January 17, 2023

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

RE: Guidelines for Evaluating Account and Services Requests, Docket No. OP-1788

Dear Secretary Misback:

Thank you for the opportunity to provide comments on the Proposed Guidelines Evaluating Account and Services Requests.

The National Community Reinvestment Coalition (NCRC) is an association of more than 600 community-based organizations that promote access to basic banking services, including credit and savings. Our members, including community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing, civil rights groups, and minority and women-owned business associations, help create and sustain affordable housing, job development, and vibrant communities for America's working families.

Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has worked for consumer justice and economic security for low-income and other disadvantaged people in the U.S. through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training.

Arthur E. Wilmarth, Jr. is Professor Emeritus of Law of George Washington University Law School.

The composition of our comments falls into two categories. We agree with the Federal Reserve's intention to provide greater clarity on how it will evaluate applications. But we remain opposed to the possibility of accounts for the uninsured institutions in Tier 2 and Tier 3, which will permit evasions of vitally important banking laws, create substantial risks to the financial system, and give banking privileges to institutions without banking obligations, including community reinvestment

I. The Federal Reserve has the authority to determine guidelines for master accounts.

i. The Federal Reserve Act (FRA) rightfully confers the right to determine access to Fed services to the Federal Reserve and only to the Federal Reserve.

ii. States may see regulatory arbitrage as an economic opportunity. By not clarifying that it will establish these boundaries, the Federal Reserve will invite political pressure and litigation that

would challenge its unique authority to determine which financial institutions have access to master accounts.

II. Public Disclosure. The Board should seek to provide transparency on the status of account access in a timely fashion.

i. The Federal Reserve should increase the transparency surrounding reviews for master accounts and other Fed services. It should publish information on pending applications, take comments from the public, and provide a list of all current account holders.

ii. Reporting tools should provide adequate detail to meet the needs of the public.

III. By providing accounts to Tier 2 and Tier 3 institutions, the Board would introduce unnecessary risks into the payments system.

i. Providing master account access to Tier 2 institutions would permit evasions of vitally important banking laws and encourage regulatory arbitrage.

ii. Providing access to master accounts to Tier 3 uninsured and unsupervised institutions will create substantial risks to the financial system.

iii. Access to the payment system by Tier 2 and Tier 3 institutions could lead to violations of the EFTA and consumer protection problems

iv. Only institutions with community reinvestment obligations should receive the benefit of a master account.

DISCUSSION

I. The Federal Reserve has the authority to determine guidelines for master accounts.

i. The Federal Reserve Act rightfully confers the right to determine access to Fed services to the Federal Reserve and only to the Federal Reserve.

Several states have passed laws permitting their state banking regulators to grant charters to novel depository institutions that are not insured by the Federal Deposit Insurance Corporation (FDIC). These include charters for trust companies and state-chartered depositories that hold crypto-assets. Legislators have spoken on behalf of institutions chartered under these programs that seek access to Fed master accounts.

If uninsured depositories could qualify for a master account simply by having a state charter, then the Federal Reserve would no longer have the authority to determine who can use its services. In such a context, approvals for master accounts for such institutions could be awarded by a state agency even though that agency does not have supervisory powers equivalent to those of the Federal Reserve and the deposits of its chartered institutions are not protected by the FDIC.

The Federal Reserve should state that it has exclusive authority to determine which institutions can access its services.

Several existing rules lay out conditions for access to Fed services. First, holders of master accounts must necessarily be members of the Federal Reserve. Second, the definition of a depository is one that is

insured or eligible for insurance by the FDIC, an insured credit union or one that is eligible to become one, a savings bank, a mutual savings bank, or a Federal Home Loan Bank member.[1]

The payments ecosystem would benefit from regulatory clarity and consistency if the Board of Governors provided clear criteria for eligibility for a master account. For a financial institution to have access to Federal Reserve payment services, it must have an account at one of the twelve Federal Reserve Banks. In recent years, one of the Federal Reserve Banks has shown a willingness to provide master accounts to state-chartered uninsured digital depositories. That approach has led to an outcome where criteria differ across various districts. Standards should be consistent. The Board of Governors could create uniformity throughout all Bank districts by issuing rules.

