

# CRYPTO BACKED FINANCING AND THE MERITS OF DIVERSIFICATION

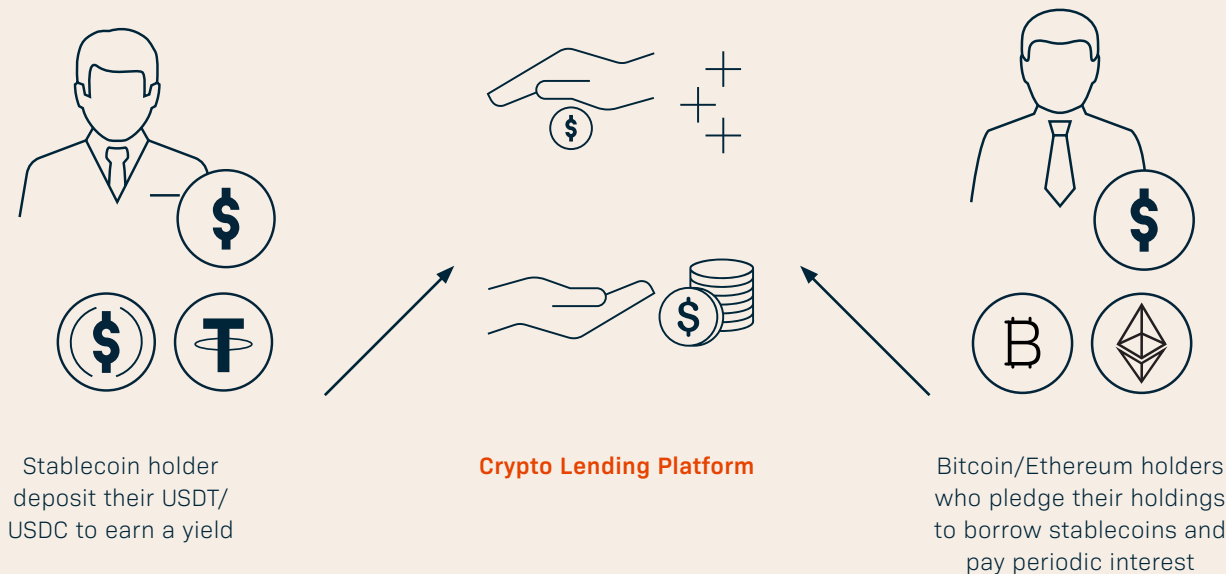
There are a number of crypto-backed financing solutions in the market (i.e. Crypto lending platform, Defi protocol and Loan through sale and repurchase agreement). This report summarizes the structure of each of the solutions and their respective advantages. It also highlights why it is economical for borrowers to use multiple solutions and the merits of diversification.

## CRYPTO LENDING PLATFORM:

### Feature:

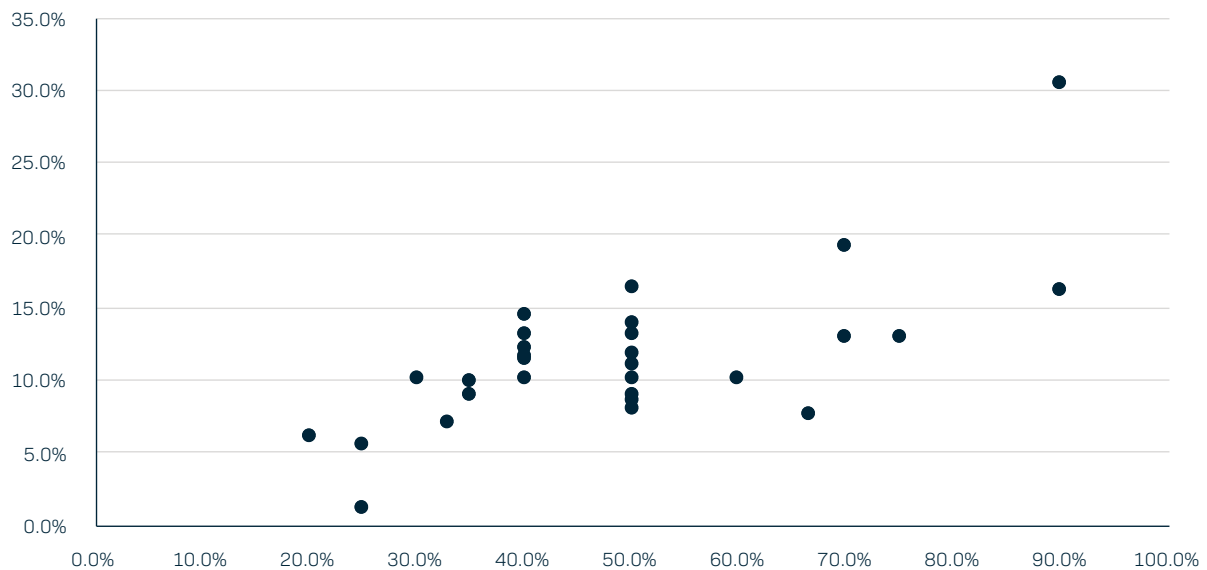
- A part of crypto lending platform's business model is matching the demand of
  - 01) Stablecoin (i.e. USDT, USDC) holders who want to earn yield from their holdings;
  - 02) Bitcoin / Ethereum holders who want to borrow stablecoins by pledging their holdings and making period interest payments

