April 22, 2022

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

Submitted electronically to regs.comments@federalreserve.gov

Re: Docket No. OP-1765: Supplemental Notice and Request on Guidelines for Evaluating Account and Services Requests.

Dear Secretary Misback:

The Center for Responsible Lending, National Community Reinvestment Coalition, the National Consumer Law Center, on behalf of its low-income clients, and Arthur E. Wilmarth, Jr., Professor Emeritus of Law at George Washington University Law School appreciate the opportunity to comment on the Board of Governors of the Federal Reserve System's (the Board) supplemental notice and request for comment on the proposed Guidelines for Evaluating Account and Services Requests.

The Center for Responsible Lending (CRL) is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, which consists of a state-chartered credit union (Self-Help Credit Union (SHCU)), a federally-chartered credit union (Self-Help Federal Credit Union (SHFCU)), and a non-profit loan fund.

The National Community Reinvestment Coalition (NCRC) is an association of more than 600 community-based organizations that work to 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 and 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, including older adults, in the U.S. through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training.

During his 34 years as a member of the faculty, Professor Wilmarth taught courses in banking law, contracts, corporations, professional responsibility, and American constitutional history. He has published two books as well as more than 40 law review articles and book chapters in the fields of financial regulation and American constitutional history.

These comments will not repeat all of our original concerns espoused in our letter dated July 12, 2021, pursuant to our Comment to the Board of Governors of the Federal Reserve System on the Proposed

Guidelines for Evaluating Account and Service Requests.[1] In particular, we note that Section 1 of the Federal Reserve's renewed request for comments, which describes the six principles that the Reserve Banks would use in evaluating requests for accounts and services, is substantially the same as the Account Access Guidelines described in the original request for comment. As we stated earlier, **we strongly urge the Federal Reserve Board to limit prospective applications to only those institutions that both accept insured deposits and whose parent companies are supervised under the Bank Holding Company Act.** While insured industrial loan companies (ILCs) fall into Tier 1 of the proposed guidelines, the Board should help to close the ILC loophole by denying master accounts to ILCs.

These comments address our concerns about, and opposition to, providing access to Tier 2 and Tier 3 entities, which are not insured depository institutions. In brief, providing this access would inappropriately provide banking privileges to entities that do not have the full oversight or responsibilities of insured depository institutions. Doing so is, we believe, outside the Board's authority, would enable evasion of reinvestment obligations, would pose risks to the financial system, and would encourage evasions of consumer protection laws. As described in more detail below:

Providing master account access for Tier 2 institutions allows for evasions of vitally important banking laws and encourages regulatory arbitrage.

- The Federal Reserve should clarify that uninsured financial institutions cannot have access to master accounts.

- Tier 2 (and Tier 3) institutions would not have a community reinvestment obligation. As is the case with all prudential regulators, the Federal Reserve has a responsibility to prevent evasions of the CRA. A voluntary community reinvestment obligation is not a valid alternative.

- Without FDIC insurance, there will be less robust federal safety and soundness supervision. Without the duty to protect depositors and the Deposit Insurance Fund (DIF) or the presence of back-up supervision of the FDIC, there is a higher probability of excessive "risk-taking" by Tier 2 (and Tier 3) institutions.

- Once approved, it is difficult to take away access to a master account.

- Institutions that do not accept deposits in fiat currency are not depository institutions as defined in the Federal Reserve Act and other federal statutes. Only Congress, not the Board, has authority to change the definition of "depository institution" to include institutions that do not accept deposits in fiat currency.

- The Federal Reserve Act does not allow the Board to grant a master account to an uninsured depository national bank, even if it receives a charter from the OCC. Granting unwarranted master account privileges to uninsured depository national banks would also risk undermining consumer protections, especially state usury laws.

Providing access to master accounts to Tier 3 uninsured institutions that are not supervised by federal banking agencies will create substantial risks to the financial system.

[1] Available here: https://ncrc.org/consumer-and-community-groups-urge-federal-reserve-board-to-ensure-that-financial-institutions-benefiting-from-the-payments-system-serve-the-public-interest/.

- Tier 3 combinations would permit largely unsupervised tie-ups between the payments system, Big Tech firms, and issuers of cryptocurrency. Allowing master accounts for these institutions would undermine and threaten to destroy our nation's long-established policy of separating commerce and banking.

- Lack of federal oversight of Tier 3 entities is a fatal flaw, as shown by the systemic problems caused by uninsured institutions in both this country and in other countries.

- 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 could be exploited by Big Tech firms. Consumer privacy would be compromised, and competition would suffer.

- 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 that have access to master accounts.

