

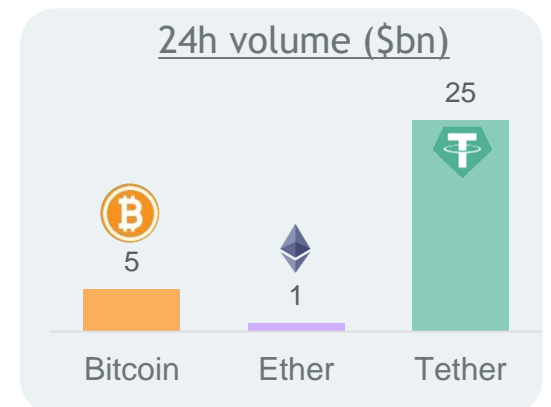
Stablecoins

What to watch

This paper provides a brief overview of the stablecoin market, explaining stablecoins specificities and reviewing the most popular tokens. It also highlights why 2021 is probably going to be an inflection point for stablecoins with several major events to monitor.

What are stablecoins?

- A stablecoin refers to a cryptocurrency designed to **minimise price volatility** by tying the value of the cryptocurrency to another, more stable, asset.
- The purpose of stablecoins is to provide the **instant processing, security and privacy of cryptocurrencies with more stable valuations**. Stablecoins have become very popular in the crypto-markets, with trading volumes competing with and even surpassing Bitcoin and Ether.
- Stablecoins support the **development of financial activities on the crypto-markets, DeFi and the use of smart contracts** as they enable to overcome the volatility issue that was considered as a limiting factor for the wider adoption and use of crypto-assets.



Asset-backed stablecoins

Off-chain

- Most stablecoins are asset-backed off-chain stablecoins.
- These stablecoins are collateralised against fiat currency (e.g. USD), precious metals or other assets that have value outside of the blockchain.

Fiat-backed



Commodity-backed



Key characteristics:

- Easily understandable concept.
- Centralised and dependent on the reliability of the central entity.
- Requires audits for transparency, which can be expensive.
- Increased regulatory scrutiny.
- Constrained by legacy payment process for liquidation to fiat.

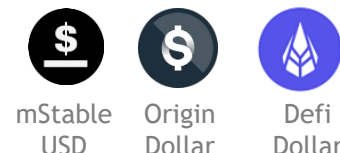
On-chain

- These stablecoins use one or several digital assets (e.g. ETH) as collateral.
- Meta stablecoins are backed by a basket of same peg assets.

Collateral-backed



Meta stablecoins

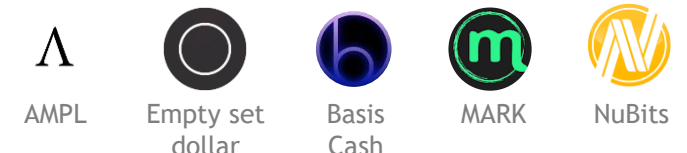


Key characteristics:

- Decentralised.
- Transparent collateralisation ratio that does not need a specific audit.
- Can be liquidated through a blockchain transaction.
- Vulnerable to collateral-crypto crash.
- Capital intensive due to over-collateralisation.

Algorithmic stablecoins

- This category of stablecoins is the most experimental as of today.
- These coins are not collateralised and use an algorithmic mechanism, that, similarly to central banks, increase or decrease the supply of tokens to maintain a stable price.
- Some protocols (e.g. Ampleforth) adjust the currency supply across all users' wallets, others use bonds and shares mechanisms.

