Crypto Lending: A healthy way to get more out of your money

By Valerio Puggioni | August 16, 2021

Alice needs a loan.

Business hasn't been going well during COVID, and she needs some quick cash to cover expenses. All she needs is a little breathing room for the next 2 weeks, before the contract with a major client begins.

So Alice walks into the Bank. She's all dressed up to see the big manager. She's got her speech ready, and has a neat figure in her head: She needs a loan of US$10,000.

The bank manager greets her, sits, and looks down at her application forms. He furrows his thick brows as he eyes her debt and credit history. Her collateral? He scratches his forehead with his pen and adjusts his tie while clearing his throat.

He's not impressed.

After weeks of anticipating this moment, Alice walks out with her head down. She recalls the bank manager's words trampling on her hopes. Her history puts her at too much risk. She doesn't have enough collateral.

In other words, Alice is too big a risk for the bank to take. Sure, she's good enough for them to take the money, just not the way around.

But then she speaks with you, and wouldn't you know it?

You read this comprehensive article about crypto lending. Maybe Alice has a shot at borrowing for the short term. After all, her husband Bob's been dabbling in crypto for some time, and he's got to have a few bitcoins up his sleeve, right?

"Oh, but Bob would never part with his dear bitcoins," Alice tells you as she serves you a nice cup o' tea.

"But that's the best part. He doesn't have to."

And Alice is all ears.

What is crypto lending, and how does it work?

Based on this earlier loan situation, we have two parties: The lender and the borrower.

The lender grants a loan to the borrower, in exchange for the loan to be returned at a later date, with interest. The borrower deposits crypto assets as collateral to secure the loan.

Let's look at this in practice.

Alice talks to Bob, explains all the risks to her hubby, and it's music to his ears.

He puts up his bitcoin as collateral, but he ends up having to put up a bit more. Why? Because he needs to "overcollateralize" to cover for any potential losses. After all, due to crypto volatility, the value of his collateral can dip below his loan amount.

For example, let's say you put up 11 bitcoins as collateral to borrow 10. At US$50,000 a pop, you're confident the value of bitcoin will continue to climb in the middle of this bull run. So the sum of your collateral is $550,000, and you've borrowed $500,000 in stablecoins.

This means you're covered for $50,000, right? As in, as long as the total value of your collateral does not go under $500,000, you're safe. This would mean that bitcoin would have to drop under roughly US$45,000 for you to maintain your collateral.

In other words, Bob the borrower has to keep an eye on his collateral to ensure that it never dips below the set limit.

In exchange, Bob and Alice receive their loan in a stablecoin like Tether. And that's a happy ever after.

But say, after borrowing, Bob gets curious about his digital assets sitting in his wallets. He wants to put them to work. In other words, *he* wants to be the lender.

It's easy to do. Several wallets and crypto exchanges let you store your crypto. In exchange, you receive high interest yields on your coins. (Some pay up to 6% for bitcoin and ether. Show me savings account rates that can do that, and I'll liquidate my positions.)

Let's talk about CeFi vs. DeFi

When people talk about crypto loans, they're talking about 1 of 2 things:

1. Centralized Finance (CeFi) platforms

2. Decentralized finance (DeFi) lending protocols, which involve smart contracts.

Both have their respective tradeoffs. Let's go over the major ones.

CeFi platforms require KYC (Know Your Customer) verification and AML (Anti-Money Laundering) compliance. This means you need to submit your personal information. You might need to take some other security measures too. (Sometimes, you might need to take a selfie while holding up your signature with today's date.)

CeFi platforms are more closely aligned with traditional finance. This isn't necessarily a bad thing. Sure, there's more paperwork with CeFi, but you get your finances backed by insurance. And if there are any issues, customer support is only a phone call away.

DeFi lending protocols, on the other hand, don't need you to give up any personal information. This also means you might not need to sign up for anything.

That's because they operate on smart contracts. Smart contracts are protocols designed to execute only once certain preconditions are met. In other words, they're trustless because they don't require a middleperson.

But because DeFi platforms by definition have done away with third parties, there's no one to call for support. This can feel risky or overwhelming, even to well-versed crypto owners.

That's actually why crypto loans have really blown up this year. These smart contracts render "trusted" third parties, like banks, redundant.

The main disadvantage of decentralized platforms? Operating without KYC disclosures could subject them to regulatory risks in the future. This could be off-putting for many borrowers and investors.

Why it's smart to speak to a tax consultant

The tax implications of crypto lending are confusing. In many instances, we lack clear tax policies and guidance, including for stablecoins.

For example, when you take out a crypto loan, you're avoiding a taxable event. For many of us, our portfolio represents a sizable portion of our wealth. But selling our crypto when we need cash triggers a taxable event. That's why using our crypto as collateral to receive a U.S. dollar-pegged loan can be a great way to gain liquidity. (All while not losing investment exposure or having to pay taxes on our gains!)

It can get pretty confusing pretty quick, right?

All this new tech is scary for some people... and that's okay. We're in the middle of a paradigm shift, and it's going to take a while for everyone to hop onboard.

Remember: When all is said and done, only invest what you're willing to lose.

Get more out of your crypto with CryptoLoans

Money that sits passively in your wallet is not working for you. Sure, it might be in a safe place, locked away in cold storage. But unfortunately, you're not maximizing your money's potential.

Here's a quick overview of the CryptoLoans lending process:

Step 1. Sign up for a Cryptoloans account

Step 2. Complete the KYC verification process

Step 3. Put up your collateral.

Step 4. Get a loan.

That's it. That's how you can take a dormant crypto asset and put it to work for you, without triggering a taxable sales event. How awesome is *that*?