

July 15, 2021

Via Electronic Submission

James P. Sheesley
Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street N.W.
Washington, D.C. 20429

RE: Request for Information and Comment on Digital Assets (RIN 3064-ZA25)

Dear Mr. Sheesley:

Silvergate Bank (“Silvergate”) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation’s (“FDIC”) Request for Information and Comment on Digital Assets (“RFI”).¹

Silvergate is a leading provider of innovative financial infrastructure solutions and services to digital currency exchanges, institutional investors, and other participants in the digital currency industry.

Below we offer (i) an overview of Silvergate’s current digital currency activities and (ii) specific issues related to deposit insurance and resolution proceedings that could benefit from regulatory clarity.² We hope that this information will be useful to the FDIC in its consideration of insured depository institutions’ (“IDIs”) current and potential activities related to digital currency activities. We look forward to working with the FDIC to promote clarity and consistency in the regulation and supervision of IDIs digital currency activities in a way that maintains a safe and sound banking system and encourages innovation.

I. CURRENT SILVERGATE ACTIVITIES INVOLVING DIGITAL CURRENCIES

Silvergate is a California state-chartered commercial bank and Federal Reserve member that uses proprietary technology and specialized digital currency-related compliance and risk management expertise to provide financial infrastructure solutions and services to participants in the digital currency industry. Silvergate is regulated and supervised by the California Department of

¹ Federal Deposit Insurance Corporation, *Request for Information and Comment on Digital Assets*, 86 Fed. Reg. 27602 (May 21, 2021).

² Section I responds broadly to Questions 1-3 of the RFI. Section II responds broadly to Questions 14-16. Although this letter does not specifically address Questions 4-13, we note that Silvergate maintains robust risk management and compliance programs for all digital currency-related activities in accordance with applicable laws and regulations.

Financial Protection and Innovation and the Federal Reserve, and its deposits are insured by the FDIC.³

In 2013, Silvergate began evaluating an initiative to provide traditional banking services to customers in the digital currency industry that found it difficult to identify a reliable insured depository institution partner due to the significant financial and human resources required to navigate the complex and opaque regulatory regimes applicable to digital currencies. To address this then-unmet need, we leveraged our traditional commercial bank expertise in creating a unique, proprietary technology-led platform to provide financial infrastructure solutions and services to digital currency industry participants.

The sections below provide an overview of Silvergate’s current activities involving digital currencies.

A. Customers

We currently provide traditional banking services for many of the largest U.S. digital currency exchanges and global investors, as well as other digital currency infrastructure providers that utilize Silvergate as a foundational layer for their products. Our digital currency customer base consists primarily of three types of customers:

- *Digital Currency Exchanges:* Exchanges through which digital currencies are bought and sold; includes over-the-counter (“OTC”) trading desks.
- *Institutional Investors:* Hedge funds, venture capital funds, private equity funds, family offices and traditional asset managers, which are investing in digital currencies as an asset class.
- *Other Customers:* Companies developing new protocols, platforms and applications; mining operations; and providers of other services.

B. Current Digital Currency Products and Activities

Silvergate provides a variety of banking products and services to digital currency market participants. The sections below provide overviews of these products and services.

1. Deposit Account Services

The initial focus of Silvergate’s Digital Currency Initiative was the offering of deposit accounts to the three types of customers described above. Our deposit accounts offer a wide variety of features and security to market participants, including access to our cash management solutions, and other relevant business banking services. These deposit accounts, which are noninterest bearing, do not hold any digital currencies, but only fiat currencies (primarily U.S. dollars) that

³ Silvergate is a wholly-owned subsidiary of Silvergate Capital Corporation, a federally registered bank holding company supervised by the Federal Reserve whose common stock is traded on the New York Stock Exchange.

represent the depositor's owned operating funds or funds held by the depositor as custodian for the benefit of its customers. At this time, we do not offer any services that involve the exchange of digital currencies.

Deposits attributable to digital currency customers were approximately \$11.0 billion as of June 30, 2021, and we invest these funds primarily in interest earning deposits in other banks, and available-for-sale investment securities.

The success of our digital currency initiative has enabled Silvergate to rapidly grow noninterest bearing deposits from digital currency customers, which has resulted in Silvergate's funding costs being among the lowest in the U.S. banking industry.

2. Fiat Transfers Using the Silvergate Exchange Network

The Silvergate Exchange Network ("SEN") is a proprietary payment network that enables efficient and rapid movement of the U.S. dollar ("USD") between Silvergate customers, specifically digital currency exchanges and institutional investors in digital currencies.

The core function of the SEN is to allow participants to make transfers of USD from their SEN account(s) at Silvergate to the Silvergate accounts of other SEN participants with which a counterparty relationship has been established. SEN also allows participants to view funds transfers received from their SEN counterparties.

The benefit of the SEN to its users is faster payments, made on a near real-time basis around the clock 24/7/365, which results in greater capital efficiency, reduced counterparty risk, and less friction. For comparison, electronic funds transfers sent outside of Silvergate, such as wire transfers and ACH transactions, can take from several hours to several days to complete.