DISCUSSION

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

The proposed guidelines categorize "Tier 2" eligible institutions as those that are not federally insured, but are subject to federal prudential supervision at the institution and, if applicable, at the holding company level. Existing institutions that fit within Tier 2 include Anchorage Digital Bank, Protego Trust Bank NA and Paxos, which are all uninsured trust-only national banks that provide cryptocurrency custody services. Other national trust banks in theory could fit within Tier 2, but they are less likely to seek payment services.

For several reasons, we believe that providing master account access for these institutions would allow for evasions of vitally important protections of consumers and the public interest and would encourage regulatory arbitrage. It would provide banking privileges to uninsured institutions that operate without full banking obligations and oversight, and would promote the growth of riskier institutions.

a) The Federal Reserve should clarify that uninsured financial institutions cannot have access to master accounts.

Section 13 of the Federal Reserve Act (FRA), 12 U.S.C. § 342, allows the Federal Reserve Banks to accept deposits from "member banks, or other depository institutions," and to accept deposits from "any nonmember bank or trust company or other depository institution" if such deposits are received "solely for the purposes of exchange or of collection." Until 1980, only member banks were eligible for master accounts, but Congress then expanded eligibility to include "any other bank that accepts deposits." That change allows insured nonmember banks that are regulated by the FDIC to have master accounts.

From the 1990s until 2019, all national banks (except for national nondeposit trust companies) and all state-chartered banks were required to maintain federal deposit insurance. However, Wyoming and Nebraska have authorized the chartering of uninsured depository institutions during the past three years. As a result, the question has arisen whether an uninsured depository institution could qualify for a master account.

The FRA defines a depository institution as including a deposit-taking institution that is eligible to make an application to become an insured depository institution. 12 U.S.C. § 461(b)(1)(A). The Federal Deposit Insurance Act (FDIA) limits eligibility to institutions that are "engaged in the business of receiving deposits other than trust funds." 12 U.S.C. § 1815(a)(1).

The Federal Reserve has not yet given a definite answer to the question of whether it will provide access to uninsured entities, maintaining that it has the right to approve such applications but also the right to deny them based on the risks they pose to financial stability and the payments system and other factors.[2] A leading banking law scholar recently concluded that a 1923 Supreme Court decision and other relevant authorities support the Federal Reserve's position that it has discretion to deny master accounts to nonmember depository institutions based on risk-based considerations and other factors that do not discriminate between member banks and nonmember depository institutions.[3]

In a series of events that underscore the potential risks of allowing uninsured depository institutions to gain access to Federal Reserve master accounts and related services, two state legislatures have passed laws that allow their states to approve applications from cryptocurrency custody banks, digital asset depositories, and other uninsured financial institutions, and similar legislation is under active consideration in other states.

In 2021, the state of Nebraska enacted the Financial Innovation Act, which authorized the creation of a digital asset depository (DAD). The act allows DADs to hold digital assets, provide custody services, issue stablecoins, use independent node verification networks and stablecoins for payments activities, and facilitate digital asset business services.[4] Nebraska has granted state charters to uninsured digital asset depositories (DADs). A condition of their charter prevents them from accepting fiat deposits or making loans of any fiat currency. DADs can hold fiat currency as reserves against the digital assets they issue, but those deposits are required to be held at a separate FDIC-insured institution.[5] The Financial Innovation Act does not explicitly prevent DADs from applying for FDIC insurance, and we are greatly concerned that DADs could apply for Federal Reserve master accounts.

In 2019, the state of Wyoming enacted the Special Purpose Depository Institutions Act, which authorized the creation of special purpose depository institutions (SPDIs).[6] The Act allows Wyoming banks to accept deposits and engage in activities related to cryptocurrencies. The Wyoming Division of Banking is the primary regulator, and deposit accounts are not required to carry FDIC insurance. The Wyoming statute provides that SPDIs are eligible to apply for Federal Reserve master accounts, and two SPDIs (owned by Custodia and Kraken) have applied for such accounts.

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[2] TNB USA Inc. v Federal Reserve Bank of New York, Memorandum of Law in Support of Defendant Federal Reserve Bank of New York's Motion to Dismiss, U.S. District Court, Southern District of New York, Civ. No. 18 Civ. 7978, Mar 8, 2019.

[3] Julie A. Hill, "Bank Access to Federal Reserve Accounts and Payment Systems," *Yale Journal of Regulation* (forthcoming) (draft of March 30, 2022), Part II.B (citing *Farmers' & Merchants' Bank v. Federal Reserve Bank of Richmond*, 262 U.S. 649 (1923)), available at https://ssrn.com/abstract=4048081.