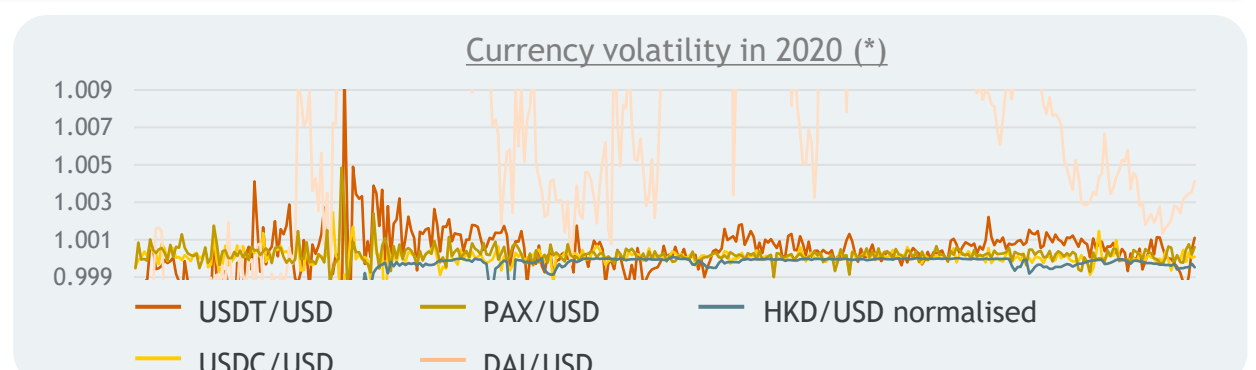


Key characteristics:

- Decentralised and independent.
- Not tied to any crypto-currency or fiat.
- High complexity.
- Difficult assessment of coin health.
- Rely on continual future demand.
- Long-term viability to be proven.

Are stablecoins really stable?

- Despite the complex and advanced mechanisms implemented to maintain a peg against the US dollar, **stablecoins remain more volatile than a "regular" fiat-currency** pegged to the US dollar, such as the HK dollar.
- Yet, fiat-collateralised stablecoins seem to be much more stable than crypto-backed coins.



* All spots normalised to 1

What are the most popular stablecoins?

Tether or USDT



- Tether is a **fiat-collateralised stablecoin pegged against the US dollar** and traded under the USDT symbol. Tether is backed by cash, cash equivalents and sometimes other assets such as receivables or loans.
- It was launched in July 2014 and started trading in February 2015. It is now live on 7 blockchains including Ethereum, BCH, and Algorand.
- Tether accounts for **~80% of the stablecoin market** and is the **most transacted currency** on public blockchains
- There was some controversy around Tether, as iFinex who owns both Bifinex and Tether was involved in a legal dispute with New York state. This has been just been settled. There is also an ongoing concern as there is no available audit of the assets backing USDT
- **Market cap: \$ 34.86bn**

DAI



- Dai is a **crypto-collateralised and decentralised stablecoin pegged to the value of \$1**. It is backed by ETH-based collateralised debt positions.
- All circulating Dai are generated by Maker Vaults and backed by a surplus of collateral assets but Dai is not a hard-pegged currency, rather it maintains a free-floating peg with very low volatility against the US dollar.
- Dai token is live on the Ethereum blockchain. MakerDAO stabilises DAI through an automated system of smart contracts.
- Dai was initially launched by MarkerDAO in 2017 as Single Collateral Dai (now renamed SAI). The multi-collateral Dai was launched in 2019.
- **Market cap: \$ 2.27bn**

Binance USD or BUSD



- Launched in September 2019, BUSD is also a **fiat-collateralised stablecoin pegged to the US dollar**.
- BUSD has been developed through a partnership between Binance and Paxos and follow the same regulatory standards than PAX.
- The partnership of the crypto-exchange with a regulated financial institution such as Paxos seemed to have been a success as it is among the most popular stablecoins.
- **Market cap: \$ 1,76bn**

USD Coin or USDC



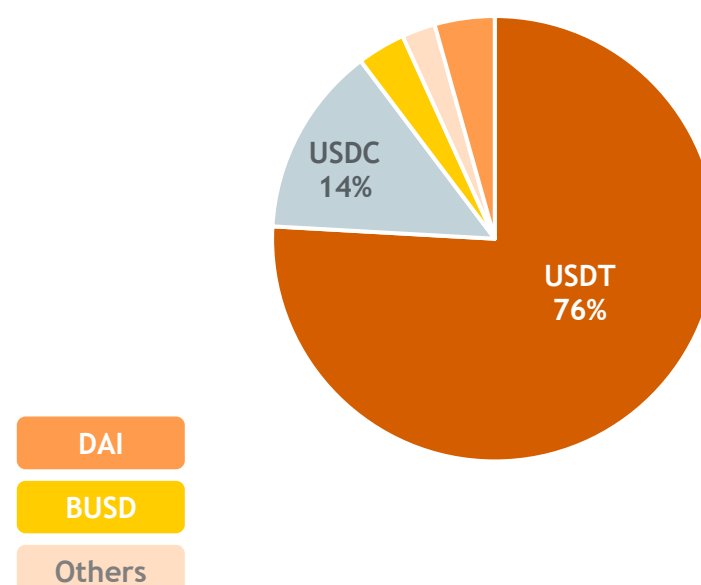
- USDC is a **fiat-collateralised stablecoin pegged to the US dollar** and fully collateralised by it.
- It was launched in 2018 by Circle (Goldman Sachs backed company) and Coinbase who founded the CENTRE consortium. CENTRE is an independent entity overseeing the issuance and redemption of USDC and **ensuring that reserves are always backed 1:1 with US dollar**.
- USDC is live on several blockchains including Ethereum, Algorand, Solana and Stellar.
- **Visa** announced its intention to link its payments network to USDC. The purpose of this partnership is to allow the issuance of credit cards that enable businesses to send and received USDC payments.
- **Market cap: \$ 7.35bn**