The ability to execute these types of transactions in virtually real-time is particularly valuable for digital currency investors and exchanges since digital currency trading occurs constantly on a global scale, with no regulated market hours.

The SEN is simply an advanced means for executing internal account funds transfer instructions on Silvergate's core banking system. The SEN only transfers fiat USD and is only available to commercial customers – not consumers.

During the first half of 2021, SEN users completed over 300,000 transactions with a cumulative value in excess of \$400.0 billion.

3. Bitcoin-collateralized Commercial Loans

SEN Leverage is a lending product that allows Silvergate commercial customers to obtain USD loans collateralized by bitcoin held at select digital currency exchanges and other custodians that are customers of Silvergate. The product uses the SEN to fund loans and process repayments in real-time. Borrowers accessing SEN Leverage provide bitcoin or USD as collateral in varying amounts providing collateral coverage in all cases greater than the funds being advanced.

SEN Leverage is offered through two different models:

- *Direct Lending:* In the Direct Lending Model, digital currency customers borrow USD directly from Silvergate to purchase bitcoin, using bitcoin as the collateral for the loans. Our exchange client holds the borrower's bitcoin and Silvergate funds the loan directly to the borrower's account at the exchange using SEN.
- *Indirect Lending:* In the Indirect Lending model, Silvergate provides loans collateralized with bitcoin to certain third-party digital currency industry lenders for loans to their customers. The indirect lender uses bitcoin to collateralize its loan with Silvergate and the funding of the loan and liquidation of the collateral may or may not occur via the SEN. In this model, Silvergate uses a custodian to custody the bitcoin collateral and a separate digital currency service provider to monitor the bitcoin collateral coverage ratio (and, if necessary, to liquidate the bitcoin collateral).

At no time does Silvergate directly hold the pledged digital currency. Silvergate sets collateral coverage ratios at levels intended to yield collateral liquidation proceeds in excess of the borrower's loan amount, but the borrower remains obligated for the payment of any deficiency notwithstanding any change in the condition of the exchange, financial or otherwise.

4. Institutional Custody

In late 2020, Silvergate began offering custody services to its commercial customers that wish to safeguard and store their bitcoin and other digital assets with a qualified custodian. Silvergate offers segregated, permission-controlled cold storage accounts with institutional-grade custody features.

II. REGULATORY CLARITY FOR POTENTIAL STABLECOIN INITIATIVES

A. Potential USD-Backed Stablecoin Activities

Silvergate remains committed to expanding our platform to serve the digital currency industry and continues to explore additional offerings, including offerings related to stablecoins. Stablecoins have many potential applications, one of the most promising of which is the potential to make payments faster and more efficient on a broad scale while lowering costs. Stablecoins also enable new means of conducting commerce through digital wallets and platforms.

To serve those purposes, Silvergate is considering issuing a USD-backed stablecoin that would broadly follow the model described by the Office of the Comptroller of the Currency ("OCC") in a January 2021 interpretive letter addressing stablecoins ("IL 1174"). In that letter, the OCC announced the permissibility under certain circumstances for national banks and federal savings associations to use new technologies, including independent node verification networks ("INVs") and related stablecoins, to perform bank-permissible functions, such as payment

activities.⁴ To reach this conclusion, the OCC analogized stablecoins to electronically stored value (“ESV”), which national banks can expressly offer under federal regulations.⁵ The OCC reasoned that like a prepaid card or other ESV instruments, “stablecoins can serve as electronic representations” of USD, and explained that “[i]nstead of value being stored on an ESV card, the value is represented on the stablecoin.”⁶ The OCC concluded that the “distinction is technological in nature and does not affect the permissibility of the underlying activity.”⁷

The OCC’s IL 1174 provided significant guidance to Silvergate and other IDIs considering USD-backed stablecoin activities. However, additional clarification from the FDIC on certain legal issues would greatly benefit such IDIs as they consider how to structure USD-backed stablecoins. We identify and discuss those issues below.

B. USD-Backed Stablecoin Issues in Need of Additional Clarification

As relevant to the FDIC’s role as deposit insurer and receiver/conservator of IDIs, the ESV classification of a USD-backed stablecoin has several key regulatory implications and considerations for IDIs. These can be summarized in three basic questions:

- i. Whether the FDIC considers stablecoins to be access mechanisms;
- ii. Whether such dollars would be considered a “general deposit” or a “special deposit” in a resolution proceeding; and
- iii. Whether deposit insurance would be available, either directly to an IDI’s customers or in the form of “pass-through” deposit insurance.

These questions are discussed in more detail in the sections below.

1. Stablecoins as Access Mechanisms

First, IDIs considering engaging in stablecoin activities would benefit from additional clarification from the FDIC on the categorization of deposits underlying “access mechanisms” referenced in

⁴ OCC Interpretive Letter No. 1174, *OCC Chief Counsel’s Interpretation on National Bank and Federal Savings Association Authority to Use Independent Node Verification Networks and Stablecoins for Payment Activities*, (Jan. 4, 2021), available at <https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-2a.pdf> (“IL 1174”).

