Demise of crypto firm FTX brings down a bank

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The demise of Sam Bankman-Fried's crypto firm FTX and his associated company, Alameda Research, has claimed its first banking system victim with the announcement by the San Diego-based Silvergate Capital on Wednesday it was ceasing operations and going into liquidation.

The collapse of the bank is significant because it was a major conduit for the flow of funds into the crypto market from the regular financial system. According to the Federal Deposit Insurance Corporation, it is the first bank failure since 2020 when four banks went under.

And it may not be the last. According to Hilary Allen, a law professor at American University who has testified before Congress on FTX, the Silvergate collapse could put "even more pressure on banks to demonstrate that their dealings with crypto are safe and sound."

The crypto world has assiduously promoted that claim, that it is independent of and an alternative to the banking and financial system. The rapid rise of Silvergate and now its precipitous decline is a further exposure of this fiction.

Announcing the decision to cease activity and try to repay its depositors, the company statement said: "In light of recent industry and regulatory developments, Silvergate believes that an orderly wind down of bank operations and a voluntary liquidation of the bank is the best path going forward."

The most significant "recent" industry development leading to its demise was the collapse at the end of last year of Bankman-Fried's crypto empire which, as he himself even made clear, was essentially a Ponzi scheme dependent on the continued inflow of money.

Silvergate was an essential component of this mechanism. In a statement issued before his operation collapsed, when he was touted as the poster boy for crypto, Bankman-Fried wrote in a comment, prominently featured on Silvergate's website: "Life as a crypto firm can be divided up into before Silvergate and after Silvergate. It's hard to overstate how much it revolutionised banking for blockchain companies."

In the wake of the liquidation announcement, there was a round of tut tutting.

Democrat Senator Sherrod Brown, the chair of the Senate Banking Committee said: "Today, we are seeing what can happen when a bank is over-reliant on a risky, volatile sector like cryptocurrencies. When banks get involved with crypto, it spreads risks across the financial system and it will be taxpayers and consumers who pay the price."

Democrat Senator Elizabeth Warren, always eager to pose as a defender of consumers, tweeted that Silvergate's activities had been "risky, if not illegal" and claimed the failure was "disappointing but predictable."

If that was the case, then the question immediately arises: why was nothing done?

Silvergate was not some fly-by-night operation. Its move into banking for crypto, which started in 2013 but then accelerated after 2016, was approved by the US Federal Reserve.

According to Silvergate president Ben Reynolds, in comments cited by the *Financial Times* (FT) back in December Alan Lane, the chief executive and mastermind of the crypto strategy, "started seeing that companies like Coinbase were getting kicked out of banks" and saw an opportunity.

"Alan went to the Federal Reserve and said we want to provide basic banking services to Bitcoin companies and they said OK."

Besides being regulated by the Fed, Silvergate was listed on the New York stock exchange.

The story of the rise and rise of Silvergate is an expression of processes throughout the US financial system, developing over many years, but intensified by the pumping in of trillions of dollars of ultra cheap money into the financial system by the Fed after the financial crisis of 2008, and then further accelerated with onset of COVID-19 in 2020.

Silvergate began as a small lender financing small real estate deals in southern California and holding less than $1 billion in assets. After its major turn to crypto in 2016 it surged. By 2019 it had become the largest crypto currency bank in the US with 1600 major operators in the crypto world using it to shift billions of dollars a month.

As clouds began to gather over Silvergate, following the demise of FTX at the end of 2022 and the charging of Bankman-Fried with criminal offences, the FT reported last December: “Deposits surged from roughly $2 billion in 2020 to more than $10 billion in 2021. By this year (2022), total assets had leapt to $16 billion. Barely 10 months after listing on the New York stock exchange at the end of 2019, at $12 a share, Silvergate’s share price had climbed to more than $200.”

The article characterised its rise, in the words of a former employee, as “a tiny real estate lender that went all-in on crypto.”

But this is much too narrow a focus. Silvergate’s rise is not the story of one little firm that got too big, but was an outcome of the $4 trillion poured into financial markets after the market freeze of March 2020, which sent Wall Street to record highs as well as the major crypto currency, Bitcoin.

After the FTX collapse, money started leaving the bank. In January it was reported that customers had withdrawn more than $8 billion, forcing Silvergate to sell securities, incurring a loss of $718 million, far exceeding the total profit it has made in the previous 10 years.

With the collapse of Silvergate attention is naturally turning to the position of other banks, not only those involved directly in the crypto market but others that cashed in on the Fed’s cheap money regime and whose position has been weakened as a result of continuing interest rate hikes.

The same day as the Silvergate demise was announced, the Silicon Valley Bank launched a more than $2 billion share sale to try to shore up its position which has been hit by losses on Treasury bonds and mortgage-backed securities, whose prices fall as interest rates rise.

The bank has lost around $1.8 billion on the sale of some $21 billion worth of securities. It has also been hit by the cash shortages of start-up companies it has financed in the high-tech sector. Of the three major Wall Street indexes, the tech-heavy NASDAQ has suffered the biggest decline.

Yesterday, shares of SVB, the parent of Silicon Valley Bank, fell more than 60 percent as part of a broader market decline in which the four biggest banks saw $47 billion wiped off their market value.

One of the issues which arises from the Silvergate liquidation is that assurances from endangered companies that their position is “sound” are generally worthless.

As FTX tanked at the end of last year, Silvergate CEO Lane issued a public letter saying short sellers were spreading “speculation” and “misinformation” and the bank had conducted “significant due diligence on FTX and its related entities.” Less than three months later the bank was liquidated.

The rise and fall of Silvergate is not a history of a company that got too big, but rather of how the policies of the Fed in supplying trillions of dollars of essentially free money created a financial minefield, sections of which are now starting to blow up.