diffusetap
Virtual Event Series

Banking Collapse Meets CBDC

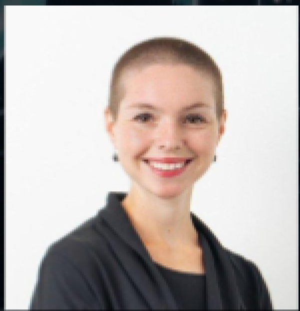
Guest Speakers:

Howard Krieger
CAO
Aegis Trust Company

Scott Christianson
Director
MU CEI

Hosts:

Kenny Estes
CEO & Founder
Diffuse



Ayla Kremb
COO & Co-Founder
Diffuse

DiffuseTap: Banking Collapse Meets CBDC

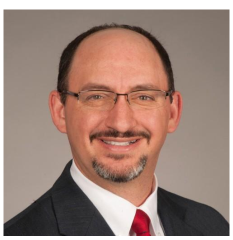
Last time on DiffuseTap, Howard Krieger, CAO at Aegis Trust Company, and Scott Christianson, Director at University of Missouri Center for Entrepreneurship and Innovation, talked to us about the recent banking collapse, how CBDCs could harm the banking sector, and why the FDIC, OCC, and Federal Reserve's stance on crypto adoption causes concern for innovation.

Want to make friends from the Diffuse Fund Ecosystem? Email contact@diffusefunds.com.

DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas)... straight from your armchair like a boss.

Meet the Speakers



HOWARD KRIEGER is a finance and digital asset leader with more than 20 years of experience in valuation, risk management, and project management in complex financial instruments.. He is currently the Chief Administrative Officer of Aegis Trust Company.

Linkedin: @howardjkrieger

SCOTT CHRISTIANSON is Director of the University of Missouri Center for Entrepreneurship and Innovation. Specializing in teaching about emerging technologies such as AI, Blockchain, and IoT, he has received teaching awards and is recognized as a leader in integrating emerging technologies into education.

Linkedin: @jscottchristianson

About Diffuse

We are an alternative fund platform offering differentiated investment products. From digital assets, to VC funds, and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information visit www.diffusefunds.com.

KENNY ESTES: Mr. Howard Krieger, do you want to tell the folks a little bit about your background and what you're up to over at Aegis?

HOWARD KRIEGER: Sure, Kenny. Thank you for having us, and welcome everybody. This is a great forum. It's my second swing at the bat here, and I'm happy to be here. I'm currently the Chief Administrative Officer of Aegis Trust Company.

We're a state-chartered SEC-qualified custodian of digital assets in the United States, one of five. We also have a license in Singapore and Hong Kong, making us the only US SEC-qualified custodian that also has national global transfer capability. We typically serve token foundations, state attorneys in the US, tokenized funds that are looking to keep their tokens in a safe harbor, and the like. For safe custody, we're a non-depository, DOB-regulated institution.

KENNY: Amazing. Thanks for coming here. Mr. Christianson, if you could do the same. And a fun little fact about me, I went to school about 30 minutes north of Missou up at Truman State. Now, maybe you could tell us a little about what you're up to.

SCOTT CHRISTIANSON: You probably came down to Missou to party.

KENNY: Once or twice. Yes, indeed.

SCOTT: All right. Very good. My name is Scott Christensen, and I'm a professor in the business school here. I'm a little bit different than some of my colleagues in that I am not in a research position but in a teaching position. I ran an IT business here in Colombia for many years, and I try to teach my students about emerging technologies. Around 2017 or 2018, I made something called "The Blockchain Game" to try to explain to them how blockchain works.

Just like in our breakout room earlier, I talk about what are good applications and what are not, and I try to walk them through that. And then, I try to look at other technologies that have emerged from that such as NF Ts and central bank digital currencies, which have been the latest thing that I'm interested in. I try to be as agnostic as possible, although I do have my opinions on some of these things. I'm happy to be here and very excited. It's a very interesting format. I'll leave it at that.

AYLA KREMB: Awesome. We'll hop right into it. I'd love to talk about crypto and the banking collapse that we experienced recently. First question would be this banking collapse that we had over the last two months with Silvergate, Signature, First Republic, and Silicon Valley Bank. All the good ones. What role did crypto play in that, if any? Was it just collateral damage? Maybe I'll pass this one to Howard.

HOWARD: Sure, certainly. I spent 10 years in banking at places like Wells Fargo and HSBC before joining KPMG, and being a national leader in banking, valuation, and risk. The interesting thing with this collapse was the run on the liability side.

Deposits in banks are liabilities. Whereas in 2007 or 2008, you had an underperformance of the investment, and a mismatch in the timing or duration of the asset of the bank relative to the liability. Here, you had the liabilities running off.