⁵ *Id.* (citing 12 C.F.R. § 7.5002(a)(3)). The OCC also recently addressed the permissibility of a national bank holding reserves for stablecoins that are backed by fiat currency on at least a 1:1 basis in situations where there is a hosted wallet. OCC Interpretive Letter No. 1172, *OCC Chief Counsel’s Interpretation on National Bank and Federal Savings Association Authority to Hold Stablecoin Reserves*, (Sept. 21, 2020), available at <https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1172.pdf>.

⁶ IL 1174, *supra* note 4.

⁷ *Id.*

FDIC's General Counsel Opinion 8 ("GC8"), as applied to the USD-backed stablecoins that the OCC has opined are analogous to ESV.⁸

In GC8, the FDIC concluded that "the statutory definition of 'deposit' is very broad" and "encompasses all funds underlying stored value cards and non-traditional access mechanisms to the extent that the funds have been placed at an insured depository institution."⁹ The FDIC emphasized that its opinion is "based upon the proposition that the form of the access mechanism is unimportant" and that "the access mechanism is merely a device for withdrawing or transferring the underlying money."¹⁰

Reading the OCC's IL 1174 in combination with the FDIC's GC8 leads to the logical inference that liabilities in the form of USD that correspond to a USD-backed stablecoin (which, per IL 1174, is analogous to ESV), including a stablecoin issued by an IDI such as Silvergate, should be considered deposits under GC8, with the stablecoin acting as the "access mechanism" for withdrawing and transferring the underlying USD.

2. General Deposits or Special Deposits

Second, IDIs considering engaging in stablecoin activities would benefit from additional clarification from the FDIC on the classification of USD deposits exchanged for stablecoins as either "general deposits" or "special deposits." FDIC's GC8 appears to contemplate that funds underlying stored value products can be either type.¹¹ Whether deposits are categorized as "general" or "special" can be critical in the event of a bank receivership, as a federal court has held:

Special deposits are like bailments in which the bank becomes a bailee and the depositor retains title to the things or money deposited. Special deposits are not the property of a bank. If a bank fails, special deposits do not become part of the receivership estate, and therefore special depositors are entitled to be paid in full before other creditors of the bank. . . . General deposits, by contrast, do not operate as bailments; rather, the depositor gives up title when loaning the bank money, allowing the bank to use the money for profit.¹²

The determination as to whether a deposit is general or special is a matter of both state law and federal law and looks primarily to the intention of the parties.¹³

⁸ FDIC, *General Counsel's Opinion No. 8: Insurability of Funds Underlying Stored Value Cards and Other Non-Traditional Access Mechanisms*, 74 Fed. Reg. 67155 (Nov. 13, 2008) ("GC8").

⁹ *Id.*

¹⁰ *Id.*

¹¹ See *id.* (discussing how funds can be general deposits under 12 U.S.C. § 1813(l)(1) or specific deposits under 12 U.S.C. § 1813(l)(3)).

¹² See, e.g., *Merrill Lynch Mortg. Cap., Inc. v. F.D.I.C.*, 293 F. Supp. 2d 98, 103 (D.D.C. 2003).

¹³ *Id.* at 105.

It is currently unclear how the foregoing principles would apply to customer-bank contractual arrangements that expressly designated the USD deposits held by a bank in exchange for USD-backed stablecoins as “special deposits.” Specifically, it is unclear whether and to what extent the assets underlying deposit liabilities (i) could be invested in low-risk securities (e.g., U.S. treasuries) while maintaining their status as special deposits, and/or (ii) would become part of the receivership estate (notwithstanding the contractual agreement to the contrary).

3. Deposit Insurance Coverage

Third, IDIs considering engaging in stablecoin activities would benefit from guidance on how deposit insurance coverage would apply to the deposits underlying USD-backed stablecoins.

Arrangements with specific agency or custodial characteristics may qualify for “pass-through” deposit insurance coverage, as the FDIC’s GC8 explained in context of stored value cards.¹⁴ In consideration of the regulatory issues discussed above, IDIs would benefit from regulatory clarification regarding whether the deposits underlying USD-denominated stablecoin arrangements may qualify for pass-through deposit insurance coverage and under what circumstances. In particular, because ownership of USD-backed stablecoins can be recorded on a blockchain, it would be useful if the FDIC could confirm whether and to what extent blockchain records can constitute “records” for purposes of 12 CFR § 330.5(b)(2).

Additionally, issuers or other parties involved in these arrangements would benefit from clarification regarding obligations to disclose relevant FDIC insurance information to customers (or pass-through customers, if deposit insurance is available on that basis). FDIC GC 8 encouraged that accurate information concerning FDIC insurance be displayed on stored value cards, but such display of information is not possible for stablecoins, which have no tangible form.

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We commend the FDIC for seeking industry input on digital currency activities of IDIs, and we would be pleased to engage with the FDIC further regarding these important issues. Thank you for your consideration of this submission.

For questions, please contact Paris Cribben at pcribben@silvergate.com.

Sincerely,

Silvergate Bank

¹⁴ See 12 C.F.R. §§ 330.5 and 330.7.