability (including during periods of idiosyncratic or market stress) to meet all of its obligations in order to remain a going concern and comply with its agreement for a Reserve Bank account and services.

The various requirements in Principle 2 are broad and do not provide any guidance at all as to what standards a Reserve Bank should apply to determine that an applicant meets the various criteria. In addition, Principle 2 states that the Reserve bank should "incorporate, to the extent possible, the assessments of an institution by state and/or federal supervisors into its independent assessment of the institution's risk profile," but the Reserve Bank is not directed to give deference to the institution's primary regulator. This risks the depository financial institution receiving conflicting or contradictory guidance from its Reserve Bank and its primary regulator. Reserve Banks should give deference to the depository institution's primary regulator and, to the extent it disagrees with the primary regulator's assessment, clearly outline the disagreement so that the depository institution, its primary regular, and the Reserve Bank can together discuss possible remedial steps.

> *Principle 3: The provision of an account and services to an institution should not present or create undue credit, liquidity, operational, settlement, cyber, or other risks to the overall payment system.*

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[25] As an example, the Federal Reserve Bank of San Francisco states that master account requests are "generally evaluated on the institution's legal eligibility, business model, financial condition and projected financial performance, compliance with applicable laws and regulations, ownership, and the risk posed to the FRBSF and the payment system." https://www.frbsf.org/banking/about/what-we-do/accounts-services/.

Principle 3 is substantially similar to Principle 2, with a focus on risks to the overall payment system instead of to the Reserve Bank providing the account and services. Principle 3 contains the same shortfalls: the various factors are broad and open to interpretation, and the Reserve Bank is encouraged to incorporate assessments from other supervisors but is not instructed to give that assessment any deference.

In Principle 3, the Reserve Banks are generally directed to assess the effectiveness of the applicant's risk management framework to limit the impact of stress, disruptions, and cyber incidents on the overall payment system. However, the Board does not make clear how a Reserve Bank can evaluate effectiveness for a de novo depository institution that has not yet begun operations or an depository institution with limited operations (the most likely applicants for a master account), or how the depository institution can demonstrate, for example, that a risk management policy that has been adopted but not yet implemented is "effective." Indeed, the six principles are forward-looking and focused on operations rather than assessing suitability at the time of application for master account and payment services. This is an outgrowth of the overall foundation of the six principles, which the Board identifies as "factors [that] are commonly used in the regulation and supervision of federally-insured institutions."[26]

Without operational history or other evidence of compliance, the Reserve Banks are left to fill the informational void to make their risk-based assessment. For innovative depository institutions dealing in new technologies such as cryptocurrencies or with cutting edge business models, there is a real risk of pretextual denials of account applications because the applicant's business "feels" too risky. Additionally, the lack of operational history makes it difficult for an applicant to counter a Reserve Bank's presumption of risks.

> *Principle 4: The provision of an account and services to an institution should not create undue risk to the stability of the U.S. financial system.*

Principle 4 is substantially similar to Principles 2 and 3, and again has similar shortfalls. Principle 4 directs Reserve Banks to coordinate with other Reserve Banks and the Board, which may increase consistency in the application of this Principle. Still, the final risk determination is left to the individual Reserve Banks, which are unlikely to have comprehensive visibility into the stability of the U.S. financial system. Although individual Reserve Banks implement monetary policy and serve on the Federal Open Market Committee on a rotating basis, they do not participate in the Financial Stability Oversight Council ("FSOC"). FSOC is responsible for identifying risks to the financial stability, promoting market discipline, and responding to emerging risks to the stability of the U.S. financial system. At the very least, the Board, which is a member of FSOC, will need to provide specific instructions and criteria for the Reserve Banks to evaluate under this principle.

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[26] Proposed Guidelines at 25,867.

> *Principle 5: The provision of an account or services to an institution should not create undue risk to the overall economy by facilitating activities such as money laundering, terrorism financing, fraud, cybercrimes, or other illicit activity*

Principle 5 directs the Reserve Banks to confirm that the applicant depository institution is in compliance with applicable requirements under the Bank Secrecy Act and Office of Foreign Asset Control regulations. It does not impose any additional requirements on the applicant depository institution because every financial institution applying for a master account will have these programs and policies in place as required by law. Principle 5 does not require the Reserve Bank to do an independent assessment of the adequacy of the financial institution's anti-money laundering program. To ensure consistency and to avoid a depository institution receiving conflicting views from its primary supervisor and a Reserve Bank, Principle 5 should clarify that the Reserve Bank's review should be limited to confirming the existence of these compliance programs and that they contain the enumerated elements.

