

August 3, 2022

Via Electronic Submission

Department of Financial Protection and Innovation, Legal Division
Attn: Sandra Navarro
Regulations Coordinator
2101 Arena Boulevard
Sacramento, CA 95834

RE: Invitation for Comments – Crypto Asset-Related Financial Products and Services

Dear Ms. Navarro:

Silvergate Bank (“Silvergate”) appreciates the opportunity to comment on the Department of Financial Protection and Innovation’s (“DFPI”) Invitation for Comments on Crypto Asset-Related Financial Products and Services under the California Consumer Financial Protection Law (“CCFPL”).

Below we offer: (i) an overview of Silvergate’s current crypto asset-related financial products and services, (ii) comments on the DFPI’s efforts to promote innovation and improve accountability and transparency in the California financial system, and (iii) suggested steps for the DFPI to better protect consumers with respect to the provision of crypto asset-related financial products and services in California.¹ We hope this information is helpful in the DFPI’s efforts to promote clarity and consistency in the regulation and supervision of crypto asset-related financial products and services and foster responsible consumer-protective innovation.

I. Current Silvergate Activities Involving Crypto Asset-Related Financial Products and Services

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 innovative financial infrastructure solutions and services to digital currency exchanges, institutional investors, and other participants in the digital currency industry. Silvergate is regulated and supervised by the DFPI and the Federal Reserve, and its deposits are insured by the FDIC.²

In 2013, Silvergate began considering providing traditional banking services to digital asset industry companies that were finding it increasingly difficult to maintain strong banking relationships, due to perceived uncertainties and risks related to this nascent industry. To address this then-unmet need, we ultimately leveraged our traditional commercial bank expertise in creating a unique, proprietary technology-led platform to provide financial infrastructure solutions and services to digital asset industry participants.

¹ This letter does not address all topics and questions presented in the DFPI’s Invitation for Comments as Silvergate provides only commercial banking products and services and does not offer products and services to consumers.

² Silvergate is a wholly-owned subsidiary of Silvergate Capital Corporation, a federally registered bank holding company supervised by the Federal Reserve whose common and preferred securities are traded on the New York Stock Exchange.

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 and infrastructure providers that utilize Silvergate as a foundational layer for their products. Silvergate’s banking services are only available to commercial customers – not consumers. 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 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.

Silvergate’s average deposits attributable to digital currency customers were approximately \$13.8 billion as of June 30, 2022, and we invest these funds primarily in available-for-sale and held-to-maturity investment securities, and interest earning deposits at the Federal Reserve and in other banks.

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*

Silvergate’s real-time payments platform, 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 SEN is at the heart of Silvergate’s customer-centric suite of payments, lending and funding solutions serving an expanding class of digital currency companies and investors around the world.

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 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 using our proprietary Application Programming Interface (API). The SEN only transfers fiat USD and is only available to commercial customers – not consumers. In this respect, the SEN is a first-of-its-kind solution for USD funds transfers used to settle digital currency transactions that take place on digital currency exchanges and through broker-dealers.

During the first half of 2022, the cumulative value of SEN user transactions was in excess of \$330.0 billion with the number of digital currency customers growing to 1,585 as of June 30, 2022.

3. *Bitcoin-collateralized Commercial Loans*

SEN Leverage allows Silvergate commercial customers to obtain USD loans collateralized by bitcoin held at select digital currency exchanges and other regulated custodians. The product uses the SEN to fund loans and process repayments in real-time. Borrowers accessing SEN Leverage provide bitcoin 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 participants. 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, typically, 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 bitcoin. 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 in loan repayment.

4. Institutional Custody

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

II. Request for Guidance Concerning the Offering and Provision of Crypto Asset-Related Financial Products and Services in California

TOPICS

Regulatory Priorities

How should the DFPI strive to harmonize its regulatory approach to crypto asset-related financial products and services with federal authorities?

By providing traditional banking services to customers in the digital asset industry,³ we discovered early on that customers found it difficult to identify a reliable, insured depository institution partner due to the significant financial and operational resources required to navigate the complex and opaque regulatory regimes applicable to digital assets. Additionally, our customers offering crypto asset-related financial products and services were subject to unclear regulatory frameworks, both at the state and federal level, making it an ongoing challenge to provide products and services to their customers.

