Dollars, coins, and tokens: Is your business prepared for digital currency?

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When **Tesla** announced that it would begin accepting **Bitcoin** payments, it sent shock waves through the automotive industry and cryptocurrency markets. Many businesses are apprehensive about accepting cryptocurrencies for payment due to a variety of factors, including crypto's volatility and uncertain regulation. Though Tesla has since reversed its policy — citing environmental concerns financial services companies continue to jump into the arena in a bid to capitalize on growing interest in a developing industry. As cryptocurrencies evolve and gain acceptance, dealers and auto finance participants should understand this new form of payment and anticipate its role in the evolution of their businesses.

New technology

Cryptocurrencies present issues and risks, and face operational constraints that are not present in legacy financial systems. For example, while the Bitcoin network processes only a few transactions per second, **Visa** and **Mastercard** can process thousands of transactions per second. Depending on network congestion, it can take anywhere from 10 minutes to two hours to finalize a Bitcoin transaction. While the parties to a transaction wait for it to settle, the price of a digital asset may fluctuate wildly, subjecting both parties to downside risk. As the exchange rate changes, a dealer may receive less money than expected while the buyer risks overpaying. Technological advances by open-source programmers and financial services companies are beginning to address these issues, which will push crypto payments further into the mainstream.

Financial services companies are exploring new crypto-related offerings for their customers. Many consumers accustomed to making payments and sending money through apps such as the **Cash App**, **PayPal,** and **Venmo** can now easily purchase and send cryptocurrency through the apps. Square recently announced it would create a new line of business focused on building a developer platform for decentralized financial services, or "DeFi," particularly on the Bitcoin blockchain.

On its blog, Visa disclosed it is partnering with 50 crypto platforms on card programs that make it easy to convert and spend digital currencies. The company announced that in the first half of 2021, spending on crypto-linked Visa cards exceeded $1 billion. Businesses do not need to accept the currency directly to receive payment, according to Visa.

Likewise, Mastercard recently announced new partnerships that allow its customers to spend their digital assets wherever the card is accepted. Crypto companies will facilitate the conversion of crypto to fiat currency, like U.S.

dollars, by exchanging digital assets for stablecoins. In practice, a customer can make payments using digital assets, which are ultimately converted into U.S. dollars for the recipient.

Stablecoins

Stablecoins are digital currencies linked directly to an underlying asset, such as the U.S. dollar or gold. The U.S. Dollar Coin (USDC), for example, is a stablecoin backed by fully reserved assets redeemable on a 1:1 basis for U.S. dollars. Stablecoins like USDC play a crucial role in the cryptocurrency market because they are instantly convertible into equivalent amounts of fiat currency, so they represent a reliable and consistent payment method. Visa recently became the first major payment network to settle transactions in USDC.

Though the use of stablecoins for payment continues to grow, auto finance companies should understand the risks associated with these digital assets. On one hand, certain stablecoin issuers — like popular crypto exchange **Gemini** — are regulated and supervised entities. Gemini is regulated by the **New York Department of Financial Services**, and its reserves are audited independently with results published monthly. Moreover, Gemini's reserves are eligible for FDIC insurance while in the custody of its bank partner. On the other hand, **Tether Limited**, which issues U.S. dollar-backed stablecoin Tether, and its parent company **Bitfinex** were sued following an investigation by the **New York Office of the Attorney General**. The attorney general alleged that Tether's claims that it was fully backed by U.S. dollars at all times were misleading. Bitfinex and Tether settled the matter earlier this year, agreeing to pay an $18.5 million penalty and to discontinue any trading activity with New York residents and entities.

Regulators and legislators recognize the risks posed by stablecoins and have urged additional regulation. In a recent hearing before the House Financial Services Committee, **Federal Reserve** Chairman **Jerome Powell** specifically discussed stablecoins such as USDC and Tether, advocating for the adoption of new rules that are similar to those applied to bank deposits and money market funds. Powell noted that unregulated stablecoins may pose a risk to traditional financial markets as the reserves used to back a stablecoin may falter in the event of an economic downturn. Treasury Secretary **Janet Yellen** echoed Powell's comments, urging regulators to move quickly to establish a regulatory framework for stablecoins. Moreover, Security and Exchange Commissioner **Gary Gensler** warned that certain stablecoins may be considered unregistered securities, and that the SEC may bring future enforcement actions. Though the details of a potential regulatory scheme remain unclear, it is evident that policymakers' concerns will translate into increased scrutiny for these digital assets.

Takeaways

Dealer and auto finance companies should take note of the "average consumer" and the speed at which they are embracing cryptocurrencies. New and developing technologies are addressing the shortcomings of cryptocurrencies and are helping to facilitate the use of digital payments in consumer transactions. With stablecoins continuing to grow and central banks evaluating the use of CBDCs, it is increasingly clear that digital payments will become a significant component of the global financial system. As more consumers embrace digital assets and consider DeFi offerings, the auto finance industry will want to evaluate their business models to ensure they are able to meet their customers' evolving needs while also considering the risks associated with transacting with digital assets.

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