> *Principle 6: The provision of an account or services to an institution should not adversely affect the Board's ability to implement monetary policy.*

The criteria in Principle 6 are particularly opaque and high level. The Reserve Banks are directed to consider, among other factors, whether access to a master account and service could affect "the overall size of the consolidated balance sheet of the Reserve Banks," and "the level and volatility of key policy interest rates," and well as to consider "implications of providing an account to the institution in normal times as well as in times of stress . . . regardless of the current monetary policy implementation framework in place."[27] From just the plain text of Principle 6, it is difficult to ascertain what the Board's goal is, as "monetary policy" itself is complex and multifaceted.[28]

Furthermore, monetary policy is set by the Board and the Federal Open Market Committee ("FOMC"), not by the Reserve Banks (although the Reserve Banks sit on the FOMC on a rotating basis). The Board and the FOMC then direct the Reserve Banks on implementation of monetary policy. If there are policy concerns with respect to financial institutions having access to a master account or payment services, the Board should directly address those concerns and clarify them in any master account guidelines.

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[27] Proposed Guidelines at 25,869.

[28] Under the Federal Reserve Act, the Board and the Federal Open Market Committee's mandate is to "maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." 12 U.S.C. § 225a.

B. The vagueness of the Proposed Guidelines threatens to politicize the master account application process

Principles, by their nature, are intended to be broad. The principles in the Proposed Guidelines, though, will be implemented on a national stage where they will be interpreted subject to intense media coverage, perceived social trends, and individual moral preference. The breadth of the Proposed Guidelines, in short, makes their implementation especially vulnerable to political whim and moralism—influences from which the Federal Reserve has historically insulated itself.

In their current breadth, Proposed Guidelines are less likely to be relied on as prudential guardrails for evaluation than they are as pretextual justifications for denial. Applicant Alpha, for example, might not be rejected explicitly because of its political alignment, but under the Proposed Guidelines it could conceivably be rejected pretextually because its approval would "risk the stability of the U.S. financial system." Applicant Beta might not be rejected explicitly because it planned to service a morally controversial, but plainly legal industry, but under the Proposed Guidelines, it could be rejected pretextually because it "created an undue risk of… illicit activity." Neither applicant should be rejected based on the equitable intent of the Proposed Guidelines, but they could end up rejected because of the politicization of the Federal Reserve fueled by the Proposed Guidelines' breadth.

There is precedent for this politicization of regulatory guidance. From 2013 to 2017, a Department of Justice initiative called "Operation Chokepoint" caused legal but politically disfavored businesses such as payday lenders to have their banking and payment processing relationships terminated. In earlier supervisory guidance, the FDIC had identified payday lenders and third party payment processors as being "higher-risk," based partially on the reputational risk of banks serving these disfavored businesses.[29] Once the Department of Justice started sending subpoenas to banks and payment processors focusing on their relationships with these "higher-risk" businesses, the banks and payment processors began terminating these customer relationships. Without access to the banking and payments system, these businesses could not continue to operate. Through indirect pressure based on regulatory guidance, the Department of Justice and the FDIC were, in fact, setting policy by forcing legal businesses to cease operations.

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[29] FDIC Office of Inspector General report number AUD-15-008, "The FDIC's Role in Operation Choke Point and Supervisory Approach to Institutions that Conducted Business with Merchants Associated with High-Risk Activities," (September 2015).

C. The discretion Reserve Banks have under the Proposed Guidelines hampers consistency

The Proposed Guidelines give the Reserve Banks discretion in both reviewing applications for a master account and services (discussed above in the analysis of the six principles), and whether to place any conditions on that access. The Proposed Guidelines state that in granting account access, a Reserve Bank

> 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.[30]

In addition, the Proposed Guidelines are "designed as a risk management framework"[31] and, by their very nature, are highly subjective. Two Reserve Banks could easily have conflicting views on the types and level of risks presented by an applicant's operations and business model, leading to inconsistent results. The Board should implement a method for monitoring Reserve Bank evaluations of account access applications to ensure consistency across the Federal Reserve System, such as reviewing Reserve Bank decisions on an annual basis. In addition, the Board and the Reserve Banks should also consider whether public disclosure of master account access applications and decisions would increase consistency.

D. Lack of a time period for reviewing applications results in uncertainty

The Proposed Guidelines do not recommend a timeline in which a Reserve Bank should be expected to review an application and make a decision, leaving the timing entirely to the discretion of the Reserve Banks. Without more clarity on expected timelines, applicants are unable to plan for commencement of operations or expansion of payment services, and are unable to make adjustments to their operations to address any concerns that the Reserve Bank may raise during the course of the application review. Such delays hinder the ability to bring innovative products to the marketplace, and restricting innovation increases costs to the consumer.[32]

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[30] *Id.* at 25,867.

[31] *Id.* at 25,866, fn. 1.

[32] "We do not want to unnecessarily restrict innovations that can benefit consumers and small businesses through expanded access to financial services or greater efficiency, convenience, and reduced transaction costs." Lael Brainard, *Where Do Banks Fit in the Fintech Stack?, supra* note 3.

Delays are especially problematic for de novo banks, which commonly have a specified period of time from the date their charter is granted to begin operations. If a de novo institution's application for a master account is not reviewed in a timely manner, they will not be able commence operations during the required time period without a modification to their planned operations, and may lose their banking charter through no fault of their own. De novo institutions could simultaneously pursue a correspondent bank relationship in order to gain access to the payment system, but such a relationship requires a significant investment of time and effort in both establishing the relationship itself and in creating the technological systems for integrating the correspondent bank and the de novo bank. Imposing such a requirement would unfairly favor incumbents, and the costs of satisfying it would be passed along to the end user in the form of more expensive financial services.