> *ii. States may see regulatory arbitrage as an economic opportunity. By not clarifying that it will establish these boundaries, the Federal Reserve will invite political pressure and litigation that would challenge its unique authority to determine which financial institutions have access to master accounts.*

Recently introduced legislation would compel the Federal Reserve to grant a master account to any depository institution with a state banking charter.[2] If passed, the law would give state banking regulators the authority to determine when a depository institution can qualify for Federal Reserve services. If implemented, that approach would encourage states to use regulatory arbitrage for their gain.

The introduction of novel state charters may stem from incentives that run counter to the best interests of the United States as a whole. Economic development policy based on regulatory arbitrage is not new in banking. The inspiration behind new crypto-chartering regimes in Wyoming and Nebraska[3] is similar to earlier agendas in Delaware and South Dakota, where each attracted issuers of credit cards to their states by loosening their limits on interest rates. In those states, tens of thousands of new banking jobs were created, and tens of millions in new taxes were collected.[4]

But the result was a race to the bottom as states worked to keep or attract banks, leading to immense consumer protection problems in the credit card and other markets. States also do not have the ability or responsibility to consider the impacts that novel charters may have on the stability of the country's, and the world's, financial system. The recent collapse of FTX and the unanticipated contagion that resulted is an early warning sign.

Prior to 2019, every state required state-chartered banks that accepted deposits from the general public to obtain federal deposit insurance. State laws requiring federal deposit insurance for deposit-taking banks were the product of hard experience during the savings and loan and banking crises of the 1980s and early 1990s. During those crises, systemic failures occurred among state-chartered depository institutions that relied on state-sponsored deposit insurance schemes. The collapse of state-sponsored deposit insurance

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[1] 12 U.S.C. § 461(b).

[2] *S. 4356 Lummis-Gillibrand Responsible Financial Innovation Act* (2021/2022). (2022, November 15). https://www.congress.gov/bill/117th-congress/senate-bill/4356/text#toc-id28ad78b48a4c49699282349b3ac836d6 See S. 4356 Sec. 702 Eligibility for Federal Reserve Services to Depository Institutions.

[3] Nebraska Financial Innovation Act, Pub. L. No. LB649 (2021). https://nebraskalegislature.gov/bills/view_bill.php?DocumentID=44186

[4] Eleanor Erdevig. (1988). Small States Teach a Big Banking Lesson. *Chicago Fed Letter*, *10*. https://www.chicagofed.org/publications/chicago-fed-letter/1988/june-10

schemes inflicted severe losses on depositors and local economies in several states, including Colorado, Ohio, Maryland and Rhode Island.[5]

Despite that experience, Wyoming's legislature passed a bill in 2019 creating a chartering regime that permits "special purpose depository institutions" (SPDIs) to provide custodial, deposit-taking, and other services for crypto activities.[6] While an SPDI may obtain FDIC deposit insurance, it is not required.[7] In 2020, Wyoming's Division of Banking approved a charter application from a cryptocurrency exchange. The applicant has used that charter to accept digital deposits and provide fiduciary services.

In 2022, a group of three US Senators and four US Congressmen filed a brief with the U.S. District Court in Wyoming where they argued that the Federal Reserve Bank of Kansas City was obligated to recognize a Wyoming-based SPDI as a state-chartered depository institution and grant it a master account. If it did not, they contended, the Fed would have exceeded the limits of the powers granted to it by Congress.[8]

Wyoming's SPDI charter represents another regulatory arbitrage scheme that imposes unacceptable risks on the rest of the country, especially in view of the ongoing "crypto winter" that has inflicted tens of billions of dollars of losses on millions of people who invested their money in crypto products. Wyoming Banking Commissioner Albert Forkner referred to the success experienced by Delaware and South Dakota with credit cards when he said, "Wyoming wants to be 'Silicon Prairie.'"[9] Similarly, the sponsor of Nebraska's Financial Innovation Act described chartering uninsured digital depository institutions as a potential boon to his state's economy, stating, "I'm looking for ways to create high-skill, high-wage jobs in the middle of America."[10] Like Wyoming, Nebraska did not consider the risks that its crypto charters would pose to the rest of the country. Four newly-chartered Wyoming SPDIs have built headquarters in the state and hired local staff.

A state's granting of a banking charter should not be the sole basis for qualifying for a Fed master account. Providing Fed master accounts to uninsured state-chartered depository institutions would give them highly significant federal benefits, including access to the Fed's clearing and settlement services for payments as well as the Fed's guarantees for intraday overdrafts and interbank payments made on Fedwire. Decisions to extend those federal benefits to uninsured state-chartered depository institutions would create very substantial risks and costs for the Fed. Such decisions cannot depend solely on the whim and discretion of state legislators and regulators.