Was crypto involved? Scott, I'd love to hear your opinion on this. I think that it really has to do with some of these banks having such a narrow industry focus, being the VCs and then the entities that got the VC money. When the VC capital dried up with the Fed raising rates, you just had this domino effect where the VCs didn't have cash. The startups needed to use their money, and the banks were just long as the government basically went against the banks.

SCOTT: Yeah, I think I think you're right, Howard. I think we know a little bit more now that things have calmed down. When Silicon Valley Bank first collapsed, there was a lot of panic. And I think there was a question of motivations by some of the VCs that were heavily invested in crypto because they did not, shall we say, comport themselves professionally on Twitter.

They got all excited about things and said things like the government is horrible, and this is why we need crypto. And a lot of people were like, “well, wait a second. These guys are benefiting from the collapse of the dollar.” I think there is this kind of animosity that exists between the crypto world and that traditional banking world.

I think we saw that on display to some degree and I think it's a little bit problematic, because there's a certain level of distrust there. It’s like I'm questioning if Howard was on one side of this. I'm questioning his motivations, and he might question mine. I think that was something we saw as a question of motivation. And perception is reality, right? That also plays into the whole thing about central bank digital currencies, too.

KENNY: Okay. We'll come back to CBDCs because that is a whole can of worms. But Howard, why just those banks? Inflation and interest rates have not been going up just in the United States. It has been a global phenomenon, but I haven't heard about any other high profile blow ups in any other countries. It's really an isolated number. What made it special? Why are these banks unique?

HOWARD: So, if you take risk and do that basic cut of systematic versus unsystematic, you could say that inflation is a systematic risk that really hurt the unrealized losses on the investments of all banks globally. All banks have to basically invest their liabilities in different termed instruments, and the longer term instruments were hurt the most. Here, the unsystematic commonality is almost the perception.

Not not so much the reality, but the perception of who banked with these entities. First Republic, Silicon Valley Bank, Silvergate, they're all concentrated in that Silicon Valley startup area. Signature was interesting because with Signature, if you recall, there was no headline. It was open, and then one day it was closed.

We don't know what happened behind the scenes there, but I think the unsystematic commonality is that regional banks are thought to be heavily concentrated in an industry where liabilities were going to start screaming off the balance sheet. And as people see the stock price fall, they equate the equity value with the health of the bank, even though the equity is really that head room between the bank's assets and its liabilities.

KENNY: So you're taking the position that it’s really the liabilities that drove the perception.

HOWARD: I hate to say it. It's happening, but it's not in the headlines. The big banks are getting bigger because people and entities are moving their assets. It's small dribs and drabs. Bank runs take months, not days.

KENNY: Scott, do you agree with that perception? Or do you have a different take on it?

SCOTT: Yeah, I think so. Kenny, you just mentioned the idea of VCs. Not only do we have Silicon Valley Bank being concentrated in a particular sector of startups, but you also have a number of venture capital firms that are very large, that are recommending that all their startups go there, and all their startups withdraw.

You have another type of institutional risk there, which I'm sure Silicon Valley Bank thought was great when Andreessen Horowitz was funneling business their way. But then, when Andreessen Horowitz says “Okay, wait a second, something's going wrong here. Let's get our money out. Everybody withdraw”, you can have a dozen people that might be able to initiate a bank run.

I think that's one of the accelerants that Howard's mentioning there. It's different than systematic risk, but I'd say institutional risk of not only specializing in a particular area, but also having this type of control that was outside of those startups.

AYLA: We'll be talking a little bit about the CBDC side of things. Do we believe that if there were CBDCs in the world that, for example, USDC would not have dropped 10% when Silicon Valley

Bank dropped off the face of the earth? Would that have made a difference? And would CBDCs create more confidence in crypto, or is it more like an institutionalized government initiative that takes away the fundamentals of what makes crypto exciting? Because everybody wants to be the future of banking.

HOWARD: Scott, this is a juicy topic for you. So please, go ahead.

SCOTT: Yes. There's both the idea of a wholesale central bank digital currency in which it will be used for bank-to-bank transfers, and I think a lot of banks are very interested in that because of the antiquated swift and ACH transfer methods, and see that as one way to help. But when we started getting to retail and started to think about a digital dollar that you would have in your wallet, and that you would be able to store on a blockchain or something like that, then I think we're starting to see something that's more about governmental control.

There might be some great benefits. Transparency would be one, where you could see how money is actually being spent at the University of Missouri, for example. You could see that in the blockchain database. You could see where that money flows. But you start to get all the complications that come with our current banking system in some ways, because I can't see a central bank digital currency that doesn't know their customer.

Crypto is nice because not only does it help the unbanked, but it really kind of turns them into a bank as well. That's the neat thing about it. And I don't see that that is the solution. If you look at what happened in Nigeria, it's interesting. They launched their central bank digital currency about 24 months ago. It is about half of a percent of usage, which is odd because they are one of the heaviest users of crypto.

