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Between crypto-backed stablecoins making a come-back and USDC on the verge of flipping USDT, the ripples of UST's collapse are still unfolding. We look at how they're changing the stablecoins landscape and potentially spinning crypto into increasingly centralized dynamics. [🌀](#)

In summary

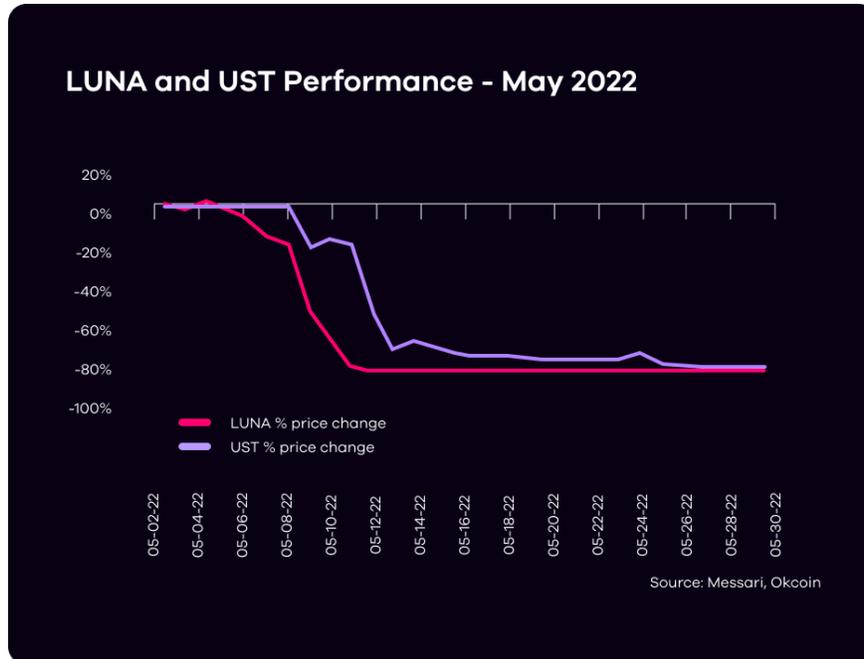
- The collapse of UST led investors to flock to stablecoins perceived as safer
- After a sharp decline of the crypto-backed stablecoin market share, it has since returned to pre-UST levels
- USDC's market share could flip that of USDT, possibly as early as Q4 2022
- Crypto's increasing reliance on USDC could push it into a centralizing spiral

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1. One collapse and three trends

In May 2022, the Terra ecosystem collapsed after the depeg from the USD of its algorithmic stablecoin, UST. In just a few days, over \$35 billion was wiped out from UST and LUNA, its companion asset in the Terra ecosystem. This caused massive ripples throughout the crypto ecosystem and contributed to major challenges for several crypto institutions such as 3AC, Celsius, Voyager, and BlockFi. UST has since been renamed to USTC, but we will refer to it as UST for this analysis.



The mechanisms of the collapse have been [described in detail](#), but its effect on the stablecoin ecosystem is less documented. By looking at token data taken from CoinMarketCap, we can see that **UST's collapse caused the market to flock to stablecoins perceived as safer**. Three trends came into play here:

1. A huge decrease in the algorithmic stablecoin market share (from 12.2% to ~1.6% as of August 2022). Just about all of UST's lost market share went to fiat-backed stablecoins
2. An initial decrease in the market share of crypto-backed stablecoins, followed by a return to pre-collapse levels
3. A reinforcement of the trend of USDC's market share taking over USDT's

Before explaining how the stablecoin landscape is changing, let's quickly look at how it's structured.

2. Why differences between stablecoins matter

Cryptocurrency is notoriously volatile, making transactions at constant exchange rates difficult. That's why stablecoins exist: they maintain a peg to a specific, stable asset (typically the U.S. dollar). There are three main models that stablecoin issuers use:

- Fiat-backed
- Crypto-backed
- Algorithmic

Fiat-backed stablecoins

Fiat-backed stablecoins are collateralized by fiat reserves off-chain, typically USD and Treasury Bills held in bank accounts or other various low-risk investment instruments. **They are often considered the safest stablecoins but they come with a centralization tradeoff:** token holders have to trust the issuers will manage their fiat reserves properly.

Currently, fiat-backed stablecoins are, by far, the most common type of stablecoins, with over 93% of the stablecoin market share. The big players include [Tether's USDT](#), [Circle's USDC](#), and Binance's BUSD.

