Will the Banking Mess Spill Over into DeFi?

By: www.ProfitableInvestingTips.com

The collapse of the 16th largest bank in the USA (SVB) was followed quickly by the closure of a New York regional bank (Signature Bank) which focused on the real estate sector but that had been starting to take crypto deposits and Silvergate Capital Corp. This banking mess threatens to spread throughout the entire financial system. Will the banking mess spill over into DeFi as well? Although crypto fell across the board on the news of bank closures, Bitcoin, Ether, and Coinbase stock have all rallied afterward.

Why Has There Been a Banking Crisis?

The current "banking mess" started with the failure of SVB (Silicon Valley Bank) which was a key lender to startups and tech companies in Silicon Valley. It was the 16th largest bank in the USA and its failure was the largest of a bank since Washington Mutual failed during the Financial Crisis in 2008. The bank experienced a run on deposits of $42 billion. It had assets in excess of $200 billion but most assets were in the form of loans or long term bonds which, if they were sold today, would be devalued by nearly 50% because of interest rate increases since the bonds were purchased. The worry was that after two more banks failed, that more regional banks would fall like dominos as depositors pulled their funds and went to larger banks. Fortunately, the Fed, US Treasury, and FDIC stepped in and, besides covering FDIC insured deposits have pledged to "make whole" all depositors of SVC. As such the worst of the banking crisis **appears to have been avoided**.

Which Crypto Businesses Were Affected by SVB Closure?

When regulators closed Silicon Valley Bank (SVB) it sent shockwaves through the banking sector. Regional banks saw their stock prices plummet as many feared more runs on middle-sized banks like SVB, Signature, or Silvergate. The companies most affected in the **crypto sector** are Ripple, Yuga Labs, Avalanche, Proof, Circle, and BlockFi. All of these companies had direct exposure to SVB bank. The problem for these companies and other tech companies with deposits in SVB is that if their funds are locked up or lost they cannot do business. They cannot do payroll, pay expenses, or even keep the lights on. This constituted, and perhaps still constitutes, a risk of spread of a crisis in the tech sector as well as decentralized finance and other crypto businesses.

Bitcoin Soars As Banks Fail

The first reaction of crypto tokens Bitcoin and Ether was to fall on the news of the SVB failure. Ether fell by 14% and Bitcoin fell by 14%. Then, Ether rose by 20% and Bitcoin went up by 24%. First of all neither of these tokens appear to have any direct connection with SVB bank. Second, they are not directly linked to the US banking system. This is the first bit of good news in the crypto sector since **crypto winter** sent prices spiraling downward in November 2021.

More Regulation Ahead for DeFi

Aside from companies directly affiliated with SVC, Silvergate, or Signature Bank, nobody in the world of decentralized finance was hurt by the bank failures. In fact, the upward spike in crypto prices can be viewed as a good thing if it portends a steady crypto recovery. The lessons of the last year, however, have not been forgotten in Washington as decentralized finance businesses and crypto exchanges collapsed and took customer money with them. Instances of **fraud** did not help the DeFi or crypto case for a hands off approach by regulators.

The worries of government regulators for quite some time included the risk of trouble in the DeFi realm spilling over into the wider financial market. The two things that triggered the recent bank failures were stocking up on long term bonds that then devalued with rising interest rates in the case of SVB and getting into crypto deposits just as crypto prices began to fall when the Fed raised interest rates. In all likelihood, DeFi businesses that accept deposits, pay interest, and provide loans will be subject to regulations similar to those for banks in terms of maintaining dollar reserves and being subject to routine inspections of their books.

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