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

[5] Nebraska Legislature. (2021, October 5). Digital asset depository; powers; digital asset depository institution; organization; operating authority; demand deposits and loans; prohibited. [Revised Statutes]. Nebraska Revised Statute 8-3005. https://nebraskalegislature.gov/laws/statutes.php?statute=8-3005

[6] Special Purpose Depository Institutions Act, Pub. L. No. 74, 13-12–101 (2019). https://wyomingbankingdivision.wyo.gov/banks-and-trust-companies/special-purpose-depository-institutions

A few state-chartered banks do not participate in the FDIC's Deposit Insurance Fund and instead hold insurance from a state-managed deposit insurance fund.[7] Several years ago, a "neobank" issued a demand deposit account backed by Treasury bonds.

The OCC has left open the question of whether it will provide charters to uninsured, deposit-taking institutions. When it applied for a national bank charter and for membership in the Federal Reserve as an uninsured depository institution, Figure Technologies proposed a structure that was designed to meet the definition of a Federal Reserve "Tier 2" institution. The legal and policy concerns posed by Figure's application were rendered moot when Figure announced that it would apply for FDIC insurance. Although the OCC issued a press release welcoming the change in Figure's charter plans, the OCC's press release asserted that the agency "has the authority to charter an uninsured institution, including one that takes deposits."[8]

Banks that have deposit insurance pay premiums for that insurance and undertake the obligation of being federally supervised to protect the federal deposit insurance fund and maintain public confidence in the stability of the U.S. banking system. Entities that do not undertake those obligations should not receive master account privileges from the Federal Reserve.

To settle one part of the question, the Federal Reserve should take the step of clarifying that uninsured Tier 2 and Tier 3 depository institutions will not be granted master accounts in view of the risks they pose and their inadequate supervision.

b. Tier 2 (and Tier 3) institutions would not have a community reinvestment obligation. As is the case with all prudential regulators, the Federal Reserve has a responsibility to prevent evasions of CRA requirements. A voluntary community reinvestment obligation is not a valid alternative.

The opportunity to receive the benefit of a bank charter, including access to Federal Reserve master accounts and services, without similar responsibilities for community reinvestment and consumer protections, will create a strong incentive for depository institutions to operate without deposit insurance.

In its original charter application, Figure stated that it was not bound by the CRA and instead proposed an alternative, voluntary community reinvestment plan. The terms of Figure's voluntary plan revealed the inherent shortcomings of any voluntary approach. Figure did not provide metrics for how regulators could evaluate its performance, and Figure conditioned its responsibility to complete some of its planned community reinvestment activities on the overall profitability of the bank. Similarly, without the statutory framework of the CRA, it was not clear whether there would be any adverse consequences if Figure's proposed bank failed to live up to its voluntary reinvestment promises.

To be subject to CRA obligations, an institution must take deposits and receive deposit insurance from the FDIC.[9] An uninsured depository institution would not have any CRA obligations. To allow some institutions to receive the benefits of a banking charter along with other privileges such as Federal Reserve master accounts, without requiring them to meet community reinvestment obligations, would create a severe inconsistency in regulatory treatment. That inconsistency would erode the CRA's

[7] The Bank of North Dakota is insured by the state of North Dakota. BND has a master account.
[8] Office of the Comptroller of the Currency. (2022, January 14). CSBS Withdraws Legal Challenge to OCC Chartering Figure Bank, N.A. News Release 2022-3. https://www.occ.gov/news-issuances/news-releases/2022/nr-occ-2022-3.html.
[9] 12 U.S.C. §§ 1813(c)(2), 2901-08. Credit unions are covered by a separate federal deposit insurance system and are not subject to the CRA.

effectiveness and provide an unfair competitive advantage to uninsured depository institutions that intend to evade any CRA obligations, thereby creating very strong incentives for institutions to choose the evasive approach.

The Federal Reserve can – and should – preserve the CRA's integrity and prevent the CRA from being undermined by evasions that Congress has not explicitly endorsed. The Federal Reserve should deny master accounts to uninsured depository institutions unless Congress expressly approves the granting of master accounts to such institutions after considering the adverse impact of such actions on the CRA as well as the safety and stability of the U.S. banking and payments systems.

c. Uninsured depository institutions would not be subject to the vitally important protections provided by the duty of federal bank regulators to protect depositors and the Deposit Insurance Fund (DIF) and the FDIC's back-up supervisory and enforcement authorities.

A primary safety and soundness concern of federal bank regulators is to protect depositors and the Deposit Insurance Fund (DIF). That motivating goal is absent when a depository institution is allowed to operate without deposit insurance and is not subject to the protections provided by the FDIA's regulatory and supervisory requirements.

