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Federal Reserve Board Rejects Application by SPDI That Is Not Federally Regulated

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On January 27, the Federal Reserve Board (Fed) announced that it denied the application of Custodia Bank, a Wyoming special purpose depository institution (SPDI), for member status on the basis that its novel business model and proposed focus on crypto-assets presented significant safety and soundness risks. Specifically, Custodia proposed to engage in novel crypto activities, including issuing a crypto asset on open networks. On the same day, the Federal Reserve Bank of Kansas City filed a motion to dismiss disclosing that it denied Custodia's application for a master account, rendering the lawsuit moot. Custodia had sued the Fed and the Kansas City bank claiming that its two-year old application for a master account was unreasonably delayed. The denials mean that Custodia won't be allowed to store funds with the Fed or have direct access to payment rails.

Custodia's denials came on the same day that the Fed, seeking to align itself with its counterparts at the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), issued a policy statement, discussed here, stating that banks under its supervision, regardless of deposit insurance status, will be subject to the same limitations on activities, including novel banking activities such as those related to crypto-assets.

Our Take:

- Access to the payment rails is provided as a matter of course to federally regulated financial institutions;
- While novel SPDIs may have attractive advantages, it is difficult — if not virtually impossible — for a SPDI to get access to the Fed when such a state bank has not been approved by and is not subject to the regulation of a federal banking regulator; and
- Organizers should not form SPDIs with the expectation that Fed membership or a master account will follow, which dramatically limits the utility of a SPDI charter.

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