HORIZON KINETICS

[Consensus Currency Musings](#)

(Published in July 2020)

CRYPTO CURRENCY AND CREDIT CARDS: PATHWAY TO A DISRUPTIVE THREAT

In order to make cryptocurrency generally available to the global population, a means is required that will enable transfer and exchange. This has not developed yet, because even the largest user of cryptocurrency lacks the means to create such a universal exchange system. It is not merely a matter of money. A de novo system would require years to construct, and even if it were to be completed, universal acceptance would be highly uncharted.

An ideal solution is the use of an existing universally accepted transfer and exchange system for fiat (government-issued) currency. Credit cards qualify as such an ideal solution since they are already universally accepted. Towards this end, Coinbase Inc. obtained permission from Visa Inc. (V) in February to issue a Visa debit card that can spend the Coinbase bitcoin balance[1]. Merchants need not accept bitcoin: the Coinbase bitcoin balance is effectively a U.S. dollar balance as Coinbase converts crypto to U.S. dollars at time of purchase. It is not exactly the same as having a merchant directly accept bitcoin, but in practice, the bitcoin can be spent.

The relationship of the Swiss company Eidoo, a decentralized finance platform, with Visa is another step closer to the acceptance of cryptocurrency[2]. In this case, the company introduced a Visa debit card that uses regulated stablecoins for the crypto-to-fiat conversion. Stablecoins are digital currencies tied to some benchmark or a combination of other assets or currencies that are sufficiently non-volatile in price that the stablecoins can function as a practical medium of exchange. Perhaps the best known one, at least for a time, was Facebook's Libra, which was to be indexed to a basket of short-term government securities and bank deposits denominated in relatively stable currencies like the euro and U.S. dollar. Eidoo is designed to facilitate conversion, at the point of sale with a merchant, of bitcoin and ether into European currencies like the euro, the British pound, or the Swiss franc, so that the conversion of the crypto creates a spendable Visa balance that can be debited for each transaction.

Very slowly, the cryptocurrency system is being integrated with the existing fiat currency payment system. Examples of these de facto crypto debit cards are Plutus, Wirex, Monolith, Revolut, Cryptopay, Bitcard, Uquid, 2gether, Coinbase, Bitpay, Paycent, Crypterium, and the MCO Visa (formerly the Monaco Card).

Many of these cards have expanded beyond bitcoin. For instance, Paycent, which is based in Singapore, uses Litecoin, Ethereum, Dash, and XRP, in addition to bitcoin. The Bitpay Card is a Mastercard: crypto can be loaded on it and converted into a fiat debit balance. Naturally, if one can convert crypto into a spendable fiat debit balance, it is possible to reverse the process and use a debit balance to purchase crypto. For example, CoinFlip Solutions, Inc., one of the leading operators of cryptocurrency ATMs, allows customers to use credit or debit cards denominated in fiat to purchase cryptocurrency.

---

[1] *https://medium.com/m/global-identity?redirectUrl=https%3A%2F%2Fblog.coinbase.com%2Fcoinbase-becomes-a-visa-principal-member-c5b73b883787*

[2] *https://www.financemagnates.com/cryptocurrency/news/eidoo-partners-with-contis-to-launch-a-visa-crypto-card/*

According to the firm Cryptowisser, there are now at least 30 Visa and Mastercard debit cards from which to choose if one wishes to maintain a crypto balance in the existing accepted fiat currency network. However, even this list does not completely cover all the ways that fiat transfer and exchange methods are incorporating crypto. PayPal is reportedly planning to allow its 325 million users to have the ability to buy and sell digital currencies on its PayPal and Venmo platform. Crypto is also entering the digital wallet space of Apple and Google. A company known as Swipe sells a crypto banking application that gives access to 30 cryptocurrencies via a digital wallet. Balances can be transferred between banks using a Swift wire transfer or even via the Single Euro Payments Area (SEPA).

SEPA contains all members of the European Union plus the United Kingdom after Brexit, Iceland, Lichtenstein, Norway, Switzerland, Monaco, and Vatican City. The accepted transfer medium is the euro, but in practice, crypto is simply converted to euro for transfer, and upon receipt, the recipient can convert to a wide assortment of possible cryptocurrencies. SEPA is important because the European financial institutions stand behind it. These institutions are the European Commission, the European Central Bank, the European Banking Federation, and the European Payments Council. The SEPA system is operative 24 hours a day, 7 days a week, just like the cryptocurrency market.