In addition to supervision by the primary federal bank regulator, the FDIC continually reviews the risks posed by all FDIC-insured depository institutions and exercises its backup enforcement and examination authorities to protect depositors, preserve the safety and soundness of the DIF, and maintain public confidence in the stability of the U.S. banking system.[10]

The duty to protect depositors and the DIF and to maintain public confidence in the U.S. banking system is a publicly visible and easily monitored duty that gives both the FDIC and other federal bank regulators a powerful motivation to prevent excessive risk-taking by banks. The authority and duty of federal bank regulators to protect the interests of depositors and to maintain public confidence in the banking system creates a strong check on the tendency of bank managers and shareholders to assume excessive risks in order to achieve higher rates of return. The role of the FDIC and other federal bank regulators in protecting bank deposits and maintaining public confidence in banking has become a foundational aspect of bank regulation, to the point where most members of the public believe that banks and federal deposit insurance are inextricably connected.

The Federal Reserve should deny master accounts to uninsured depository institutions, as granting such accounts would encourage the formation of risky depository institutions that will receive much weaker oversight and evade the FDIC's backup authority to protect depositors and maintain public confidence in the safety and soundness of our banking system. As explained below in Part II.b, the collapse of privately-insured depository institutions in several states during the 1980s and 1990s imposed severe losses on depositors and eroded public faith in the soundness of our financial system.

d. Once approved, it is difficult to take away access to a master account.

Given that approvals of master accounts for some uninsured depository institutions would give them a significant competitive advantage over other uninsured depositories, the Federal Reserve should acknowledge that political pressures have been and will continue to be brought to bear on its decision-

[10] 12 U.S.C. §§ 1818(t) & 1820(b)(3); *see, e.g.,* FDIC, Annual Report 2015 at 21-24, https://www.fdic.gov/about/financial-reports/reports/2015annualreport/2015AR_Final.pdf; FDIC, Press Release, "FDIC Board Votes to Revise MOU on Backup Supervision Authority" (July 12, 2010), https://www.fdic.gov/news/press-releases/2010/pr10153.html.

making by influential supporters of uninsured depository institutions with connections to Big Tech giants and other powerful interests. Sponsors and supporters of applications by uninsured depository institutions for master accounts would apply great pressure on the Federal Reserve to place the desires of special interests above the priorities of protecting the public from unsafe and unsound financial practices and inadequately supervised financial institutions.

If problems arise, even greater political pressures could prevent the Federal Reserve from revoking master accounts after they are granted. To the extent that political pressures exist today to issue master accounts to uninsured depository institutions, such influence would only be enhanced over time. Uninsured depository institutions with master accounts would be motivated to preserve "economic rents" and consumers would face disruptions if the Fed chose to suspend or remove an institution's access to a master account.

Adopting a clear rule requiring federal deposit insurance for master account access – without the need to exercise judgment calls about particular uninsured institutions – would protect the Federal Reserve from being placed in the position of being pressured or persuaded to provide or continue master account access for risky uninsured institutions.

e. Institutions that do not take deposits in fiat currency are not depository institutions. Only Congress can amend the FRA to change the definition of "depository institutions" that are entitled to receive master accounts.

The FDIC only insures fiat currency. Under the FDIA, a financial institution that does not receive deposits payable in fiat currency is not eligible to apply for federal deposit insurance. *See* 12 U.S.C. §§ 1813(*l*), 1815(a). Under the FRA, the definition of a depository institution is an institution that is eligible to apply for deposit insurance from the FDIC. 12 U.S.C. § 461(b)(1)(A). Thus, a financial institution that only holds digital assets (which do not represent claims payable in fixed amounts of fiat currency) on behalf of customers does not meet the definition of a depository institution under the FRA. The Federal Reserve cannot provide a master account to a depository that does not take deposits in fiat currency. A DAD is neither FDIC-insured nor a depository institution under the definition of the FRA – so there is no basis for the Federal Reserve to provide a DAD with a master account.

The President's Working Group on Financial markets recently published a report recommending that payment stablecoins should only be issued through insured depository institutions.[11] That report appropriately requested legislation to ensure that payment stablecoins and payment stablecoin arrangements are subject to a federal supervisory framework on a consistent and comprehensive basis, complementing existing authorities with respect to market integrity, investor protection, and illicit finance, and addressing key concerns about stablecoins.

The Federal Reserve may not provide banking privileges to uninsured institutions holding digital assets that are not payable in fixed amounts of fiat currency without express Congressional approval. The Federal Reserve must defer to Congress's decision on the question of whether any type of digital asset that does not represent a claim for payment of a fixed amount in fiat currency should be recognized as a "deposit" for purposes of eligibility for master accounts.

