

Small banks' lessons learned on crypto inform big banks' strategy for jumping in

Article

The news: Small banks that saw an opportunity in crypto are now feeling the effects, per the Wall Street Journal. There are lessons to be learned by big banks pleading for a larger role in

the asset class.

The role of small banks: At the advent of crypto and digital assets, small banks saw an avenue to build a place for themselves in the sector and provide a service that most larger banks shied away from.

Banks like **Silvergate Capital**, **Signature Bank**, and **Customers Bancorp** took on billions of dollars in deposits from crypto exchanges, investment firms, and stablecoin issues. But 2022 has been a year unlike any other.

- Silvergate Capital saw its deposits fluctuate by \$5 billion in Q2. But by the end, deposits remained stable at \$13.5 billion.
- Signature Bank reported a decline in deposits for Q2, only the second time this occurred over the past 10 years. The bank faced some struggles when one of its major clients, **Celsius Network**, [filed for bankruptcy](#).

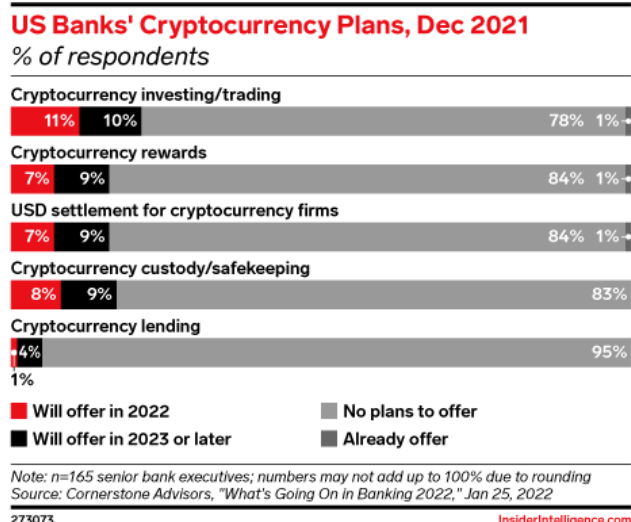
Driving deposits: Smaller banks often struggle to maintain a healthy level of deposits as customers are enticed away by bigger banks' better rates and other incentives. The crypto market offered small banks an alternative to boosting their deposits.

- The banks don't hold crypto or digital assets. Instead, they provide corporate accounts for crypto firms, which makes it easier for the crypto firms to provide liquidity to customers or purchase digital assets quickly.
- Big banks tend to stay away from holding deposits for crypto firms—they'd rather hold stable, low-cost deposits that will help them offer more long-term loans.
- Banks with deposits for crypto firms typically aren't able to increase their loan books as quickly because they need a bigger cash cushion for a potentially wild fluctuation in deposits.

This year offers a prime example of quickly changing deposit levels. When crypto market volatility spiked, banks saw an increase in deposits, trading decreased, and investors waited to see how things would play out. But when investors learned their assets weren't insured, they flocked to divest from the asset class and pull their deposits.

The bigger picture: While smaller banks have been the main players for crypto exchanges and issuers, [big banks are petitioning](#) for a position in the field. Earlier this month, banks made a case to the Biden administration for having a bigger role in developing digital asset regulation and for permission to engage in further crypto activities.

- The banks argue that their heavily regulated sector makes it the perfect space for innovation.
- But **critics** fear that if big banks get wrapped up in crypto, the volatility of the asset class could bleed over into traditional markets.



Lessons learned: Bigger banks considering entering the digital asset market should look at lessons the smaller banks learned in H1 2022.

- Stocks for banks more deeply involved with crypto firms are trading more like a crypto firm's stock than a bank's. So far this year, Silvergate Capital's stock is down 30%, while Signature Bank and Customers Bancorp's stocks are down 40%, after doubling and tripling in value last year.
- The increased deposit volatility risks triggering runs on the holding bank, and in a tough crypto market, poor stock performance will make it harder for these banks to raise additional capital for operations.

Despite the challenges, many of these smaller banks are profitable. Silvergate and Signature both recorded record profits in Q2. And Consumers Bancorp's head of digital banking, Christopher Smalley, said the risks are worth it to bring on large deposits from the crypto firms. The risks simply require preparation and planning.

- The bank intends to offer loans backed by customers' crypto as well as co-branded credit cards with crypto exchanges.
- "We're prepared for an extinction-level event where bitcoin would go to zero," Smalley said.

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