Crypto-backed stablecoins

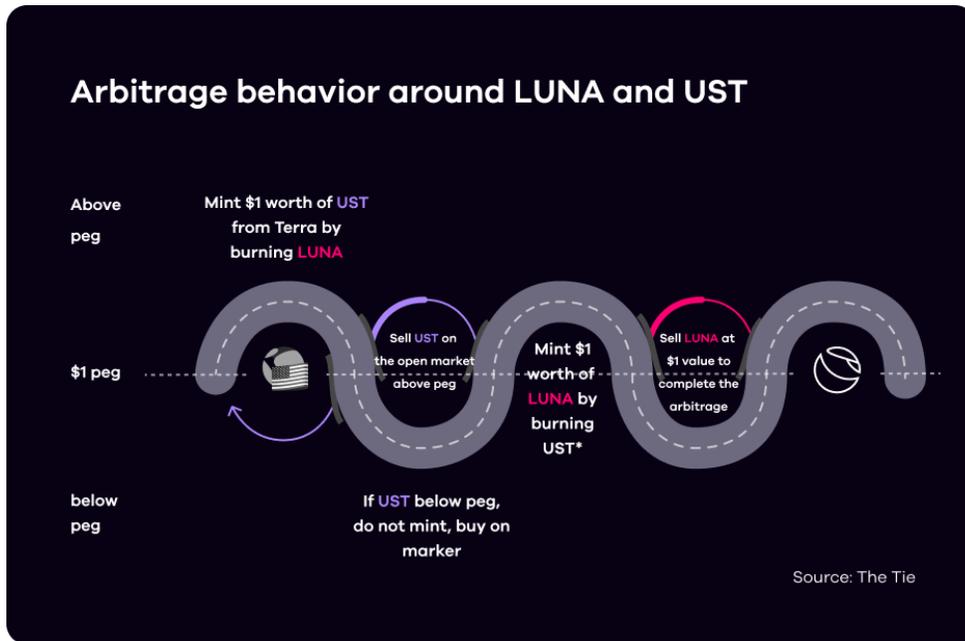
Crypto-backed stablecoin are collateralized by a basket of cryptocurrencies such as BTC, ETH, or other altcoins. The main example of this is [MakerDAO's DAI](#) which also follows the USD. Because of the volatile nature of their collateral, crypto-backed stablecoins are typically overcollateralized which means that the initial dollar value of crypto in reserves exceeds the dollar value of outstanding stablecoins. Each user must deposit more in another coin, like ETH or BTC, than they pull out in stablecoin.

For example, since the current ETH:DAI collateralization ratio is 170%, if a user wants to use their ETH to withdraw 1,000 DAI, they would need to deposit \$1,700 in ETH. If the value of their collateral falls below a certain amount, the user either needs to deposit more ETH or liquidate their position (which could mean selling at a bad time). **The advantage of crypto-backed stablecoins, however, is that they're completely on-chain, which is meant to remove the need for a centralized third-party.**

Algorithmic stablecoins

Algorithmic stablecoins maintain their peg with smart contract code and are typically linked to another asset with a community and ecosystem behind it. UST was paired within the Terra

ecosystem to LUNA: 1 UST could always be redeemed for \$1 worth of LUNA in the mint/burn mechanism shown below:



Since there are no other assets to back up their value, algorithmic stablecoins can be prone to “death spirals” if the stablecoin depegs from its intended price. Once UST lost its dollar peg, people rushed to sell it, crashing the price further. LUNA’s mint/burn mechanism was intended to fix this but liquidity issues and loss of faith in the system placed selling pressure on both UST and LUNA, causing both their prices to collapse. You can read about the collapse in more detail [here](#).

Type of stable	How it works	Examples	Current market cap (share)	Perceived level of risk
Fiat backed	Collateralized by fiat currency in a bank	USDT, USDC, BUSD	\$141B (93.6%)	Lowest
Crypto backed	Overcollateralized by a basket of crypto assets	DAI	\$7.3B (4.8%)	Medium
Algorithmic	Maintained by smart contract code with community support	UST(C), FRAX, USDN	\$2.4B (1.6%)	Highest

