

How the War on Crypto Triggered a Banking Crisis

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*According to an article in American Banker titled "[SEC's Gensler Directly Links Crypto and Bank Failures](#)," SEC Chair **Gary Gensler** has asked for more financial resources to police the crypto market. Gensler testified at an April 18 House Financial Services Committee hearing:*

[Crypto companies] have chosen to be noncompliant and not provide investors with confidence and protections, and it undermines the \$100 trillion capital markets ...

Silvergate and Signature [banks] were engaged in the crypto business — I mean some would say that they were crypto-backed ...

Silicon Valley Bank, actually when it failed, saw the country's — the world's — second-leading stable coin had \$3 billion involved there, depegged, so it's interesting just how this was all part of this crypto narrative as well.

Cryptocurrency experts Caitlin Long and Nic Carter take the opposite view. They acknowledge the link between crypto and the recent wave of bank failures and the runs and threatened runs they triggered, but Carter and Long make a compelling case that it was the FDIC, the SEC and the Federal Reserve that brought the banks down, by a coordinated, extrajudicial "war on crypto" that blocked that otherwise-legal industry from acquiring the banking services it needs.

The public banking movement has run up against similar roadblocks. Both cryptocurrencies and publicly-owned banks compete with the Wall Street-dominated private banking cartel, but more on that after a look at the suspicious events behind the recent bank runs.

The War on Crypto

In a February 2023 article on *Pirate Wires* titled "[Operation Choke Point 2.0](#)," Carter laid out the case that the federal government was quietly attempting to ban crypto. In a 7,000-word March 23 follow-up titled "[Did the Government Start a Financial Crisis in an Attempt to](#)

[Destroy Crypto?](#)", he writes:

The two most crypto-focused banks, Silvergate and Signature, were forced into liquidation and receivership, respectively. The established narrative is that they made "bad bets" and lost, or that they couldn't handle flighty depositors in the form of tech and crypto startups.

But there's an alternative version of events being pieced together that is far more sinister ...

The preponderance of public evidence suggests that Silvergate and Signature didn't commit suicide — they were executed.

In January 2023, ... [s]ome in the crypto space noticed highly coordinated activity between the White House, financial regulators, and the Fed, aimed at dissuading banks from dealing with crypto clients, making it far more difficult for the industry to operate. This is problematic because it represented an attempted seizure of power far beyond what is normally reserved for the executive branch.

He observes that banking crypto firms wasn't prohibited. It was just made very expensive and reputationally risky, by burying the bank in paperwork and unpleasant interrogations from regulators. The Fed also made it clear that new crypto-focused bank charters would be denied. Silvergate, Silicon Valley Bank (SVB), and Signature were put out of business:

Now, depositors are fleeing to the largest banking institutions, money market funds, or simply holding Treasuries directly. Whether intentional or not, these policies will cause smaller banks to die off, making credit more scarce, reducing competitiveness in the bank sector, and making it easier to set policy by marshaling a few large banks for political ends.

Carter observes that the distress in the banking sector was caused by the Fed's attempt to reverse the inflationary effects of excess government spending, particularly for COVID-19 relief, by rapidly raising interest rates. As a result, government bond portfolios, "the foundational collateral asset of the financial system," radically depreciated, causing \$620 billion in unrealized losses collectively to U.S. banks. "But," he writes, "there's also a political subtext here. Most banks are now sitting on mark-to-market losses in their bond portfolios, but they're not facing runs from their clients. ... Silvergate met its end because — well after the crypto credit crisis of '22 had concluded — its remaining depositors were cajoled and bullied into withdrawing their funds."

The most visible smoking gun, says Carter, was the decision to seize Signature Bank:

On Sunday the 12th of March, Signature (SBNY) was abruptly sent into [FDIC receivership](#) by the NYDFS [New York State Department of Financial Services]. This was not a two-bit crypto bank. They had \$110B in deposits as of YE 2022, of which around 20 percent came from crypto-focused companies. ...

Almost immediately, we knew something was wrong. Signature was not a "crypto bank" like Silvergate, where the majority of deposits were derived from crypto firms. It was a pretty venerable NY bank that primarily serviced real estate. It was not in as bleak a financial position as Silvergate or SVB, or other beleaguered regional banks. They

weren't closed on a Friday afternoon after market close, as is typical in receivership situations, but snuck in on a Sunday night, practically a footnote to the SVB shutdown. The FDIC was reportedly surprised on Sunday when SBNY was delivered into their hands. The NYDFS has maintained a well known long-running animus against crypto. The bank crisis was the perfect cover to take down the last remaining bank, which was unapologetic about servicing crypto firms (and ran important fiat settlement infrastructure).

The only problem: based on what we know, it appears that Signature wasn't actually insolvent when they were nationalized and \$4.3B of shareholder value was vaporized.

Carter writes that the crypto industry found an unlikely ally in Barney Frank, former chair of the House Financial Services Committee, the Frank in Dodd-Frank, and a Signature board member. He [alleged](#) that the bank could have opened on Monday, and that leadership was shocked when they were put into receivership. In an [interview](#) with New York Magazine, Frank left "absolutely no doubt that the closure was a political hit job, primarily motivated by a desire to send a message to the crypto industry." Carter observes:

As more data emerged, even the taciturn WSJ became convinced that Signature was a political execution.

In particular, the disparate treatment given to Signature versus their peers PacWest or First Republic is extremely telling. Both banks were in similar or worse financial positions, yet both were given time to save themselves, whereas Signature was seized on a Sunday night, right after SVB's collapse. ...

Most worryingly, the takedowns of Silvergate and Signature represent a rank lawlessness associated with authoritarian regimes. In a lawful society, solvent banks are not seized by the government simply because their clientele is politically disfavored. Shareholders in Signature had \$4.3B in equity (\$22B at peak) wiped out with no recourse. ... Shareholders who saw their equity wrongly vaporized should sue under New York law.

