# Keeping fintech's promise: A modest proposal

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The Federal Reserve is contemplating new rules for granting "master accounts" to "fintechs" — firms that offer high-tech payment services but aren't eligible for ordinary bank charters. Firms with Fed master accounts can deposit funds in them and move them expeditiously along the Fed's electronic rails. All ordinary banks have such accounts. But so far, fintechs don't. The Fed can change this. And, despite the bank lobby's concerted opposition, it should.

Mobile banking and other recent fintech innovations have already vastly improved the quality and the variety of payments options elsewhere, especially for people without bank accounts. To encourage similar progress here, state and federal regulators have come up with less burdensome "bank" charters meant especially for fintechs, including a Special Purpose National Bank charter introduced by the Office of the Comptroller of the Currency (OCC). But the Fed has yet to grant a master account to any bank with such a charter.

The banks want to keep it this way. And they aren't pulling punches. Last fall, they asked Congress to block the OCC's special charters; and in March, American Bankers Association President Rob Nichols urged the Fed to close the "backdoor to its payments rails," saying it threatened "the financial system's safety and soundness, consumer protection laws and international reputation." A press release from the Bank Policy Institute (BPI), which represents the nation's largest banks, declared that "innovation shouldn't come at the cost of banking's most foundational cornerstone."

Some lawmakers are buying the bankers' line. The very title of an April 15 House Financial Services subcommittee hearing – "Banking Innovation or Regulation Evasion?" – suggests so. And Rep. Blaine Luetkemeyer (R-Mo.), the subcommittee's ranking member, unequivocally took the banks' side: "If you want to be a bank," he said, "you need to be regulated like a bank."

But sound as their banks may be, bankers' arguments shouldn't be taken at face value. For one thing, businessmen don't like new competitors. Might the bankers' efforts just be their version of taxi drivers' attempts to slam the brakes on Uber, or hotels' to deflate Airbnb?

More importantly, most fintechs don't really want to be banks — not ordinary banks, anyway. They want to do things ordinary banks can't. And fintechs that don't mimic ordinary banks don't necessarily need to be regulated like them. "One size fits all" is a lousy regulators' mantra.

Banks are strictly regulated because they engage in "maturity transformation," using short-term deposits to finance longer-term loans. That's risky, so banks can suffer large losses. Unless a bank is well-capitalized, its uninsured depositors, or the FDIC, could end up paying the piper.

But many fintechs don't take similar risks. Consider Kraken Bank. Despite its name, and the fact that it got one of Wyoming's "special purpose depository institution" (SPDI) charters last September, the San-Francisco cryptocurrency firm isn't a traditional bank. Instead of using deposits to fund risky investments, it offers cryptocurrency exchange and safekeeping services, profiting from fees it charges. Its charter doesn't even allow it to make loans.

Yet bankers still don't want Kraken to get a Fed account. Last October, BPI called Kraken "an accident waiting to happen," likening it to the "shadow banks" that helped set-off the 2008 financial crisis. Although Kraken can't lend money, BPI says, it might still invest in corporate and government securities, exposing itself to interest-rate risk. BPI even claims that, had it been around last March, Kraken might have gone belly-up.

To call this stretching a point is putting it mildly. Kraken's capital, though less than a bank's, would still protect its creditors from losses. More importantly, although its charter allows it to invest in some other assets, Kraken plans to back its deposits entirely with Fed balances. If Kraken sticks to its plan, there's no reason for the Fed to send it packing. And the Fed already has the right to compel Kraken to stick to it.

Kraken's case points to a simple, if only partial, solution to the fintech challenge. Let the OCC grant charters to any fintech that follows Kraken's example. And let the Fed in turn follow the example the Bank of England set in 2017, by opening its doors wide to such ultra-safe fintechs. Such a compromise would make it much easier for U.S. fintechs to offer the same high-tech payments options consumers elsewhere enjoy, without sacrificing financial stability.

Chances are that even this modest proposal will have the bankers up in arms. But then, no one need wonder why.

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