As one can clearly see, the credit/debit card network applied to cryptocurrency is both a custody system and a payment transfer system. Custody of funds, plus the ability to transfer funds, is a rudimentary banking system, although it is not a bank, properly speaking. For most people, it is a network that possesses the faculties of a bank. To that end, in July 2020, the Office of the Comptroller of the Currency (OCC) provided clarification on national banks' and federal savings associations' authority to provide cryptocurrency custody services for customers,

> *"a national bank may provide these cryptocurrency custody services on behalf of customers, including by holding the unique cryptographic keys associated with cryptocurrency."*[3]

> *"[t]his opinion clarifies that banks can continue satisfying their customers' needs for safeguarding their most valuable assets, which today for tens of millions of Americans includes cryptocurrency" and that "[t]oday's opinion applies to national banks and federal savings associations of all sizes and is consistent with a number of states which have already authorized state banks or trust companies to provide similar functions."*[4]

Major institutions seem to have been anticipating this green light. Visa, almost concurrently, disclosed efforts it's taken to position itself as the preferred network for digital currency wallets.[5]

If one were to accept that these rudiments of a bank constitute a de facto banking system, then it logically follows that what is developing is a banking system that operates outside of the traditional banking system. Since the traditional banking system is presently conducted within the context of the zero interest monetary policies of the world's major central banks, then what is developing is a banking system that is operating outside the context of the current monetary policy and the influence of the central bank.

---

[3] *https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1170.pdf*

[4] *https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-98.html*

[5] *https://usa.visa.com/visa-everywhere/blog/bdp/2020/07/21/advancing-our-approach-1595302085970.html*

The zero-interest monetary policy has created a nearly flat yield curve throughout most of the world. Within this system, it is difficult to earn an adequate spread on an otherwise good lending client. One could surely earn a larger spread on less creditworthy borrowers, but that is the pathway to default and loan loss, which is not a viable pathway for a conventional bank. Moreover, given zero interest as a permanent feature of banking, there is no incentive for deposit clients to retain funds in a bank, and the danger is that it will be difficult to attract funding.

The emerging cryptocurrency custody transfer system might be called an informal banking system that can use the traditional bank infrastructure but which is not bound by the central bank's monetary policy. Under these circumstances, it would be a logical development for a market-based interest rate structure to evolve.

Indeed, this has already begun to happen. For example, at BlockFi.com, it is possible to earn interest on cryptocurrency balances denominated in bitcoin, ether, and Litecoin. The only reason for paying interest on crypto is that the institution in question wishes to lend crypto. There are already a variety of possible cryptocurrency-based loans. The most simplistic is the case in which a holder of crypto would like to borrow some fiat money against the crypto collateral purchased at much lower prices than is currently the case. Fiat money can always be generated simply by selling some cryptocurrency, but that would be a taxable event. It is arguably more tax efficient to hold the crypto as collateral against a fiat currency loan. If one believes that the crypto will appreciate against fiat, it is also reasonable to assert that the earnings from the crypto collateral might comfortably exceed the value of the fiat loan and, in this sense, the fiat loan ultimately extinguishes itself.

Given that central banks have stabilized rates at low levels and appear to have no intention of increasing interest rates, the conventional banking or interest rate differentials have ceased to exist. The result is that the conventional profits on the customary banking transactions are most difficult to achieve.

The system of evolving transactional possibilities is known as DeFi in cryptocurrency parlance. DeFi is vernacular for decentralized finance. Essentially, it entails the recreation of much of the existing set of financial transaction possibilities outside of the controls and constraints imposed by the central banking system.

It is not merely cryptocurrency in the conventional sense. Stablecoins, for instance, which might be tied or pegged to the U.S. dollar, are basically digital fiat currencies that act like money market funds. The difference is that they are not within the reach of the central banking system, so that in some cases one can earn a reasonable rate of interest.

Naturally, stablecoins come without many of the safeguards of the traditional banking system. It is surely possible that, based on open source code, the stablecoins could be penetrated and money stolen. Another possibility is that even a stablecoin, despite the intent of its design, can be used for speculative purposes. For instance, the Dai stablecoin is frequently used by holders to purchase Ethereum on leverage. Dai is controlled by another coin known as MKR. The holders of this latter coin vote to set the Dai interest rate. One might call this a form of decentralized central banking in which speculation is actually encouraged to some degree. This sort of activity could have negative consequences one day, but in the meantime is a profitable banking transaction of a sort.

