January 17, 2023

Via Electronic Mail

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

Re: Revised Guidelines for Evaluating Account and Services Requests (Docket No. OP-1788)

Ladies and Gentlemen:

The Bank Policy Institute[1] appreciates the Board of Governors of the Federal Reserve System's recent efforts to promote transparency regarding access to Federal Reserve master accounts and services, including the adoption of the Board's final Guidelines for Evaluating Account and Services Requests[2] in August that establish a transparent, risk-based, and consistent set of factors for Reserve Banks to use in reviewing applications for Federal Reserve Bank accounts and/or financial services, and the more recent proposed amendments to those Guidelines, under which the Board proposed to provide for periodic publication of a list of federally-insured and uninsured depository institutions that have access to Reserve Bank accounts and services.[3]

However, after the Board issued its most recent proposal, the National Defense Authorization Act was signed into law on December 23, 2022. Section 5708 in Title LVII of that law provides the following:

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[1] The Bank Policy Institute is a nonpartisan public policy, research, and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks, and the major foreign banks doing business in the U.S. Collectively, they employ almost two million Americans, make nearly half of the nation's bank-originated small business loans, and are an engine for financial innovation and economic growth.

[2] Board of Governors of the Federal Reserve System, Guidelines for Evaluating Account and Services Requests, Final guidance, 87 Fed. Reg. 51099 (Aug. 19, 2022), available at: https://www.govinfo.gov/content/pkg/FR-2022-08-19/pdf/2022-17885.pdf.

[3] Board of Governors of the Federal Reserve System, Guidelines for Evaluating Account and Services Requests, Notice and request for comment, 87 Fed. Reg. 68691 (Nov. 16, 2022), available at: https://www.govinfo.gov/content/pkg/FR-2022-11-16/pdf/2022-24929.pdf.

The Board shall create and maintain a public, online, and searchable database that contains—

> ''(A) a list of every entity that currently has access to a reserve bank master account and services, including the date on which the access was granted to the extent the date is knowable; '
> '(B) a list of every entity that submits an access request for a reserve bank master account and services after enactment of this section (or that has submitted an access request that is pending on the date of enactment of this section), including whether, and the dates on which, a request—
> ''(i) was submitted; and
> ''(ii) was approved, rejected, pending, or with[1]drawn; and
> ''(C) for each list described in subparagraph (A) or (B), the type of entity that holds or submitted an access request for a reserve bank master account and services, including whether such entity is—
> ''(i) an insured depository institution, as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813);
> ''(ii) an insured credit union, as defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752); or
> ''(iii) a depository institution that is not an insured depository institution or an insured credit union.
> ''(2) UPDATES.—Not less frequently than once every quarter, the Board shall update the database to add any new information required under paragraph (1).
> ''(3) DEADLINE.—Not later than 180 days after the date of enactment of this section, the Board shall publish the database with the information required under paragraph (1).''.

As we have stated previously, determining whether and when institutions should be permitted to open master accounts with a Federal Reserve Bank and obtain related services remains a critical question, particularly in light of the recent increase in the availability of novel charters[4] at a federal and state level that may seek such accounts and services and the potential unique risks of their obtaining such accounts and services to the U.S. payments and financial systems.[5] While the requirements set forth in the NDAA that the Board must implement represent a positive step towards providing greater transparency into the application process for master accounts and services, in implementing the statute, we respectfully request that the Board go beyond what the statute requires to provide additional public transparency and greater process that important Reserve Bank decisions in this area clearly warrant.

[4] Throughout this comment letter, we use the term "novel charters" to describe potential applicants for Reserve Bank accounts and services that are neither (i) insured depository institutions subject to federal prudential oversight under the Federal Deposit Insurance Act (or other applicable Federal law regarding deposit insurance, such as the Federal Credit Union Act) nor (ii) uninsured institutions that are part of a bank holding company (for example, an uninsured national trust bank that is a subsidiary of a bank holding company), and thus subject to consolidated federal prudential oversight by the Board. Under the tiered framework recently established under the Guidelines, these novel charters are generally treated as either Tier 2 or Tier 3 applicants.

[5] We strongly oppose any nonbank stablecoin issuer from gaining access to Federal Reserve accounts and services because of the demonstrated risks they create. However, should such access be granted, the recommendations herein that apply to Tier 2 and Tier 3 applications would also apply to those entities.

