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INSIDE DIGITAL ASSETS
with RIC EDELMAN

Issue No. 10 | December 21, 2021 | DACFP.com

SHOULD YOU GENERATE INCOME VIA STABLECOIN LENDING?

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Zero point nothing. That's about the rate of interest you're earning from bank accounts these days. This is causing lots of people to seek alternatives, in an effort to obtain higher yields.

Enter stablecoin lending – a new way to earn passive income. You accomplish this by lending your digital assets to others.

A stablecoin is a digital asset whose price is pegged to a fiat (government-issued) currency, such as the dollar, euro, rupee, or yen. More than 200 stablecoins exist worldwide, worth an aggregate $130 billion. That's a 6x increase from a year ago, demonstrating the increased engagement by investors around the world.

Unlike bitcoin and other digital assets, whose prices fluctuate wildly, stablecoins are designed to reliably maintain, uh, a stable value over time. No volatility.

But no volatility means no potential for upside because the price won't rise. And like the dollars in your pocket or purse, stablecoins pay no interest. But you can earn interest by lending your stablecoins to others.

Staking Versus Lending

There are two ways you can generate income with digital assets: Staking and lending. Interest rates range from 1% to 15%, depending on which digital asset you use and how long you provide the loan.

When you engage in staking, you pledge your digital assets to support a blockchain network. In return, you receive payments in the form of interest or tokens paid to your account. You sometimes have to agree to leave your coins there for a certain period, and in those cases, staking is best for long-term investors.

When you lend your coins, borrowers pay interest to you. To reduce your risk, borrowers post collateral – typically, their own digital assets.

At present, there is a lot of demand for loans of stablecoins and digital assets – which is why borrowers are willing to pay very high rates of interest.

Risks

When lending, your holdings could be tied up for long periods – a problem if you need the money. So be sure you are aware of any liquidity restrictions with the platform you are using.

Also be aware of counterparty risk. Who is borrowing your coins? You will never know – making it challenging to see recourse if something goes wrong.

How might something go wrong? Well, borrowers, in most loan agreements, are allowed to "pledge, repledge, hypothecate, rehypothecate, sell, lend, or otherwise…use any amount" of digital assets at their discretion. Hypothecating means they can use the coins they borrow from you to serve as collateral for another loan they are obtaining. In other words, a loan can be collateralized by coins that were themselves borrowed. Sort of sounds like what happened in the housing and securities markets in the 2000s, which led to…well, we know what that led to, so consider lending with a firm that doesn't hypothecate your digital assets.

When participating in crypto lending, you often place your digital assets on a hot wallet, which is connected to the internet and thus exposed to hacker risk. Consider using platforms that let you use a cold wallet (yours or one they provide), which isn't connected to the internet and thus offers more protection from hackers.)

To protect investors from losses due to hacking, some vendors use sophisticated security procedures. They also submit to independent security audits, and they maintain insurance to protect against losses from theft, including cybersecurity breaches.

And keep in mind that none of this activity is protected by FDIC or SIPC.

Tips for Financial Advisors

- If crypto lending sounds strange to your clients, you can make an analogy to securities lending. Stablecoin lending is similar in principle.
- Confirm that clients interested in staking or lending have cash reserves equal to at least 12 months of expenses. This will reduce the likelihood they'll need their coins anytime soon.
- You might consider positioning stablecoin lending as an inflation hedge or an addition to portfolio diversification.
- Limit these strategies to stablecoins pegged to USD.