



# Federal Reserve: Master Accounts and the Payment System

October 12, 2022

Financial technology ([fintech](#)) has led to innovation in retail payments by both traditional banks and fintech firms. Although these fintech firms do not provide traditional banking services, some have sought—and some have been granted—state or federal bank charters. For payment firms, a major motivation for [seeking a bank charter](#) is to obtain a Federal Reserve (Fed) “master account” to access wholesale payment systems and related Fed [payment services](#) (but not the Fed’s [discount window](#)) without needing a bank to act as an intermediary. More recently, [cryptocurrency firms with state bank charters](#) have applied for master accounts in order to more seamlessly transact between crypto and official currency.

Banks hold most of their reserves in master accounts at the Fed. Reserves are assets held as liquid cash balances, as opposed to funds invested in loans or securities. Banks were subject to minimum reserve requirements until 2020, when the Fed [removed](#) them. All types of payments between end users (such as customers and merchants) with different banks using different payment systems can be completed because master accounts are connected to each other at the Fed. Customer payments are aggregated and netted by banks, which can then debit and credit each other’s master accounts through wholesale payment systems, where they are cleared and settled.

Institutions must apply to the Fed to receive master accounts. These applications have [typically been approved quickly](#) for traditional banks, but some nontraditional applicants have reportedly faced delays, causing consternation. The growing number of nontraditional applicants has raised policy questions about who is and who should be eligible for master accounts (under existing law or through legislation), how transparent the application process should be, and what safeguards the Fed should impose on firms with master accounts.

Emblematic of this debate, two recent examples have attracted policy interest. First, the master account application of Reserve Trust, a fintech payment company with a state trust bank charter, was [raised at the confirmation hearing](#) for Fed nominee Sarah Bloom Raskin, who had previously served on Reserve Trust’s board of directors. Second, Custodia Bank, a Wyoming state-chartered special purpose bank specializing in cryptocurrency services, has [sued](#) the Fed for delaying a decision on its October 2020 master account application. Other [examples](#) of controversial applications include a public bank, a “[narrow bank](#),” and a bank to provide services to cannabis businesses.

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IN12031

## 2022 Guidance

The Fed issued [final guidance](#) in August 2022 through the notice-and-comment process explaining how it would evaluate master account applications. According to the Fed, the guidance would make the application process more transparent and ensure that applications from nontraditional institutions were treated consistently among the 12 regional Federal Reserve banks that decide on applications in their districts.

According to the final guidance, by law, the Fed may grant master accounts only to firms that meet the statutory definition of *member bank* or *depository institution*, designated financial market utilities, certain government-sponsored enterprises, the U.S. Treasury, and certain official international organizations. For eligible institutions, applicants must be in compliance with relevant laws and regulatory requirements related to payments, anti-money-laundering, sanctions, and risk management, among others; be financially healthy; and not pose risk to the Fed or financial stability.

Assuming an applicant is legally eligible, the final guidance separates applicants into three tiers, with each tier receiving progressively more scrutiny before approval. Applicants that are federally insured depository institutions will receive the least scrutiny, institutions that are not federally insured but are subject to prudential supervision by federal banking agencies or have holding companies that are supervised by the Fed will receive more scrutiny, and eligible institutions that are not federally insured and do not have holding companies supervised by the Fed but have state or federal charters will receive the most scrutiny. The Fed's rationale for this tiered application process is based on how closely regulated the institution is and how much information is available to the Fed about the institution.

## Policy Considerations

In the context of fintech and crypto applicants, there is a policy tradeoff between the desire to foster innovation and mitigate risks—which may be poorly understood—to the Fed and financial stability posed by innovation. Master accounts for innovative payment firms may deliver lower costs and new product options for consumers and merchants. Meanwhile, the lack of an explicit, comprehensive federal regulatory system for payments leaves the Fed reliant on [rules](#) within the payment systems it operates and federal regulation of banks to manage payment risks. (There are a limited number of federal laws pertaining to payments generally, most dealing with consumer protection or preventing illicit activity.) At the same time, the dual state-federal banking system can result in limited federal oversight when a state-chartered institution does not have federal deposit insurance. (State-chartered depository institutions with federal insurance are subject to federal regulation comparable to federally chartered institutions.) Absent statutory changes, the Fed could find itself with limited ability to monitor or mitigate risks after a master account has been granted to an institution with no primary federal regulator. This [raises the question of whether](#) a nontraditional firm should benefit from valuable Fed services without bearing the regulatory costs applied to other users to access those services (and other benefits). Compared to non-crypto fintech payment firms, crypto firms pose additional risk given the extreme volatility in cryptocurrency prices, widespread scams and fraud, regulatory uncertainty, and several high-profile, abrupt failures of crypto firms.

It is unclear whether the Fed has processed nontraditional applications more quickly since the guidance was released. [Some observers](#) have called for legislation to provide greater clarity on whom should be granted master accounts and force the Fed to act more quickly on applications. In the 117<sup>th</sup> Congress, [S. 4356](#) would require the Fed to provide master accounts to all depository institutions. Other observers have called for more strictly limiting master accounts to traditional banks.

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