Access to accounts and services affords institutions the extraordinary benefit of being able to clear and settle private transactions in central banks without concern about liquidity or credit risk. As the Guidelines make clear, such access can serve as the source of considerable risk to individual Reserve Banks, to the U.S. payments system and its participants, to financial stability and to the effective execution of monetary policy. Given these high and unique stakes, it is critical that the standards governing access are clear, transparent, and rigorous. Furthermore, greater transparency and process should be provided regarding novel charters that seek access to accounts and services in light of the risks posted by those institutions, which are not federally insured and, in some cases, not even subject to any federal oversight. Indeed, granting these applicants access to accounts and services would establish new interlinkages between those institutions and insured and more robustly regulated institutions, thus creating a new mechanism by which the risks entities with novel charters pose could be transmitted throughout the payments and financial systems.

Given the critical public importance of these decisions, we respectfully request that in addition to publishing periodically a list of applicants for master accounts and/or services, as the NDAA requires, with respect to applicants with novel charters, the Board provide even greater transparency regarding the terms on which such access may be provided and the level of ongoing oversight and monitoring to which any such entity would be subject as a result of being granted a Reserve Bank account and/or access to services.[6] To further increase transparency, we also recommend that the Board publish relevant information on a more frequent basis than the NDAA requires and classify institutions for purposes of that disclosure in a manner that aligns with the Board's Guidelines. We describe these recommendations in greater detail below

I. <u>The Board should publish for comment applications for Reserve Bank accounts and/or services submitted by entities with novel charters</u>.

The NDAA requires the Board to publish a list of firms that have applied for Reserve Bank accounts and/or services and the date on which the request was submitted, rejected, or withdrawn, as applicable. As we have previously observed, applications from Tier 2 applicants that are not part of a regulated bank holding company and all applications from Tier 3 institutions should be published for public comment to provide an opportunity for other participants in the payments system and the public to review and comment on such applications, including any commitments into which the applicant or its affiliates propose to enter.[7]

As the Board itself has acknowledged, such applications can raise difficult and novel issues; thus, the public should (i) be apprised of pending applications, and (ii) have an opportunity to provide, where relevant, information to the Board and relevant Reserve Bank related to the factors to be considered under the Guidelines or any other information that could be relevant to the application. Providing the opportunity for public input on applications from entities with novel charters will help identify potential

[6] The Federal Reserve advised in the Final Guidelines that "the Reserve Banks are working together, in consultation with the Board, to expeditiously develop an implementation plan for the final Guidelines," and thus, presumably, there is ongoing work in this regard.

[7] All of the recommendations for publication in this letter presume that any information that would be exempt from disclosure under the Freedom of Information Act would be withheld from publication, including, but not limited to, account-related information that is confidential business, trade secret or supervisory information. *See* 12 U.S.C. §§ 552(b)(4) and (b)(8).

gaps in the application and lead to a more thorough understanding of the risks associated with an application. We thus continue to strongly believe that publication and the opportunity for public comment on the entire application submitted by these institutions, including any commitments into which they propose to enter, is of critical importance given the risks presented by these institutions to other institutions and the payments and financial systems that would be created if accounts and services were granted to them given the interconnections a master account would create.

For example, Custodia, a Tier 3 "'first-of-its-kind digital asset bank'" that "will offer digital asset custody, serve as a "bridge" between digital assets and the U.S. dollar, and facilitate payments with a self-issued digital "instrument," the "Avit," submitted an application for a Federal Reserve master account to the Federal Reserve Bank of Kansas City in October 2020. Custodia sued the FRBKC and the Federal Reserve Board for failing to make a final determination on its application within a reasonable period of time.[8] In connection with the litigation, the FRBKC has stated that the activities of Custodia "are laden with novel risks" including "risks to [the FRBKC] itself, the payment system, and the implementation of monetary policy"[9] and that the FRBKC is thus taking the necessary time to gather "more detail on Custodia's anticipated business model, evaluat[e] whether mitigating actions and controls would lessen risks, and determin[e] whether granting Custodia an account could result in financial loss to FRBKC or an operational disruption or could affect the implementation of monetary policy and the broader financial system."[10] The public and other entities with Federal Reserve master accounts and those that participate in the payment system should have the opportunity to comment on those risks as part of the Reserve Bank's evaluation process for applications such as Custodia's.

II. <u>The Board should publish additional information regarding any entity with a novel charter approved for accounts and/or services</u>.