[11] President's Working Group on Financial Markets, Federal Deposit Insurance Corporation, & Office of the Comptroller of the Currency. (2021). *Report on Stablecoins*. US Department of the Treasury. https://home.treasury.gov/news/press-releases/jy0454.

f. The Federal Reserve cannot grant a master account to an uninsured national bank because a deposit-taking national bank cannot operate without FDIC insurance. In addition, giving master accounts to uninsured deposit-taking national bank would undermine vitally important consumer protections, especially state usury laws.

All national banks, except for nondeposit national trust companies authorized by 12 U.S.C. § 27(a), must become members of the Federal Reserve, as required under the FRA[12] and must also become insured banks under the Federal Deposit Insurance Act (FDIA).[13] The FRA provides:

> "Every national bank in any State shall, upon commencing business or within ninety days after admission into the Union of the State in which it is located, become a member bank of the Federal Reserve System by subscribing and paying for stock in the Federal Reserve bank of its district in accordance with the provisions of this chapter and shall thereupon be an insured bank under the Federal Deposit Insurance Act, and failure to do so shall subject such bank to the penalty provided by Section 501a of this title."[14] .

Thus, under the FRA, every deposit-taking national bank must be a member of the Federal Reserve, and it must also obtain FDIC insurance. Under Section 501a, a deposit-taking national bank that fails to obtain FDIC insurance "must forfeit its charter."[15]

A federal district court has ruled that the OCC does not have the authority to issue national bank charters to institutions that do not take FDIC-insured deposits.[16] That decision was vacated when the Second Circuit dismissed the case on standing grounds without ruling on the merits of the OCC's appeal. Thus, it is possible that the OCC in the future could resume efforts to charter an uninsured national bank. Yet such a bank would not have CRA obligations and its parent holding company would not be subject to consolidated supervision by the Federal Reserve under the Bank Holding Company Act, resulting in the risks discussed throughout these comments.

In addition, an uninsured deposit-taking national bank would also present another concern: It could potentially enjoy preemption of state usury laws and other state consumer protection laws. Indeed, one of the primary reasons that state-regulated lenders have chosen national bank charters is to escape the application of state usury laws. Yet in the absence of federal interest rate limits, state interest rate laws are the best protection against predatory lending. While preemption has led to predatory lending and other problems by banks as well, the risk of predatory lending by uninsured entities is even greater, as they do not have the same full relationship with the consumer including a deposit account, and are more likely to target consumers with damaged credit.

Providing Federal Reserve payment services to uninsured national banks would enhance the attractiveness of that charter and promote the spread of entities able to escape interest rate limits and engage in

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[12] 12 U.S.C. § 222.
[13] 12 U.S.C. § 1811.
[14] 12 U.S.C. § 222.
[15] 12 U.S.C. § 501a.
[16] *Vullo v. Office of Comptroller of Currency*, 378 F.Supp.3d 271 (S.D.N.Y 2019) ("First, the Federal Reserve Act requires national banks to obtain membership in the Federal Reserve System and insurance under the Federal Deposit Insurance Act (FDIA). See 12 U.S.C. § 222. But a national bank must be "engaged in the business of receiving deposits" to obtain insurance under the FDIA. 12 U.S.C. § 1815(a)(1). Chartering national banks that do not receive deposits -- which are ineligible for insurance under the FDIA and therefore unable to join the Federal Reserve System -- would introduce an anomaly into this scheme."), *rev'd & remanded sub nom* Lacewell v. Office of Comptroller of Currency, 999 F.3d 130 (2nd Cir. 2021).

predatory lending. The Board should not support efforts to grant bank privileges to entities that seek to evade the full responsibilities of banks.

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

Under the proposed guidelines, Tier 3 eligible institutions are not federally insured and are not subject to federal prudential supervision at either the institution or the holding company level. All of the risks described above for Tier 2 institutions are compounded for Tier 3 institutions, and the Federal Reserve should not give them access to master accounts.

a. Tier 3 combinations would permit largely unsupervised tie-ups between the payments system, Big Tech firms, and issuers of cryptocurrency. Allowing master accounts for these institutions would contradict important barriers between commerce and banking.

The United States has followed a long-established policy of separating banking and commerce. *See* 12 U.S.C. §§ 24 (Seventh) & 1843. The separation of banking and commerce protects the banking system from risks created by commercial activities, requires banks to act as objective lenders, provides some protection from unauthorized sharing of consumer information, and prevents commercial firms from using bank charters to gain a competitive advantage over other commercial firms that do not control banks.

Creating the possibility of master accounts for Tier 3 companies threatens to undermine the separation of banking and commerce and represents a dramatic restatement of these principles.