The FRA addresses the treatment of applications from state member banks. In Section 9, the FRA indicates that any bank chartered by a state can apply but such applications must be made to and approved by the Board of Governors. Thus, approval of Fed membership for state-chartered banks is conditioned on the decision of the Board; there is no path where another entity determines eligibility.

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[5] Arthur E. Wilmarth, Jr., "Gillibrand-Lummis crypto bill ignores the lessons of history," American Banker (June 17, 2022), https://www.americanbanker.com/opinion/gillibrand-lummis-crypto-bill-ignores-the-lessons-of-history.

[6] Wyo. Stat. § 13-12-101

[7] Wyoming Division of Banking. (n.d.). *Special Purpose Depository Institutions*. Retrieved January 6, 2023, from https://wyomingbankingdivision.wyo.gov/banks-and-trust-companies/special-purpose-depository-institutions

[8] Kyle Campbell. (2022, September 28). Lawmakers join Custodia's legal battle with KC Fed over master account. *American Banker*. https://www.americanbanker.com/news/lawmakers-join-custodias-legal-battle-with-kc-fed-over-master-account

[9] Carolyn Duren. (2020, September 23). Wyoming aims to become "Silicon Prairie" with 1st cryptocurrency bank. *S&P Global Market Intelligence*. https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/wyoming-aims-to-become-silicon-prairie-with-1st-cryptocurrency-bank-60423622

[10] Penny Crosman. (2021, October 18). States take lead on crypto bank charters and digital asset rules. *American Banker*. https://www.americanbanker.com/news/states-take-lead-on-crypto-bank-charters-and-digital-asset-rules

However, unless the Federal Reserve clarifies that it is the only entity with authority to determine master account access, more states might follow Nebraska and Wyoming's misguided examples. An Illinois bill to create a state crypto charter passed the House and has been read in the Senate, although the legislation does not address the expectations for eligibility for a master account.[11] Nonetheless, Wyoming's first-mover gains could tempt other states to create similar chartering regimes, putting in play a potential "race-to-the-bottom" that permits risk and undermines federal supervision.

For these reasons, the Federal Reserve must reaffirm its exclusive authority to determine eligibility. It must end the uncertainty surrounding the question of who can determine eligibility for master account access. To wait further encourages more states to follow Wyoming's path, leading to more confusion and controversy.

II. Public Disclosure. The Board should seek to provide transparency on the status of account access in a timely fashion.

i. The Federal Reserve should increase the transparency surrounding reviews for master accounts and other Fed services. It should publish information on pending applications, take comments from the public, and provide a list of all current account holders.

The proposed Account Access Guidelines call for the Board to provide a "transparent, risk-based, and consistent set of factors" for reviewing applications for master accounts and services.

Transparency will benefit many parties in the banking regulatory ecosystem. For the public, greater transparency should enhance their understanding and awareness of these concerns. In practice, interest is likely to be narrow. However, the depth of concerns among those audiences is high, given the rapid evolution in how payments are made and deposits are held. It has only been a few years since the issue of how digital assets are situated in the banking system arose, but the questions posed will not go away, and they will likely increase.

The Federal Reserve should provide notice to the public when a formal application for services has been submitted. The information should be made available through an online portal and be published in the Federal Register. The same portal should keep a running list of all pending applications. The Federal Reserve should take comments from the public on those applications.

If these steps were introduced, the level of transparency associated with reviewing applications for master accounts would be consistent with the standards associated with banking charter applications. In the supplementary discussion section of the notice for comment, the Federal Reserve expresses concerns that too much transparency could put applicants at risk of suffering reputational harm. However, those same concerns exist when regulators review banking charter applications. Regulators have found solutions to mitigate those concerns elsewhere.

ii. Reporting tools should provide adequate detail to meet the needs of the public

In Section 3 of the Account Access Guidelines, the Federal Reserve proposes to produce two quarterly reports. One would indicate the federally-insured institutions with access to accounts and services, and the other would provide the same information for institutions that do not have federal deposit insurance. However, the report would only contain two descriptors: the name of the institution with the account and

[11] *Illinois General Assembly—Bill Status for HB3968*. (n.d.). Retrieved January 6, 2023, from https://www.ilga.gov/legislation/BillStatus.asp?DocNum=3968&GAID=16&DocTypeID=HB&LegId=133083&SessionID=110&GA=102

the Reserve Bank District where it is located. A separate report would indicate changes to the list of account holders since the previous one.