Paxos standard or PAX



- Paxos Standard is a **fiat-collateralised stablecoin pegged to the US dollar** and issued on the Ethereum blockchain, it started traded on September 2018.
- PAX has been developed by Paxos a New York Trust charter company regulated by the New York State Department of Financial Services. It is fully reserved by US dollars and its reserves are audited on a monthly basis.
- Paxos also partnered with **PayPal** and **Revolut** for the development of their crypto services.
- **Market cap: \$ 677.17m**

Most popular stablecoins at the end of 2020
(% of total Market Cap)



A turning point? 5 themes to monitor to understand the future development of stablecoins

N°1

The clarification of the regulatory framework



The clarification of the regulatory framework could boost users confidence in crypto-assets and lead to a wider use of crypto-currencies. Yet, it is not clear how regulations could apply to DeFi, and many voices in the industry fear that regulations will limit competition and prevent innovation.

In the UK

- The FCA put several rules in place recently, related to:
 - AML / CTF regulations
 - The ban of crypto-derivatives sale to retail clients
- The government also launched a “consultation and call for evidence” regarding the regulation of crypto-assets and stablecoins

In the EU

- EU Commission works on the proposal of a Markets in Crypto-Assets (MiCA) Regulation, which includes:
 - Classification of crypto-assets
 - Requirements for crypto-currency issuers
 - Requirements for crypto-services providers
 - Prohibition of market manipulation & insider trading

In the US

- The OCC has clarified its position and authorised banks and FSAs to offer crypto-custody services, to participate in INVN and use stablecoins to conduct payment activities and other bank-permissible functions
- Controversy on proposed STABLE Act as crypto-companies could be required to get a banking charter and to maintain reserves at the Federal Reserve

N°2

The rise of CBDCs



Combining the technological benefits of digital currencies with the reliability of government-backed currencies, CBDCs and synthetic CBDCs, could represent a solid alternative to stablecoins for payments purposes and trading on centralised exchanges.

10% of Central Banks consider to launch their digital currency within 3 years and 20% within 6 years.. These digital currencies would:

- enable costless and frictionless transactions
- provide payment capabilities to unbanked people
- enable real-time monitoring of economies for fiscal and monetary policies adaption



N°3

The launch of diem, the “Facebook Coin”



The very much anticipated launch of diem will be a significant milestone in the development of stablecoins. Monitoring of adoption will provide valuable information on the democratisation of stablecoins.

The diem project (initially Libra) is expected to become live in early 2021:

- Among the most high-profile stablecoins due to the potential important network effect
- Regulators have raised some concerns regarding the potential threat to the stability of the monetary system and the scale of the diem project had to be downgraded



Legal concern cleared on Feb 23rd. Reserves quality concern still live

N°4

The potential collapse of a major stablecoin?



Should Tether be adversely impacted by the fallout of the ongoing legal disputes, the whole crypto ecosystem could suffer due to the important amount of money “invested” in USDT and due to impact on users trust. Likewise, any issue with the quality of assets used to back the crypto-currency would most likely erode trust.

Tether has been involved in a long-standing legal dispute:

- According to New York General Attorney, iFinex, who owns both Tether and BitFinex have engaged in “a cover-up to hide the apparent loss of \$850 million dollars of co-mingled client and corporate funds,”.
- The legal procedure is ongoing but BitFinex announced that the loan at the centre of the legal dispute has been repaid through the repayment of \$550m to Tether.



N°5

The use of stablecoins for foreign aid distribution



Stablecoins proved their usefulness, where “regular” fiat-currency cannot be used. Governments, international organisations and charities could be willing to use stablecoins more regularly for these specific use cases.

In November 2020, the US Government used stablecoins to deliver financial aid to medical workers in Venezuela. The use of USDC enabled the bypass of the controls on the financial systems linked to the political crisis.



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