Finally, without a final determination from a Reserve Bank regarding a request for access to a master account and services, an applicant will be challenged to pursue any administrative or legal remedies to which it may be entitled, since a court might find that a final determination is a prerequisite to making certain claims of injury.[33] In establishing criteria for review of a master account application, the Board should include guidance on expected timelines.

III. Allowing all eligible financial institutions access to Federal Reserve services will decrease risks to the U.S. financial system

The Proposed Guidelines do not meaningfully add to the ability of the Board and the Reserve Banks to monitor the risks and benefits of innovative bank products. The Reserve Banks and the Board currently employ a number of risk management practices that include the monitoring of the condition of institutions with accounts and services on an ongoing basis using supervisory ratings, capitalization data, and supplementary information. The same risk management practices can continue to be employed to ensure that the provision of a master account and services to a particular depository institution does not create undue credit, operational, settlement, cyber, or other risks to the Reserve Bank or the Board.

The Board and Reserve Banks can better monitor the risks and operations of financial institutions that directly use its payment services than those financial institutions that utilize correspondent banking relationships and "shadow banks" to access the payment system. Information gathered directly from financial institutions with a master account will assure that the Board has better insights into the salient risks to be included in the stress tests and its setting of the capital/reserve requirements across the entire U.S. financial system. This ability to directly

[33] In *TNB USA, Inc. v Federal Reserve Bank of New York*, 2020 U.S. Dist. LEXIS 62676 (S.D.N.Y. 2020), the United States District Court for the Southern District of New York granted the Federal Reserve Bank of New York's ("FRBNY") motion to dismiss based on the premise that the FRBNY had not yet issued a decision on TNB's application for a master account, thereby causing TNB to lack standing and rendering TNB's claims unripe. At the time of the court's decision in March 2020, TNB's application had been officially pending for almost 2 years, and it had engaged in discussions with the FRBNY approximately 6 months prior to filing the official application.

gather information is especially valuable with respect to innovative bank charters and business models where there is often little historical data regarding risks and benefits, and would allow the Board to more accurately and quickly monitor trends and risks. Steering innovative financial services providers to "shadow banking" is contrary to long-standing Board policy of "permitting socially beneficial innovations to flourish, while ensuring the risks that they may present are appropriately managed, consistent with the legal requirements."[34]

Curiously, the Board does not discuss any of the benefits to allowing innovative depository institutions to have a master account and instead the Proposed Guidelines "focus on risks an institution's access could pose."[35] Yet the Board acknowledges in a footnote that "an institution's access could have net benefits to the financial system that are not a focus of the risk management framework."[36] To the extent that the Board provides guidance to the Reserve Banks regarding master account access, that guidance should highlight both the benefits and the risks that the Reserve Banks should weigh in their analysis. A complete risk analysis must weigh *both* risks and benefits.

IV. Conclusion

We support the Board's goal of increasing transparency and certainty in the master account application process. The Proposed Guidelines, however, provide little clarity regarding what applicants need to demonstrate to meet their various requirements. Indeed, we have ourselves carefully studied the Proposed Guidelines with the aid of counsel and have not developed any better insight into the likelihood of Kraken Bank's pending master account application being approved or denied. We expect the Reserve Banks would not divine any greater clarity from them, either. In practice, implementation of the Proposed Guidelines as drafted, without providing further clarity as set forth in these comments, would do more to justify vague, politically-motivated denials by Reserve Banks than guide prudent approvals. The Board should not risk enabling the politicization of the master account application process.

Similarly, the Proposed Guidelines as currently drafted enshrine a discriminatory approach to application evaluation. They, by the Board's own admission, subject state-supervised banks to a more difficult diligence process than federally-supervised banks. This not only exceeds, but contradicts, the Board's congressional mandate. It is also misguided: Allowing well-supervised state-chartered depository institutions to obtain a master account reduces risk to the payment system. Innovative bank charters such as the SPDI are generally subject to the same banking laws and regulations as other banks chartered in the same state. They are required to undergo the same comprehensive exams for the same compliance categories (safety and soundness,

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[34] Lael Brainard, *Where Do Banks Fit in the Fintech Stack?*, *supra* note 3.

[35] Proposed Guidelines at 25,866, fn. 1.

[36] *Id.*

anti-money laundering, cybersecurity, etc.) to ensure that their services do not facilitate activities such as money laundering, terrorism financing, fraud, cybercrimes, or other illicit activity.

If there are policy or other concerns that the Board has with respect to innovative depository institutions accessing Federal Reserve services, a more focused and direct discussion of those concerns and possible ways to address or mitigate them would be more effective and appropriate. As always, we welcome discussions with the Board, the Reserve Banks, and other federal financial regulators on the benefits and risks of innovative bank charters, and the Wyoming SPDI charter in particular.

Thank you for your consideration. We would be pleased to provide additional detail at your request. You may contact us at legal@kraken.com.

Sincerely,

Payward, Inc.