I think the government thought, "Oh, people really like our digital dollar. Well, they probably are using Bitcoin and other cryptocurrencies for reasons other than they just wanted the convenience of a digital dollar." So, even though the bankers kind of liked it, it's not clear whether people will like it or not. It almost scares me when we start to look at what authoritarian governments could do with that. China has experimented a lot with airdropping their digital Chinese yuan, that's kind of a state that also likes to control people.

We saw that the President was reelected unanimously out of a thousand representatives, so it's not exactly a democracy. It's kind of disturbing whether these could be used as another method of control. I'm getting into my opinions here. I'm getting a little bit into Scott's soapbox. Even though I'm a technologist, and I am really fascinated by technology, I'm not sure I like this one.

HOWARD: And I have to say, what I find interesting is that banking is one of the few industries where inefficiency has been built into the business model. This includes the purposeful delay with approvals, paperworks, forms, etc. Even the mere act of entering a pin when you use your debit card. These are all built into the economics.

I think the challenge with the CBDC is that if you make markets too efficient too quickly, you're going to have this bullwhip effect where you're going to have greater, faster bank runs at a scale much larger than regional banks are prepared to handle. CBDC in the US, by the way, is nicknamed Project Hamilton. And if you remember what Hamilton did, he basically sold the soul of states rights in order to centralize money in America. The reality here is that with CBDC, the potential efficiency might cause more harm to the existing banking system than efficiency.

KENNY: Alright, that's an interesting take. You want some efficiency, you need to have an individual having control of transactions. I guess that takes us to another question. Do you think banks can really work with crypto in general? Or are crypto clients just all going to move offshore? Maybe they saw what happened to the First Republics and the Signature Banks of the world, and they just don't want to take that risk anymore. So, they're going to move to the Caymans and Bahamas. Is it hurting innovation in the US? Scott, back to you.

SCOTT: From what I've seen from our banks, they were interested in how crypto could be part of an investment portfolio, and now they've backed away from that as far as their wealth management departments. Other than that, I'm not really sure. When crypto was going up and up, they were like, “Oh, we better get into this.” But now, they're not so inclined.

HOWARD: Let me add to that. So the FDIC, OCC, and The Fed issued a joint statement in January where they basically came out with a very passive aggressive memo. They wrote that from their understanding, there is nothing in a national chartered bank’s permissions that allow them to custody public on-chain assets. This is the FDIC, the OCC, and the Fed.

They also said that they do not believe that any bank, or state chartered trust, or what have you has the ability to properly manage and mitigate the risks associated with digital assets that are on public blockchains. And in essence, those three entities are the ones calling the shots. It’s the golden rule. “He who has the gold makes the rule.”

They basically said “private on-chain assets? The banks can handle it. But public? They're not touching it.” And I don't see them moving off that anytime soon. I don't know what that means for CBDCs. As one of the callers asked, if the FDIC and the Fed and the OCC are saying that banks can't handle the risk of public on-chain assets, how does the CBDC differ?

KENNY: I mean, those are contradictory thoughts. We'll stick with that. Actually, Howard, just for a second maybe we could go a little deeper. Are they just burying their heads in the sand? They’re saying “no bank has that expertise today” without providing a roadmap to how they can actually get comfortable with it. They're almost avoiding that innovation. Is that short sighted? This is a crazy question, but go ahead.

HOWARD: They're under no obligation to provide any solutions. If anyone on this call has worked with regulated entities before, you might know what I'm talking about. I worked with the South Dakota division of banking all the time, and they basically asked you to make the rope that they will eventually hang you in. AML, BSA, KYC, all these gut frameworks are not instruction manuals on how to run a business or financial institution. They basically are a framework for you to then create the rules that they will check an audit and make sure you're following.

I think from the Fed and the OCC's perspective, they're just saying, "Look, we don't have rules on the books to deal with this stuff. And yet, frankly, we don't think that you, the independent nationally chartered banks, could figure out the right way to do this." This is why the OCC is trying to step back Anchorage's bank charter. Because when Brian Brooks greenlit it as a lame duck chair, the rest of the organization didn't feel that the proper infrastructure was in place to manage the risks.

KENNY: Scott, anything you want to add to that concept?

SCOTT: No, I think that's a very interesting take on it. And I think bankers, by default, are very conservative. And certainly, banking regulators are even more conservative. I do think that we need banks to be able to take risks, and I'm a little worried that all that's happening right now will discourage banks from taking important risks.

Thank you for downloading this DiffuseTap event transcript.

Sign up for upcoming sessions and check out past features and event transcripts.

Dennis Chookaszian
Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

Sharing his decades-long expertise on corporate governance, Dennis talked about how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. Read on

Susan Brazer
CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan described the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. Read on

Raj Mukherjee J.D.
VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for Coinbase and Binance from scratch, and how investors can profit from crypto without getting caught in a taxation mess. Read on

JOIN US