The Board should ensure that these disclosures are produced in a way that is easily accessed and interpreted by the public. As a temporary measure, the Board could publish the information in a sortable list on its website. However, to fully meet the needs of the public, the Board should commit to creating an online, searchable database.

III. By providing accounts to Tier 2 and Tier 3 institutions, the Board would introduce unnecessary risks into the payments system.

i. Providing master account access to Tier 2 institutions would permit evasions of vitally important banking laws and encourage regulatory arbitrage.

Requiring FDIC insurance for access to Fed master accounts will ensure the presence of robust federal safety and soundness supervision. In contrast, without a requirement for FDIC insurance, there will not be a duty to protect depositors, any obligation to pay risk-based deposit insurance premiums, any access to the financial resources of the Deposit Insurance Fund (DIF), or the safeguards provided by the FDIC's supervisory authority. Consequently, there will be a much higher probability of excessive "risk-taking" by Tier 2 and Tier 3 institutions.

The Federal Reserve Act (FRA) speaks directly to the question of membership in the Federal Reserve. It states that all national banks must necessarily become members.[12] The FRA also provides that all national banks must have deposit insurance. Any uninsured deposit-taking national bank must forfeit its charter.[13]

Tier 2 (eligible institutions that are not federally insured but are subject to federal prudential supervision and, if applicable, at the holding company level) and Tier 3 (eligible institutions that are not federally insured and not subject to prudential supervision at the institution or banking holding company level)[14] will be uninsured and thus not suitable for inclusion inside the payments system. For example, a request for services by a depository of digital assets would not meet the relevant definition of depository institution because institutions that do not accept deposits in fiat currency are not depository institutions as defined in the FRA and other federal statutes. Only Congress, not the Board, has the authority to change the definition of "depository institution" to include institutions that do not accept deposits in fiat currency.

Limiting membership to FDIC-insured and federally-supervised depository institutions will not undermine innovation. Many non-bank payment providers are able access Fed services indirectly through a relationship with a correspondent bank that is FDIC-insured and a member of the Federal Reserve. As a result, access to Fed services is possible but inside a safe framework.

Granting unwarranted master account privileges to uninsured depository national banks would also risk undermining consumer protections, especially state usury laws.[15]

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[12] 12 U.S.C. § 222.
[13] 12 U.S.C. § 222 501a.
[14] The Board of Governors of the Federal Reserve System. (2022, August 19). *Guidelines for Evaluating Account and Services Requests*. Federal Register. https://www.federalregister.gov/documents/2022/08/19/2022-17885/guidelines-for-evaluating-account-and-services-requests
[15] See 12 U.S.C. § 85.

ii. Providing access to master accounts to Tier 3 uninsured and unsupervised institutions will create substantial risks to the financial system.

The lack of federal oversight of Tier 3 entities is a fatal flaw, as shown by the systemic problems caused by uninsured institutions in this country and other countries.[16] Tier 3 combinations could permit largely unsupervised tie-ups between the payments system, Big Tech firms, and cryptocurrency issuers. Allowing master accounts for these institutions would undermine and threaten to destroy our nation's long-established policy of separating commerce and banking.

Providing master accounts to non-federally-supervised institutions that want to accept and transfer uninsured deposits without being subject to consolidated federal supervision of their parent companies would create dangerous supervisory gaps in the financial system that Big Tech firms could exploit. Such a decision could compromise consumer privacy. As well it could undermine competition in commercial sectors.

Protecting the financial system from money laundering, tax evasion, and other forms of illicit finance is a primary rationale for requiring consolidated federal supervision of all institutions with access to master accounts.

iii. Access to the payment system by Tier 2 and Tier 3 institutions could lead to violations of the EFTA and consumer protection problems

One reason that some Tier 2 and Tier 3 entities seek access to master accounts is to enable them to access the payment system for purposes of transferring crypto-assets. Yet those who transfer crypto-assets do not comply with the Electronic Fund Transfer Act (EFTA). That is yet another reason why those entities should not be given access to master accounts.

