Federal Reserve's New Master Account Guidelines Provide Transparent Path For Crypto Industry

August 18, 2022

State-chartered crypto banking entities and other crypto financial institutions will now be subject to a "transparent and equitable framework" when applying for direct access to the Federal Reserve's payment systems (specifically, access to so-called "master accounts") and to engage in other financial transactions permitted only to such accountholders under new guidelines approved by the Board of Governors of the Federal Reserve System (Federal Reserve) on August 15.

Master accounts have long been sought by state-chartered crypto bank entities and other crypto financial institutions as a means to both diversify customer product offerings and to lower the costs of processing certain payment transactions. Some of these institutions as well as one US senator have complained regarding the delays by the Federal Reserve in processing applications for master accounts.[1] Indeed, in June 2022, Custodia Bank, Inc. (the Bank), a Wyoming Special Purpose Depository Institution chartered in October 2020, sued the Federal Reserve claiming it had not acted upon the Bank's application for a master account for over 19 months.[2]

Currently, applications for master accounts have not been subject to a set of publicly available evaluative criteria. Under the new "Guidelines for Evaluating Account and Services Requests" (Guidelines) that are effective upon publication of the Guidelines in the Federal Register, the applicable Reserve Bank where the applicant is located is required to consider a variety of express factors with respect to a master account application. These factors include, but are not limited to:

1. a determination of the legal basis for the applicant's application;
2. an assessment of the applicant's risk to both the Reserve Bank, the overall payment system, and the US financial system, including credit, operational, settlement, cyber and other risks; and
3. a determination as to whether approval of such application would facilitate activities such as money laundering, terrorism financing, fraud, cybercrimes, or economic or trade sanctions violations.

The Guidelines further provide a three-tiered review framework related to the "level of due diligence and scrutiny" that should be applied to a master account application. Tier 1 institutions are those that are federally insured. Tier 2 institutions are eligible institutions that are not federally insured but are subject to a federal banking agency's prudential supervision. And Tier 3 institutions are those that are not federally insured and are not otherwise considered to be in Tier 2.

1 See "Federal Reserve 'illegally' delaying Kraken's master bank account, says Senator," *Protos*, December 3, 2021.

2 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).

According to the Federal Reserve, the publication of the Guidelines was necessary to accomplish the agency's "primary goal [of establishing] . . . a transparent and consistent framework for all access requests across Reserve Banks from both risk and policy perspectives . . . [that] will benefit the financial system broadly." In setting forth this evaluative framework, however, the Federal Reserve made clear that each application must be reviewed on a case-by-case basis and that the Reserve Banks "retain the discretion to deny a request for access to [Federal Reserve] accounts and services where, in the Reserve Bank's assessment, granting access to the institution would pose risks that cannot sufficiently be mitigated."

Why This Matters

State-chartered crypto banking entities and other crypto financial institutions that have long sought the benefits of master accounts have not been advised of the express analytical framework by which potential applications for such accounts will be assessed. Potential master account applicants should now carefully consider each of the evaluative measures with counsel to craft materials that support such applications based upon the requirements set forth in the Guidelines.

Preparing comprehensive evaluative materials setting forth an applicant's position on each criterion set forth in the Guidelines will both ensure confidence that such application satisfies the Guidelines and ensure that the relevant analyses are "in hand" should the Reserve Bank identify perceived risks or deficiencies in connection with its review of the application.

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8/17/22