The concept of DeFi, decentralized finance, has entailed the evolution of the "decentralized application," the DAPP, decentralized application, spelled in lower case letters, in cryptocurrency parlance. The salient characteristic of dapp is that the software is not managed by an institution. This can be a "smart contract" that in practice will run itself with no human intervention once it is deployed to the blockchain of the cryptocurrency in question.

A dapp is based on open source code that is visible to anyone who cares to examine the code. It is also permissionless in the sense that anyone can create a dapp and anyone can use one. This is because there is no such thing as proprietary technology in the world of decentralized (i.e., permission-less) cryptocurrency. All of the code is open source, and anyone is at liberty to see and modify the code – everyone has access to the most up-to-date technology. Monetary or mining policies, on the other hand, are not as easily replicable and, hence, exceedingly few of the over 5,600 cryptocurrencies that exist have fixed issuance.

That said, it is this open source decentralized platform that made possible the equivalent of a banking system outside the fabric and structure of the conventional banking system. An example is a dapp known as Compound. It is a blockchain-based borrowing and lending application. One can lend crypto and earn interest. One can deposit crypto and borrow against the balance used as collateral for a loan. The dapp has the equivalent of a matching engine that adjusts interest rates based upon the supply and demand for loans. This is not the only conventional banking dapp. Dharma, dYdX, and LoanScan are other examples.

The central point is that a significant change is commencing because of the crypto evolution. At one time, the universal belief was that the cryptocurrency world would develop its own applications and transfer and payments system. This process is continuing, as one can readily see by the development of a wide variety of so-called dapps. Yet, there is a separate development occurring, as well. If the banking system were to completely isolate itself from crypto, the risk is the evolution of a parallel banking system that might eventually completely displace the conventional banking system based upon fiat currencies that are continually losing purchasing power due to excess money creation. Therefore, the evolution of cryptocurrency-oriented debit cards is actually the opening of the conventional existing payment and transfer system to crypto. It should greatly accelerate the universal adoption of cryptocurrency.

HORIZON KINETICS

Important Disclosures

This information should not be used as a general guide to investing or as a source of any specific investment recommendations. This is not an offer to sell or a solicitation to invest. Opinions and estimates offered constitute the judgment of Horizon Kinetics LLC ("Horizon Kinetics") and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. Under no circumstances does the information contained within represent a recommendation to buy, hold or sell any security, and it should not be assumed that the securities transactions or holdings discussed were or will prove to be profitable.

This material references cryptocurrencies, including bitcoin. Horizon Kinetics' subsidiaries manage products that seek to provide exposure to bitcoin and other cryptocurrencies. The value of bitcoins is determined by the supply of, and demand for, bitcoins in the global market for the trading of bitcoins, which consists of transactions on electronic bitcoin exchanges ("Bitcoin Exchanges"). Pricing on Bitcoin Exchanges and other venues can be volatile and can adversely affect the value of the bitcoin. Currently, there is a relatively small use of bitcoins in the retail and commercial marketplace in comparison to the relatively large use of bitcoins by speculators, thus contributing to price volatility that could adversely affect a portfolio's direct or indirect investments in bitcoin. Bitcoin transactions are irrevocable, and stolen or incorrectly transferred bitcoins may be irretrievable. As a result, any incorrectly executed bitcoin transactions could adversely affect the value of a portfolio's direct or indirect investment in bitcoin. Only investors who can appreciate the risks associated with this investment should invest in cryptocurrencies or products that offer cryptocurrency exposure. As with all investments, investors should consult with their investment, legal and tax professionals before investing, as you may lose money.

Horizon Kinetics Asset Management LLC ("HKAM"), a subsidiary of Horizon Kinetics, manages separate accounts and pooled products that may hold certain of the securities and cryptocurrencies mentioned herein, and Horizon Kinetics and each of its respective employees may have positions in the securities and cryptocurrencies mentioned herein. Horizon Kinetics is parent company to HKAM, a registered investment adviser. Past performance is not indicative of future returns and investors can lose money.

For more information on Horizon Kinetics, you may visit our website at www.horizonkinetics.com.

All material presented is compiled from sources believed to be reliable, but no guarantee is given as to its accuracy. No part of this material may be: a) copied, photocopied, or duplicated in any form, by any means; or b) redistributed without Horizon Kinetics' prior written consent.