We are in the midst of an explosion of fraud and other problems involving crypto-assets.[17] In addition to defrauding consumers into sending funds to criminals using crypto-assets, criminals have also hacked into crypto-accounts to drain their assets. This unauthorized access may happen in a variety of ways, including hacking of insecure crypto exchanges, tech support scams used to obtain remote access to consumers' computers, and the unauthorized creation of accounts at crypto exchanges in the consumer's name.

The EFTA gives consumers critical protection against unauthorized charges and errors impacting electronic fund transfers. The EFTA and Regulation E cover not only bank accounts, but also digital wallets and other types of prepaid accounts that may be held by banks or nonbank entities. Yet it is unclear whether and how the EFTA covers transfers of crypto-assets. There is a plausible argument that it does in some circumstances, at least if crypto-assets are used as a form of payment or person-to-person fund transfer. Yet, today, consumers are being given no recourse when their crypto accounts are hacked or there are errors in those accounts. Compliance with liability protection for unauthorized transfers and errors may be difficult to impossible given the way crypto-assets are designed to prevent transfers from being reversed and given the decentralized way in which crypto-assets are held and controlled, with no clear supervised entity taking responsibility for making consumers whole.

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[16] Wilmarth, A. E. (2020). The OCC's and FDIC's Attempts to Confer Banking Privileges on Nonbanks and Commercial Firms Violate Federal Laws and Are Contrary to Public Policy. *Banking Policy & Financial Services Polity Report No. 10*, *81*. https://papers.ssrn.com/abstract=3750964

[17] *See, e.g.,* Consumer Financial Protection Bureau, CFPB Publishes New Bulletin Analyzing Rise in Crypto-Asset Complaints (Nov. 10, 2022), https://www.consumerfinance.gov/about-us/newsroom/cfpb-publishes-new-bulletin-analyzing-rise-in-crypto-asset-complaints/; Federal Trade Comm'n, Reports show scammers cashing in on crypto craze (June 3, 2022), https://www.ftc.gov/news-events/data-visualizations/data-spotlight/2022/06/reports-show-scammers-cashing-crypto-craze.

Put simply, no entity should be given access to the Fed's payment system for purposes of consumer payments if those payments do not comply with the EFTA and consumers are not protected as they are with other payment types.

iv. Only institutions with community reinvestment obligations should receive the benefits of a master account.

Tier 2 and Tier 3 institutions would not have a community reinvestment obligation because they are not FDIC-insured banks.[18] As is the case with all prudential regulators, the Federal Reserve has a responsibility to prevent evasions of the CRA. Entities should not be given bank privileges without bank responsibilities.

The structure of the CRA reflects lessons learned from decades of practice, but there is no precedent for applying the existing CRA structure to Tier 2 and Tier 3 institutions. Some novel charter applications for uninsured national banks made by institutions that intended to apply for membership in the Federal Reserve offered to provide a voluntary community reinvestment plan.[19] However, neither the applicants nor the OCC settled on a framework for accountability. Regulators have yet to develop any procedures for how they would examine performance. CRA regulations also impose penalties on depositories that fail to meet their commitments. No language exists to describe enforcement tools that could be applied for non-compliance by uninsured financial institutions.

By approving a master account request to an institution in either Tier 2 or 3 without any expectations for how the institution would conduct community reinvestment activities or how those activities would be evaluated, the Board would create a regulatory loophole. The resulting injury suffered by the public would be substantial and with each additional request, the damages would expand.

CONCLUSION

We appreciate the opportunity to comment on the proposed guidelines.

We agree in principle to the need for the Board to provide a "transparent, risk-based, and consistent set of factors" for how requests for master accounts are considered.

Nonetheless, we firmly believe that the Federal Reserve should limit eligibility for master accounts to financial institutions that have federal deposit insurance and are subject to consolidated federal supervision. To do otherwise would lead to unacceptable risks to the banking system and the public.

Thank you for considering our views. If you have any questions, please contact Adam Rust at arust@ncrc.org.

Sincerely,

National Community Reinvestment Coalition
National Consumer Law Center (on behalf of its low-income clients)
Professor Emeritus of Law Arthur E. Wilmarth, Jr, George Washington University Law School

[18] See 12 U.S.C. §§ 2901-08.

[19] Klaros Advisors on behalf of Figure Bank. (2020, November 6). *Figure Bank, National Association: Charter Application* [To the Office of the Comptroller of the Currency].