He says that the upshot will be to [drive crypto innovators abroad](#). In fact that move is [happening already](#).

Killing Custodia: A States' Rights Issue

A second smoking gun was the denial of FDIC insurance to Custodia Bank, which had a 100%-reserve business model that would have cost the FDIC nothing and posed no risk to the public. Custodia's goal was just to provide a secure onramp from dollars to cryptocurrencies and an offramp back again. In fact, Custodia didn't need to ensure its deposits, because it would not have been making loans from them. It would have kept them in reserve for the depositors. The bank needed FDIC insurance only because without it, the Fed refused to give Custodia a master account, necessary to participate in the national payment system.

Caitlin Long, the Wall Street veteran who founded Custodia, argues that this newly-imposed rule constitutes an unconstitutional violation of the long-standing right of states to charter their own banks. In an April 17 article titled "[Why Defending the Right of States to Charter Banks Without Federal Permission Is Critical](#)," she writes:

Until a decade ago, it was unheard of that a bank would stop serving entire groups of customers or the people in lawful — if controversial — industries. It was also unheard of that banks would be blocked from accessing either of the two federal utilities in the banking industry: (i) deposit insurance and (ii) the U.S. dollar payment system (which the FDIC and Fed operate, respectively). Indeed, [legislative history](#) shows that Congress took great pains to keep the operation of these two utilities standalone and fully separated from the power to charter banks. As a check and balance, Congress wanted all chartering work done exclusively by the states or the lone federal agency that can charter banks, the OCC. Access to the two utilities was automatic for eligible banks, albeit with bank-specific insurance premiums and overdraft restrictions.

The dual banking system – federal and state – goes back to the days of Abraham Lincoln, when the National Bank Act was passed. Before that, state-chartered banks were issuing their own currencies as paper promissory notes with their own names on them, an unstable system. The National Bank Act unified the country under a single paper currency, the U.S. dollar, by imposing a 10% tax on other bank-issued promissory notes. With the founding of the Federal Reserve in 1913, the U.S. dollar became the Federal Reserve Note. The national currency was federally issued but states retained the right to charter banks. As Long observes:

Historically, states have acted as a check against federal overreach in banking. There is a key reason why: the mission statements of state banking agencies usually require them to support both safety and soundness AND economic development, while federal bank regulators do not have economic development within their wheelhouse. This creates a healthy tension and explains why innovation in banking often originates within the states. The Fed and FDIC have no veto power over state chartering decisions.

... Congress again respected the delicate balance in 1980 when it further clarified the utility nature of the Fed's role as payment system operator by requiring the Fed to provide services to [all eligible banks on a non-discriminatory basis](#). ... In denying payment system access to Custodia, the Fed cited Custodia's lack of FDIC insurance and lack of a federal regulator among its [reasons for denial](#) and, in doing so, the Fed improperly created for itself the unilateral power to require all state banks to be both insured and federally regulated.

Custodia sued the Fed, and the Attorney General of Wyoming, the state chartering the bank, [joined the lawsuit](#). The Attorney General noted in the filing that the Fed had created a "Kafkaesque situation" where a Wyoming-chartered bank is denied access to the U.S. dollar payment system "because it is not federally regulated, even while it is also denied federal regulation."

Five states have enacted bank charters that don't require deposit insurance or federal regulation – Connecticut, Maine, Nebraska, Vermont and Wyoming. Such uninsured banks are prohibited from lending; they must hold 100% cash to back customer deposits, plus up to 8% of deposits as an additional capital requirement. Long concludes:

Congress tasked the Fed and FDIC with running utilities; it did not give the Fed and FDIC veto power over U.S. states – and, in turn, power to block the responsible innovations that state banking authorities create as they fulfill their economic development mandates.

Public Banks and the FDIC Conundrum

The public banking movement is particularly geared toward local economic development. The stellar and only model in the U.S. is the Bank of North Dakota, formed in 1919 when local farmers were losing their farms to foreclosure by big out-of-state banks. With assets in 2021 of \$10.3 billion and a return on investment of 15%, the BND is owned by the state, which self-insures it. There is no fear of bank runs, because the state's revenues compose the vast majority of its deposits, and they must be deposited in the BND by law.

The state's local banks are also protected by the BND, which is forbidden to compete with them. Instead, it partners with them, helping with liquidity and capitalization. The BND has been called a "mini-Fed" for the state and its banks. That helps explain why [North Dakota has more local banks](#) per capita than any other state, at a time when other states have been losing banks to big bank mergers, causing the number of U.S. banks to shrink radically.

UK Prof. Richard Werner recently published [a briefing memo](#) supporting the case for a public bank. It was prepared for the state of Tennessee, which is considering a sovereign state bank on the North Dakota model, but the arguments apply to all states. Benefits discussed include dividends, higher state-level tax revenues, greater job creation, greater local autonomy and resilience to shocks, more options for funding public sector borrowing and state pension funds, and protection of financial transaction freedom and privacy.

The FDIC has not formally rejected insurance coverage for state-chartered publicly-owned banks, but regulators have intimated that it is not interested in covering them; and as [noted by Julie Andersen Hill](#) in an Iowa Law Review article, the Fed is "especially hesitant" to process payments without that coverage. Federal usurpation of state banking regulation not only drives cryptocurrency innovation abroad but kills innovation in local economic funding of the sort pioneered in North Dakota. Andersen Hill writes, "The language and structure of the Federal Reserve Act require that the Federal Reserve provide payment services to all eligible banks.... If the Fed wants to exclude banks, it should ask Congress to change the law."

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