In connection with novel charters, an important aspect of the Guidelines is the requirement that any holding company of a Tier 2 applicant not otherwise subject to consolidated Board oversight subject itself to such oversight by commitment. Given the crucial importance of ensuring that such commitments encompass the prudential and supervisory requirements applicable to BHCs under Federal law (and not merely the enforcement jurisdiction of the Board),[11] we previously recommended

[8] Complaint, *Custodia Bank, Inc. v. Fed. Reserve Bd. of Governors, Fed. Reserve Bank of Kansas* City (D. Wyo. 2022) (Case 1:22-cv-00125-SWS).

[9] The Federal Reserve Bank of Kansas City's Reply in Support of its Motion to Dismiss, *Custodia Bank, Inc., v. Federal Reserve Board of Governors and Federal Reserve Bank of Kansas City*, U.S. Dist. Ct. Dist WY, at 1 (Oct. 4, 2022).

[10] *Id* at 16.

[11] We had noted that this would include, for example, (i) the activities restrictions of sections 3, 4 and 13 of the Bank Holding Company Act, (ii) all applicable capital, liquidity and resolution planning requirements (and other enhanced prudential standards, where application would be appropriate based on the factors the Board considers in applying those standards to BHCs), and (iii) the anti-tying restrictions of section 106 of the Bank Holding Company Act. We also had suggested that Tier 3 applicants should be subject to a rebuttable presumption that an application for accounts or services will not be approved unless the applicant enters into commitments with the Board by which it is obligated to meet requirements that (i) at the applicant level, are at least as strenuous and effective at limiting the risks posed by the applicant as those that apply to federally insured depository institutions, and (ii) at the holding company level, are at least as strenuous and effective at limiting risks posed by the applicant and its affiliates as those that apply to regulated BHCs.

that the Board publish the specific form of commitment to be required in this respect as part of the final guidelines to ensure both transparency and accountability on this point.

The Board did not adopt this recommendation in its final Guidelines, and to not do so in implementing the NDAA would continue to leave an important gap in the public understanding of whether and how Reserve Banks are evaluating applications pursuant to the Board's Guidelines. We therefore continue to believe that transparency about these commitments is critical to ensure the continued safe operation of the payments system should the Federal Reserve consider granting an entity with a novel charter an account and/or services.

Furthermore, transparency regarding any commitments and requirements imposed on a novel charter that is granted access to accounts and/or services is important to (i) foster a common understanding among other payments system participants and the financial system more broadly that appropriate risk mitigating measures are being taken by any entity with a novel charter granted such access, and (ii) promote consistency of the commitments and related requirements imposed on novel charters. Therefore, all relevant commitments and other requirements upon which a Tier 2 or Tier 3 applicant's access to accounts and/or services is conditioned should be included in the periodic information to be published by the Reserve Banks.

Similarly, we also have previously recommended that the Guidelines establish, both for Tier 2 applicants that are not part of a regulated BHC and Tier 3 applicants, a clear framework of periodic monitoring based on standards as rigorous as those applicable to federally insured depository institutions or BHCs under federal banking law, including those regarding capital, liquidity, operational and other risk management, cybersecurity, anti-money laundering, operational resilience, consumer protection, affiliations and affiliate transactions and other prudential requirements.[12] For Tier 3 applicants, we recommended that the final guidelines should provide for annual, on-site examination of the institution by the examination staff of the relevant Reserve Bank. The final Guidelines do not establish any such framework, and it remains unclear whether and how the Board and/or Reserve Banks will monitor these institutions' use of accounts and services, compliance with associated commitments, and financial condition and risk management capabilities. Given that the Guidelines do not address this important issue, we believe that transparency regarding ongoing monitoring and examination is also