The record of industrial loan companies – the only category of FDIC-insured institutions that can be controlled by commercial firms – underscores the risks presented when federal supervisory authority does not extend across the entirety of a bank, its parent company, and its other affiliates. Commercial firms that own ILCs are not subject to the Bank Holding Company Act because ILCs are exempted from the definition of "bank" under that statute. Thus, ILCs and their parent companies escape consolidated supervision. The Government Accountability Office acknowledged the substantial risks created by this gap in 2005.[17] Their views were underscored several years later when several corporate owners of ILCs encountered financial difficulties, with the result that their chartered subsidiaries experienced significant distress and the corporate owners received federal bailouts (including CIT, General Electric, GMAC, Goldman Sachs, Merrill Lynch, and Morgan Stanley). Two ILCs (including Fremont) were sold under conditions of distress and two ILCs failed (including Advanta). Other ILCs converted to commercial banks, motivated at least in part by the opportunity to benefit from master accounts and access to the Federal Reserve's discount window.[18]

The problems caused by the mixing of banking and commerce and lack of consolidated supervision would be exacerbated by granting master account access to Tier 3 companies that do not have the same level of supervision at the "bank" level as ILCs and other FDIC-insured banks. Granting access to master accounts would provide banking privileges to companies that pose immense risks and would also

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[17] *Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority* (Report to the Honorable James A. Leach, House of Representatives GAO-05-621). (2005). U.S. Government Accountability Office. https://www.gao.gov/assets/gao-05-621.pdf

[18] Perkins, D. W. (2020). *Industrial Loan Companies (ILCs): Background and Policy Issues* (No. R46489; p. 20). Congressional Research Service. https://sgp.fas.org/crs/misc/R46489.pdf; Wilmarth, Arthur E., Jr., "The FDIC Should Not Allow Commercial Firms to Acquire Industrial Banks," 39 *Banking & Financial Services Policy Report* No. 5, at 1, 4-10 (May 2020), available at https://ssrn.com/abstract=3613022.

encourage the growth of poorly-regulated companies that deliberately evade the responsibilities and oversight of insured banks.

b. Lack of federal oversight of Tier 3 entities is a fatal flaw, as shown by the systemic problems caused by uninsured institutions in both this country and in other countries.

The Federal Reserve has made clear that a depository institution may not receive a master account unless it has developed "an operational risk framework" to ensure its resiliency against "events associated with processes, people, and systems that may impair the institution's use and settlement of Reserve Bank services" (Proposed Guidelines, at 13). To ensure that the recipient of a master account has satisfied this standard, the Federal Reserve must have the ability to see across the entire scope of an institution's operations.

While the Federal Reserve's request for comment states that Tier 3 institutions would receive the highest level of review, it also acknowledges that Tier 3 institutions would be subject to a substantially weaker regulatory framework compared with FDIC-insured banks. Granting master accounts to Tier 3 institutions would create a perverse and self-defeating scenario in which the Federal Reserve would have a very limited time horizon to scrutinize Tier 3 institutions before granting the accounts and would subsequently have to rely on sources of supervisory information that are clearly inadequate to protect the stability of our financial system and the integrity of our payments system.

Recent history both in this country and abroad shows that the lack of federal oversight is a fatal flaw that should categorically prevent Tier 3 entities from gaining access to Federal Reserve services.

Many state-supervised, privately-insured depository institutions collapsed during the banking crises of the 1980s and early 1990s, resulting in severe losses to their depositors and highly adverse effects on local economies in states such as Maryland, Ohio, and Rhode Island. The absence of federal oversight of those institutions contributed significantly to their unsound practices and their vulnerability to systemic runs by depositors. As a result of those disasters, many states prohibited state-chartered depository institutions from operating without federal deposit insurance.[19]

In Germany, Wirecard obtained access to the payments system but its parent and affiliates were not supervised. Regulators did not discover Wirecard's lack of controls until Wirecard had already perpetrated a massive fraud.

Independent entities, include investment analysts and leading media outlets, eventually uncovered pervasive accounting and financial fraud at Wirecard. Their work revealed that Wirecard had falsified its financial statements, permitted self-dealing by its senior managers, and participated in money-laundering schemes. The absence of effective regulatory oversight and uncertainty among investors had destabilizing effects. In 2020, an independent auditor refused to sign off on Wirecard's financial statements because the auditor could not verify $2.3 billion of foreign deposits purportedly held by Wirecard, a sum that