### Business model of Crypto Lending Platform:



- Based on our research, as of 9 March 2022, crypto lending platform offers an 8.8% APY (Annual Percentage Yield) on average on stablecoin staking (i.e. USDT). On the other hand, they charge an 11.4% APR (Annual Percentage Rate) from borrowers (who pledge Bitcoin / Ethereum as collateral) to borrow stablecoins. The platform earns the spread in between.
- The interest rate that the platform charges depends on the Loan to Value Ratio (LTV). Essentially, the higher the LTV, the higher the cost of borrowing. On average, the crypto lending platform offers around 50% LTV and there will be a liquidation event when the price of the collateral drops 20-30% (this also correlates with the LTV, the higher the LTV, the lower the price down limit)
- We note that some of the crypto lending platforms charge a 0.5% to 2.0% origination fee

**CRYPTO LENDING PLATFORM: CORRELATION BETWEEN LTV AND ANNUAL PERCENTAGE RATE (APR)**



**The advantages of working with crypto lending platforms includes:**

- A flexible loan tenure (the loan can be repaid anytime with a small service fee)
- Funding arrives almost immediately after the borrower deposits the collateral
- The size of the loan can be as small as USD 100
- Some crypto lending platforms are large companies with multi-billion (USD) valuations

## DEFI PROTOCOL:

**Feature:**

- Defi Protocol's structure is like crypto lending platforms except it is decentralized. Some of the Defi borrowing and lending applications include the Anchor Protocol under the LUNA ecosystem
  - Currently, it enables users to put Ethereum and Luna as collateral to borrow stablecoin UST (an algorithmic stablecoin on Terra that is pegged to the value of US dollar). Like crypto lending platforms, the loan liquidation is automatic when the price of the collateral drops below a certain threshold
- The cost of borrowing is typically >10% but this depends on the Defi protocol and the demand for staking vs. borrowing. For instance, Anchor Protocol charges a 13.06% APR as of 9 March 2022
- The Total Value Locked (TVL) in Defi has peaked in December 2021 at around USD 110bn. As of 9 March 2022, the TVL in Defi was below USD 75bn, according to Defi Pulse
- Because there is no centralized platform, Defi protocols often reward borrowers who use its application with its native token. For example, Anchor gives its borrowers ANC (its native token) as rewards for borrowing from the protocol

**TOTAL VALUE LOCKED (TVL) IN DEFI (USD BN)**



**The advantages of working with Defi protocol include:**

- The borrower is not exposed to the same credit risk as a centralized platform. However, the borrower is exposed to smart contract risks
- Some Defi applications reward borrowers with its native token
- Flexible loan tenure and loan size, the funding arrives almost immediately after you pledge the collateral

**LOAN THROUGH SALE AND REPURCHASE AGREEMENT:**

**Feature:**

- This is what EquitiesFirst offers (a loan structured under a sale and repurchase agreement):
  - 60-70% LTV
  - Low to mid-single digit APR
  - 12 months+ loan tenure
  - Borrower friendly margin call mechanism

**BITCOIN BACK FINANCING: THE MERIT OF DIVERSIFICATION**



We believe this provides diversification to existing borrowers under crypto lending platform and Defi protocol as EquitiesFirst:

- Brings down the average effective interest rate. The APR that EquitiesFirst charges is substantially lower than other crypto lending platforms and Defi applications
- Charges a fixed interest rate during the loan term. This gives the borrower more visibility with their cash flow
- Offers the ability to liquidate collateral that is pledged to crypto lending platform or Defi protocol with no notice or time to top up during a steep market downturns.
  - However, this is not the case if the coins are pledged to EquitiesFirst, where a valuation event will only be triggered when the 3-day average price of the collateral (i.e. Bitcoin) drops >30%. When this happens, EquitiesFirst gives borrowers 5 business days to top up
- Offers the option to fund in fiat currency instead of stablecoin

EquitiesFirst is one of the few non 100% crypto-concentrated lenders who can lend against major cryptocurrencies at large size. This eliminates the systemic risk to crypto lending platforms and Defi protocols in emergencies. Compared to other crypto lenders, EquitiesFirst also has a 20 year track record in lending and is regulated across multiple jurisdictions.

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