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DeFi Lending on the Blockchain

Decentralized routes of lending and borrowing through smart contracts allows DeFi to eventually overthrow the traditional finance industry.

The world of decentralized finance (DeFi) is gradually expanding to encompass a significant share of the global financial lending landscape by virtue of the inherently trustless manner of operation and easy access to capital. As the crypto ecosystem has grown to a \$2-trillion industry by market capitalization, new products and offerings have emerged thanks to burgeoning innovation in blockchain technology.

Lending and borrowing have become an integral part of the crypto ecosystem, especially with the emergence of DeFi. Lending and borrowing are one of the core offerings of the traditional financial system, and most people are familiar with the terms in the form of mortgages, student loans, etc.

In traditional borrowing and lending, a lender provides a loan to a borrower and earns interest in exchange for taking the risk, while the borrower provides assets such as real estate, jewelry, etc., as collateral to obtain the loan. Such a transaction in the traditional financial system is facilitated by financial institutions such as a bank, which takes measures to minimize the risks associated with providing a loan by conducting background checks such as Know Your Customer and credit scores before a loan is approved.

Lending and Borrowing in the Blockchain Ecosystem

In the blockchain ecosystem, lending and borrowing activities can be conducted in a decentralized manner wherein the parties involved in a transaction can deal directly with each other without an intermediary or a financial institution through smart contracts. Smart contracts are self-executing computer codes that have a certain logic where the rules of a transaction are embedded (coded) in them. These rules or loan terms can be fixed interest rates, the loan amount, or contract expiry date and are automatically executed when certain conditions are met.

Loans are obtained by providing crypto assets as collateral on a DeFi platform in exchange for other assets. Users can deposit their coins into a DeFi protocol smart contract and become a lender. In return, they are issued native tokens to the protocol, such as cTokens for Compound, aTokens for Have or Dai for MakerDao to name a few. These tokens are representative of the principal and the interest amount that can be redeemed later. Borrowers provide crypto assets as collateral in exchange for other crypto assets that they wish to borrow from one of the DeFi protocols. Usually, the loans are over-collateralized to account for unexpected expenses and risks associated with decentralized financing.



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Total Value Locked (TVL)

One can lend and borrow through various platforms in the decentralized world, but one way to gauge the performance of a protocol and select the right one is by observing the total value locked (TVL) on such platforms. TVL is a measure of the assets staked in smart contracts and is an important indicator used to evaluate the adoption scale of DeFi protocols as the higher the TVL, the more secure the protocol becomes.

Smart contract platforms have become a major part of the crypto ecosystem and make it easier to borrow and lend due to the efficiencies offered in the form of lower transaction cost, higher speed of execution and faster settlement time. Ethereum is used as a dominant smart contract platform and is also the first blockchain to introduce smart contracts. The TVL in DeFi protocols has grown by over 1,000% from just \$18 billion in January 2021 to over \$110 billion in May 2022.

Ethereum takes up more than 50% of the TVL at \$114 billion as per DefiLlama. Many DeFi lending and borrowing protocols are built on top of Ethereum due to the first-mover advantage. However, other blockchains, such as Terra, Solana and Near Protocol, have also increased traction due to certain advantages over Ethereum such as lower fees, higher scalability and more interoperability.

Ethereum DeFi protocols such as Aave and Compound are some of the most prominent DeFi lending

platforms. But one protocol that has grown significantly in the past year is Anchor, which is based on the Terra blockchain.

The transparency provided by DeFi platforms is unmatched by any traditional financial institution and also allows for permissionless access, implying that any user with a crypto wallet can access services from any part of the world.

Nevertheless, the growth potential of the DeFi lending space is enormous, and the use of [Web3 crypto wallets](#) also ensures that DeFi participants maintain a hold over their assets and have full control over their data with the cryptographic security provided by blockchain architecture.