Many issues facing the offering and provision of crypto asset-related financial products and services are matters of both state and federal law. A harmonized and coordinated regulatory approach between the DFPI and federal regulators would provide much needed regulatory clarity to both bank and non-bank digital asset industry participants. In order to achieve such a harmonized and coordinated regulatory approach, we encourage the DFPI to continue to engage with current digital asset industry participants that may be currently supervised at the federal level or actively engaged in conversations addressing federal oversight of the digital asset industry, solicit public commentary such as this, and proactively keep an open line of communication with the various federal initiatives taking place in the United States today including the work being performed as a result of President Biden's Executive Order Ensuring Responsible Development of Digital Assets.⁴

We commend the DFPI's efforts to develop a state regulatory framework in alignment and coordination with federal rules and regulation which will aid in establishing consistency in the administration, oversight, and enforcement of crypto asset-related financial products and services.

Additionally, we believe the same approach as discussed above will aid the DFPI in working with other state financial regulators to promote a common and comprehensive regulatory approach to crypto asset-related financial products and services.

³ Executive Order N-9-22 defines the term "crypto asset" as "a digital asset, which may be a medium of exchange, for which generation or ownership records are supported through a blockchain technology."

⁴ Executive Order Ensuring Responsible Development of Digital Assets (March 9, 2022), available at <https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/>.

How can the DFPI make California the most desirable home state for responsible companies when developing guidance and, as appropriate, regulatory clarity and supervision of persons involved in the offering and provision of crypto asset-related financial products and services in California?

As a California state-chartered bank, we encourage the DFPI to continue providing leadership in its encouragement of technological innovation to promote more effective and efficient provision of consumer financial products and services to the population of California, and by giving further consideration to the permissibility of more robust crypto asset-related services by financial institutions.

The issuance of Executive Order N-9-22⁵ and the DFPI's mandate to develop guidance and regulatory clarity and supervision involving crypto asset-related financial products and services in California demonstrates the state's commitment towards establishing itself as a hub for the digital asset industry and its ever-growing list of participants. In that regard, California's technology-forward environment has enabled Silvergate's mission to build a safe and trusted payments platform, including providing necessary infrastructure to all regulated U.S. dollar-backed stablecoins.

For companies like Silvergate which seek to advance digital asset and blockchain technologies, including fiat-backed stablecoins, and provide infrastructure solutions and services to the digital asset industry, a regulatory environment which solicits continued input from participants while being considerate of state, interstate, and federal laws is necessary. By continuing its efforts in engaging with federal and other state agencies to develop a harmonized regulatory framework, the DFPI is well-positioned to make California the premier home state for companies seeking to responsibly offer and provide crypto asset-related financial products and services.

Scope and Definitions

Financial Code section 90005, subdivision (k)(12) of the CCFPL states that “financial product or service” includes “offering another financial product or service as may be defined by the department, by regulation,” subject to certain criteria. Are regulations needed to specify crypto asset-related financial products and services that should be included in the definition of a “financial product or service” subject to CCFPL authority?

Generally, yes. Crypto asset-related financial products and services may encompass a very broad range of offerings and regulatory clarity as to which specific financial products and services are intended to be captured by the CCFPL's authority should be identified. Clear definitions are essential to provide guidance for entities offering such products and services as well as to ensure an equal and competitive landscape for such entities. As demonstrated today, the lack of clarity at the federal level around crypto asset-related financial products and services, including which products and services may be subject to select regulatory requirements, is a challenge for market participants as they cannot find stable footing amongst the various federal agencies and the vast discrepancies amongst the potential regulatory oversight regimes and applicable regulatory requirements, which leads to the potential of increased operational and financial risk. By providing transparent and specific criteria for crypto asset-related financial products and services,

⁵ Executive Order N-9-22 (May 4, 2022), available at <https://www.gov.ca.gov/wp-content/uploads/2022/05/5.4.22-Blockchain-EO-N-9-22-signed.pdf>.

the DFPI is seizing a valuable opportunity to provide clarity on this topic, helping to further innovation, protect consumers, and support the industry as it continues to mature.

We are happy to continue to participate in any future conversations that will contribute to the overall growth and regulatory clarity for the digital asset industry.

* * * *

We commend the DFPI for seeking public input on the offering and provision of crypto asset-related financial products and services and thank you in advance for your consideration of our comments on this important topic.

For questions, please contact [REDACTED] at [REDACTED].

Sincerely,

[REDACTED]

Paris Cribben
General Counsel
Silvergate Bank