[19] Quian Chen et al., "The Macroeconomic Fallout of Shutting Down the Banking System," 105 *Economic Review* No. 2, at 31 (Fed. Res. Bank of K.C., 2020), https://www.kansascityfed.org/documents/8185/v105n2sharma.pdf; Walker F. Todd, "Lessons from the Collapse of Three State-Chartered Private Insurance Funds," *Economic Commentary* (Fed. Res. Bank of Cleve., May 1, 1994), https://www.clevelandfed.org/en/newsroom-and-events/publications/economic-commentary/economic-commentary-archives/1994-economic-commentaries/ec-19940501-lessons-from-the-collapse-of-three-state-chartered-private-deposit-insurance-funds.aspx; *see also* Christine Bradley & Valentine V. Craig, "Privatizing Deposit Insurance: Results of the 2006 FDIC Study," 1 *FDIC Quarterly* No. 2, at 23, 28-30 (2007) (discussing the collapses of numerous state-sponsored private insurance systems for depository institutions between the 1830s and the 1990s), https://www.fdic.gov/analysis/quarterly-banking-profile/fdic-quarterly/2007-vol1-2/privatizing-deposit-insurance.pdf.

amounted to almost one-fourth of Wirecard's reported assets. Later that year, Wirecard filed for insolvency and revealed that it would be unable to pay $4 billion in outstanding debts.[20]

In China, Ant Group and Tencent became leading suppliers of deposit, payment, lending, and asset management services by exploiting their dominant positions in ecommerce while evading government banking regulations. The close links between the ecommerce activities and financial services of Ant Group and Tencent gave them huge advantages in terms of accessing the data of individuals, compiling comprehensive credit scoring profiles for their customers, and marketing financial services to consumers throughout China.[21]

In 2020, China launched a regulatory crackdown against Ant Group, Tencent, and other Chinese technology firms. China instructed those firms to organize separate holding companies for their financial activities and to bring those activities into compliance with banking regulations. Chinese authorities charged Ant Group, Tencent, and other technology firms with anticompetitive practices (such as blocking their customers from dealing with competitors), misuse of customer data, reckless and unsound lending, and exerting improper influence over government officials.[22]

Big Tech firms would be likely to create similar threats to the public interest in the United States if they were allowed to offer banking services and obtain master account privileges from the Federal Reserve without complying with the prudential regulatory rules, supervisory standards, and consumer protection requirements that apply to FDIC-insured banks and their parent companies.

The unacceptable financial risks and abuses that occurred at Wirecard, Ant Financial, and Tencent illustrate the types of problems that are likely to occur if the Federal Reserve provides master account access to Tier 3 institutions. The Federal Reserve's proposed guidelines acknowledge that Tier 3 institutions and their parent companies "may pose the highest level of risk. Detailed regulatory and financial information regarding Tier 3 institutions may not exist or may be unavailable."[23]

Rather than keeping open the possibility of granting these institutions access, even after the "strictest" level of review, the Board should simply deny access to master accounts for Tier 3 institutions. Severe

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[20] Reuters staff. (2021, June 13). "Timeline: The rise and fall of Wirecard, a German tech champion." *Reuters*. https://www.reuters.com/article/us-germany-wirecard-inquiry-timeline-idUSKBN2B811J; Wilmarth, Arthur E., Jr., "Wirecard and Greensill Scandals Confirm Dangers of Mixing Banking and Commerce," 40 *Banking & Financial Services Policy Report* No. 5, at 1 (May 2021), available at https://ssrn.com/abstact=3849567.

[21] Kathryn Petralia, Thomas Philippon, Tara Rice, & Nicolas Véron, *Banking Disrupted? Financial Intermediation in an Era of Transformational Technology* 24-27, 34, 54, 70-71, 85-87, 105-08 (Geneva Reports on the World Economy 22, 2019), available at https://www.cimb.ch/uploads/1/1/5/4/115414161/banking_disrupted_geneva22-1.pdf; Stella Yifan Yie, "Ant Grows from Outsider to China's Hope," *Wall Street Journal* (July 22, 2020), B8; Quentin Webb & Jin Yang, "Tencent Builds Investment Powerhouse," *Wall Street Journal* (Mar. 4, 2021), B1; Xie Yu, "China's Curbs to Pinch Online Lenders," *Wall Street Journal* (Feb. 23, 2021), B10; Xie Yu, "Regulators Eye Debt Held by China's Youth," *Wall Street Journal* (Mar. 15, 2021), B5.