[12] The importance of restrictions and limitations on affiliate transactions for entities not subject to such requirements currently was illustrated most recently by the bankruptcy of FTX Trading Ltd., which had been one of the largest digital currency exchanges. The extensive transactions between FTX and its affiliate, Alameda Research, were among the causes of their collapse. Alameda served as the primary market maker for FTX's token FTT, which Alameda used as collateral for loans to facilitate its trading activities. When crypto prices fell last spring, the value of FTT dropped, and Alameda could not repay its lenders. FTX executive permitted Alameda to borrow unlimited funds from FTX, a fact that was concealed by FTX and Alameda executives. Some of those funds belonged to customers. *See*, *e.g.,* Timmy Shen, "Sam Bankman-Fried, FTX misled investors, lent billions to Alameda, Caroline Ellison says" (Dec. 26, 2022), available at: Sam Bankman-Fried's FTX misled investors, lent billions to Alameda, Caroline Ellison says (forkast.news); Nikou Asgari, "FTX allowed trading affiliate Alameda to borrow unlimited funds" (Dec. 12, 2022), available at: FTX allowed trading affiliate Alameda to borrow unlimited funds | Financial Times; Matthew Goldstein, Alexandra Stevenson, Maureen Farrell and David Yaffe-Bellany "FTX's Sister Firm, Alameda Research, Was Central to Collapse" (Nov. 30, 2022), available at: What Is The Relationship Between Almeda Research and FTX? - The New York Times (nytimes.com); Joe Miller, "Bankman-Fried associate admits to misuse of FTX customer funds" (Dec. 23, 2022), available at: Bankman-Fried associate admits to misuse of FTX customer funds | Financial Times.

important to foster a common understanding among other payments system participants that these entities are subject to appropriate oversight to ensure their continued safe and sound operation. Thus, should either a Tier 2 applicant that is not part of a regulated BHC or a Tier 3 applicant be granted a master account and/or related services, the publication of the approval of the application as required by the NDAA should include a description of the monitoring and/or examination to which the entity is subject.

III. The Board should publish the list of account holders and applicants weekly, rather than quarterly, and in so doing should classify those holders and applicants using the Guidelines' three-tier framework.

The NDAA requires the Board to "create and maintain a public, online, and searchable database that contains a list of every entity that currently has access to a reserve bank master account and services" and "a list of every entity that submits an access request for a reserve bank master account and services" and provides that "Not less frequently than once every quarter, the Board shall update the database to add any new information required under paragraph (1)."

First, such publication should be more frequent, as such greater frequency would appear to create little to no incremental burden on the Board (as presumably it maintains such information for its own purposes on a real-time basis), but would produce substantially greater benefits by notifying the public and payments systems participants of the entities seeking, receiving or losing access to accounts and/or services on a timely basis, rather than several months after the fact. In addition, it is important that information about applications filed be published frequently so that interested parties may provide the Federal Reserve information relevant to its evaluation of the application on a timely basis to ensure that it is given due consideration. If applications were only published quarterly, interested institutions may not be able to submit information in time for it to be considered by the relevant Reserve Bank. Weekly publication also would accord with the Board's practice of publishing "Actions of the Board, Its Staff, and the Federal Reserve Banks, Release Dates - H.2," which includes applications received by the System on a weekly basis.[13] If, contrary to our understanding, weekly publication would impose undue burden on the Federal Reserve, we recommend, in the alternative, that the Federal Reserve publish applications, approvals, or revocations no less frequently than monthly.

The NDAA also requires that the Board's published lists indicate whether an entity is an insured depository institution, an insured credit union, or a depository institution that is not an insured depository institution or an insured credit union.

However, in the required publications of applicants (including the outcome of such applications) and account holders and changes to those statuses, rather than classifying account holders and applicants solely according to whether they are federally-insured or not, the Federal Reserve should also indicate into which one of the three tiers the entity falls based on the Guidelines. Such an approach would be consistent with the requirements of the NDAA and is more consistent with the Board's own Guidelines, would provide greater information to the public, and would impose no incremental burden on the Board, given that the Board's own Guidelines already require the Board and the relevant Federal Reserve Bank to ascertain the appropriate tier under which the institution's application should be evaluated. Indeed, for the very same reason that the Board chose to differ its standard of application

[13] *See* The Fed - Actions of the Board, Its Staff, and the Federal Reserve Banks - H.2 - Release Dates.

review among these three tiers – namely, the very different risks that they may pose – such information is equally important to the public in understanding the scope and scale of entities that have applied for and/or received Reserve Bank accounts and services and risks related thereto.

Third, the Federal Reserve should indicate in the periodic publication whether the applicant or account holder has, has applied for, or no longer has a master account, related services, or both. Such information would again provide greater and more useful information to the public while imposing no incremental burden on the Federal Reserve (as again, the Federal Reserve presumably maintains such information for its own purposes on a real-time basis).

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BPI appreciates the opportunity to provide comments to the Board and would welcome the opportunity to discuss them further with you. If you have any questions, please contact me by phone at 703-887-5229 or by email at paige.paridon@bpi.com.

Sincerely,

/s/ Paige Pidano Paridon

Paige Pidano Paridon
Senior Vice President,
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Bank Policy Institute