MAY 16
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Repegging of stablecoin Tether shows cash is king in a cryptocurrency crisis

Article

The news: Tether, the world's largest stablecoin, has regained its peg to the US dollar after falling to $0.95 earlier this week and facing $3 billion in redemptions, per CNBC.

How stablecoins work: Stablecoins are forms of digital currency whose value is relative to the value of a national currency or other asset. Some of the most prominent stablecoins, such as Tether, USD Coin, and **TerraUSD** (UST), are pegged to the US dollar, meaning one coin represents one US dollar. The purpose of a stablecoin is to make transacting in digital currencies easier from blockchain to blockchain while ensuring the currency retains its value.

- To keep their value stable, the coins are generally backed by some type of asset, usually an actual US dollar or other short-term cash equivalent.
- Some coins, like UST, are backed by an algorithm that props up the value of the currency with another digital currency—like **LUNA** in UST's case.

The bigger picture: The recent volatility in the cryptocurrency markets spooked droves of investors this week, causing many to withdraw their assets from the system.

- The sudden influx of withdrawal requests made it difficult for UST to maintain its peg to $1.
- The volatility of the backing asset, LUNA, made it difficult for Terraform Labs, the creator company, to honor the withdrawal requests.

Fears of contagion started to materialize when the world's largest stablecoin, Tether, also strayed from its $1 peg. But Tether differs from UST because it's backed by cash. As investors withdrew their assets from the system, the company's cash reserves were able to meet the demand.

Where are we now? Tether has again re-pegged to the US dollar. The cash reserves allowed the company to satisfy $3 billion in withdrawal requests in a 24-hour period and stabilize the coin.

By contrast, UST was unable to control the volatility of its backing currency and temporarily halted trading by turning off the blockchain. Trading has since resumed, but UST's value has not re-pegged to the US dollar.

What really happened?: The crypto meltdown this week and the drastically different outcomes for Tether and UST call digital trust into the spotlight. Here's how Tether was able to swim, rather than sink:

- After being fined for using less-liquid commercial debt to back the Tether stablecoin, Tether pledged transparency and built up its cash reserves.
- Those cash reserves allowed it to be flexible during this week's crisis and satisfy all withdrawal requests.

Here's how UST sank:

- UST is backed by a synthetic currency, LUNA, that is vulnerable to volatility.
- As the price of LUNA became more volatile, investors raced to pull assets out of the system to preserve their wealth.
- The overwhelming number of requests could not be satisfied because the value of LUNA dipped so low that it could not confidently peg the value of UST to $1.
- As Terraform Labs failed to pull enough LUNA from the system to satisfy the withdrawal requests, the price of UST plummeted. Terraform Labs ultimately called a trading halt to stop the bleeding.

The big takeaway: The emphasis on digitization in finance is undeniable, but companies must learn to balance the line of technological innovation and consumer trust. Our Banking Digital Trust Report highlights the threats to consumer trust posed by cybercrime, breaches, and PR disasters. Investors' trust has been shaken by the events of the past week. Now more than ever, they will question the stability of a digitally-backed stablecoin, and demand transparency about its liquidity. The cash-backed stablecoin Tether, which came out of the week relatively unscathed, will retain consumers' trust. But UST, backed by crypto assets and stabilized through a convoluted process, looks to be on the verge of failure. Terraform Labs will struggle to regain the faith of investors.

UK/US Cryptocurrency Owners'* Beliefs in the Future of Digital Currencies, Jan 2022

% of respondents

	Agree	Disagree
Most people still don't trust cryptocurrencies	66%	11%
Withdrawing funds need to become easier before crypto adoption is more widespread	65%	11%
You will be able to use cryptocurrencies to make digital purchases with many more ecommerce vendors this time next year	60%	14%
The lack of real-world applications (e.g., digital payments is preventing cryptocurrencies reaching their full potential)	59%	14%
Cryptocurrency is the future of finance and will take over as the dominant form of international currency	54%	19%
Everyone will own cryptocurrencies within five years	49%	22%
Accepting cryptocurrencies in physical stores will become commonplace within the next 12 months	47%	23%
Cryptocurrencies will be less popular in 12 months' time than they are today	39%	34%

*Note: n=2,015 with at least 1,000 each from the US and UK; *includes current and former cryptocurrency owners*
Source: Paysafe, "Inside the crypto community: Plotting the journey to mass adoption" conducted by Sapio Research, Jan 11, 2022

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