[22] Ryan McMorrow & Primrose Riordan, "How China's big tech companies upset Beijing," *Financial Times* (Nov. 16, 2020), available at https://www.ft.com/content/72317ec5-5a5c-44ab-8b8b-a752f9792168; Lingling Wei & Stephanie Yang, "China Steps Up Oversight of Tech," *Wall Street Journal* (May 1, 2021), A1; Jing Yang, "Ant Falls in Line as China Tightens Oversight," *Wall Street Journal* (April 13, 2021), A1; Yuan Yang, "Chinese regulators tell fintech groups to fix 'problems'," *Financial Times* (April 30, 2021), available at https://www.ft.com/content/e69d7064-a126-47c4-a57c-58489ba59d0b; Yuan Yang & Sun Yu, "Ant ordered to restructure by Chinese regulators," *Financial Times* (April 12, 2021), available at https://www.ft.com/content/5c14c1d1-bd9e-4654-9a12-93c4ac46792d; Xie Yu & Jin Yang, "Ant Group to End Some Practices that Fueled Its Growth," *Wall Street Journal* (April 14, 2021), B3; Keith Zhai, "Chinese Tech Giants Told to Curb Financial Services," *Wall Street Journal* (May 1, 2021), A1

[23] https://www.regulations.gov/document/FRS-2022-0059-0001.

problems could develop that are not apparent at the time of application, and the Federal Reserve and other federal bank regulators would not be able to exercise effective oversight to prevent such problems from developing.

c. The combination of giving master accounts to institutions that want to accept and transfer uninsured digital assets and simultaneously permitting them to avoid consolidated supervision creates a dangerous gap in the financial system that would likely be exploited by Big Tech firms. Consumer privacy would be compromised. Competition would suffer.

Although Facebook has abandoned its efforts to launch a stablecoin for now, its future plans in the cryptocurrency space are unclear. Walmart has partnered with a venture capital firm to reinvent its Money Centers. The firm holds investments in Coinbase, Figure Technologies, and a leading bank in the banking-as-a-service area.[24] There is widespread concern that a "Big Tech" firm may move to create a closed-loop digital stablecoin.

A Tier 3 arrangement would remove important boundaries that protect privacy. As shown by the examples of Ant Financial and Tencent in China, if Big Tech firms are not required to use a commercial bank partner to access the payments system and instead could process those payments independently, they would be able to ascertain immense details about consumer financial transactions and personal lives. Currently, card networks do not transmit granular "Level 3" data and banks do not share consumer data with third parties. If Big Tech had direct access to such information, it would enhance their power to surveil citizens and exploit their private financial data.

Similarly, access to a wide array of consumer financial information would provide a huge competitive advantage to Big Tech (and possibly Big Retail) over smaller firms. A report to the House Judiciary Committee found that Big Tech firms could use their monopoly power in search and social networking to enhance their market power in digital advertising. Near monopolies exist in several other spaces. All share a common mission to extract, maintain, and monetize consumer data.[25]

The Federal Reserve should not provide the keys to this type of collection and exploitation of personal data by giving Tier 3 firms direct access to the payment system.

d. Protecting the financial system from illicit finance is a primary rationale for supervisory authority.

Rigorous supervision by federal banking agencies prevents money laundering, trading in illicit goods, and other abuses to the payments system. Federal bank regulators examine banks for compliance with the Bank Secrecy Act (BSA) and other anti-money laundering (AML) laws. They can use enforcement actions and have agreements with other prudential regulators, FinCEN and the Office of Foreign Asset Control. Through these arrangements, these agencies share information about violations and deficiencies.[26]

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[24] Hochstein, M. (2020, August 26). Crypto and Fintech Investor Ribbit Capital Files to Raise $350M for "Blank Check" IPO. *CoinDesk*, https://www.coindesk.com/business/2020/08/26/crypto-and-fintech-investor-ribbit-capital-files-to-raise-350m-for-blank-check-ipo/.

[25] Chairman Jerrold Nadler & Chairman David Cicilline. (2020). *Investigation of Competition in Digital Markets: Majority Staff Report and Recommendations*. House Judiciary Committee, Subcommittee on Antitrust, Commercial, and Administrative Law. https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf?utm_campaign=4493-519.

[26] Office of the Comptroller of the Currency. (2019). *Bank Secrecy Act (BSA) Supervision and Examination*. https://www.occ.treas.gov/topics/supervision-and-examination/bsa/index-bsa.html.

Tier 3 firms would have none of the regular federal oversight that FDIC-insured banks have, yet would be able to transmit payments. While nonbank entities may have some BSA and AML obligations, they have no direct, regular federal supervision over their operations. This lack of robust federal oversight would likely lead to greater BSA and AML compliance problems.

III. CONCLUSION

The Federal Reserve Board should protect the stability and integrity of our financial system, prevent a myriad of problems and evasions, simplify its own decision making, and stop powerful outside interests from obtaining unjustified regulatory favors by limiting the eligibility for Federal Reserve master accounts and services to insured depository institutions with holding companies that are supervised under the Bank Holding Company Act.

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

Yours very truly,

Center for Responsible Lending

National Community Reinvestment Corp.

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

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