



The Stablecoin Challenge: Can it crack the Visa-Mastercard fortress?

Is stablecoin¹ the next big thing or is it overhyped? When it comes to our key holdings Visa and Mastercard (V/MA), we believe much of the excitement around stablecoin being the next big disruptor in consumer payments is misplaced.

Stablecoins still face fundamental challenges, including, regulatory uncertainty, limited trust and acceptance by payment participants, and a lack of compelling use cases in developed markets. While they may have niche applications, particularly in cross-border or underbanked contexts, the idea that they will upend global consumer payments infrastructure in developed markets remains more noise than substance.

It's important to remember that whilst consumer payments in developed markets have consolidated around the V/MA networks over the last several decades, it's not been from a lack of competitive threats or innovation. Globally there are more than 70 real-time payment networks, hundreds of digital wallets and thousands of cryptocurrencies (including stablecoins). V/MA have been able to withstand competition because of their quality² and reinvestment into their businesses to drive innovation. This investment improved the payments experience for all participants (existing and emerging), bolstering business quality and delivering ~17% compounded annual returns to shareholders over the past decade.

We see two scenarios, albeit both are low probabilities, that could disrupt V/MA's grip on consumer payments in developed countries. First, a new technology, like stablecoins, could be disruptive if it could replicate and exceed the networks' capabilities. Second is regulation seeking to increase competition or decrease profitability of V/MA. Let's discuss each in turn.

New technology; for example, Stablecoins

To compete effectively, every feature and network rule in the current payment's ecosystem needs an equivalent. As a reminder, V/MA provide a seamless, secure, ubiquitous and trusted global payment network, connecting over 4.7 billion cardholders with more than 150 million merchants and 14,500 financial institutions.

¹ Stablecoin, a coin whose value is pegged to fiat currency, is an alternative currency that runs on distributed ledger technology (blockchain). Historically, stablecoins were put into the cryptocurrency basket, not regulated and offered limited optionality in commerce. The Genius Act seeks to regulate stablecoin, requiring Anti-Money Laundering and Know Your Customer compliance and governance (how reserves are managed and audited). These guardrails are a step in the right direction for stablecoins to be considered as an 'alternative payment' mechanism.

² A company's competitive advantages that enable them to protect and grow earnings into the future. The most powerful attribute of V/MA's quality assessment is the network effect. Network effects mean that every user of the network benefits as the network grows.

For stablecoins to take share, the needs of all network participants must be considered. These participants will be unwilling to accept more risk or fewer rewards. This is no easy feat, as the current V/MA networks are incredibly efficient. Visa, for example, is capable of processing ~65,000 transactions per second in-store and online, across more than 200 countries and more than 180 currencies while complying with global and domestic regulations, with high conversion rates, in a frictionless, trusted and safe manner. In addition, consumers are incredibly loyal to debit and credit, not only because of the rewards but also due to the consumer protections. At present, the stablecoin ecosystem, while it can transact at a high speed (in some instances), offer instant settlement, and a lower headline cost, it can't match the features of V/MA. Significant, co-ordinated investment across the fintech sector will be required to scale and compete. Within consumer payments, stablecoins are more likely to be used as an alternative currency and leverage the V/MA networks, just as other new payment forms have (e.g. Buy Now Pay Later, gig economy or Bitcoin).



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We do, however, see stablecoin as more likely to take share in other payment flows; for example, remittances, business-to-business payments, smart contracts or institutional payments. These flows can take multiple days to settle and, in the case of remittances, are very expensive. Stablecoins can, for these use cases, improve the experience for participants. Stablecoins can also be used as a store of wealth for those in countries with high inflation and volatile exchange rates. These are non-core payment flows for V/MA and do not have a material impact on profits.

Regulation seeking to increase competition


At Magellan, the companies we invest in, including V/MA, typically hold dominant market positions. So dominant, in fact, that their primary risk lies not in competitive disruption, but in regulatory intervention. As such, government policy decisions play a critical role in shaping their long-term prospects. The motive for these decisions is typically to improve consumer outcomes, most notably through lower prices. For V/MA this risk may unfold via capping the headline interchange rate – which funds network, fraud, bank and reward services – as we've seen in the EU and in Australia; or through judicial oversight that seeks to reduce scale advantages and encourage competition. We are confident V/MA will be able to navigate the regulatory risks they are facing, given their diversified earnings across geography, payment type and value-added-services. It is however, essential for investors to take a step back and assess the underlying reasons behind these regulatory pressures, and evaluate whether governments have any real incentive to significantly alter the existing regulatory framework.

In our view, while there is significant hype around the potential disruption of V/MA networks from stablecoins, we remain confident in their long-term earnings capabilities. We have confidence given the quality of both companies, and management's persistent investment in innovation, enabling the networks to continue to be the payment rails that connect all existing and new participants. Enabling participants to pay with any currency, be it fiat or cryptocurrency, in store, online or via an agent. As active investors, we will continue to monitor emerging technologies and regulatory developments that may have an impact on V/MA's integral role in consumer commerce in developed markets.

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