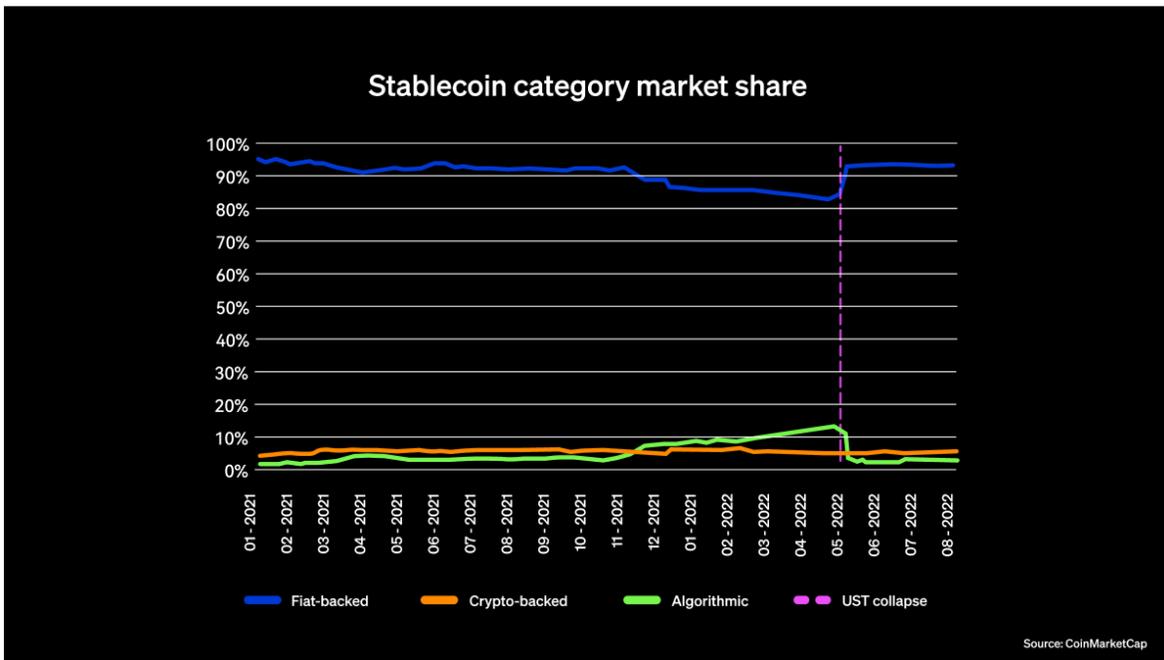
Source: CoinMarketCap

Despite all stablecoins having the same goal of maintaining their peg, their financial mechanics differ greatly and their role in the crypto markets differ. With the collapse of UST, these differences have become even more salient, changing the game for stablecoins and crypto at large. 🙅

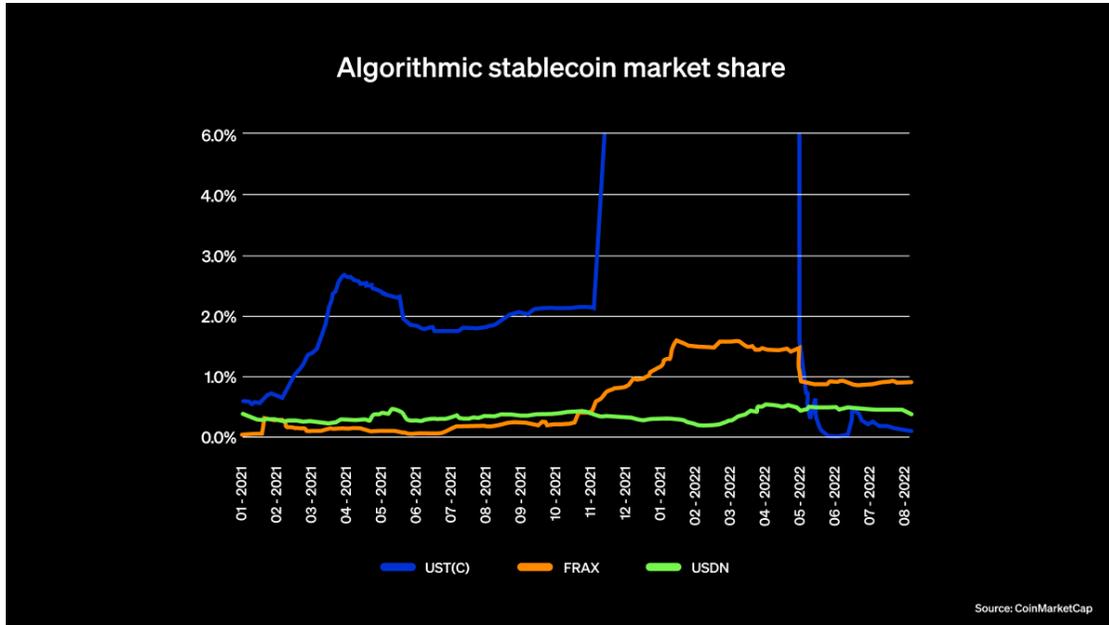
3. The decline of algorithmic stablecoins

Around November 2021, algorithmic stablecoins started to grow in popularity, driven almost entirely by UST. Right before the collapse, algorithmic stablecoins comprised over 12% of the market with a market cap of over \$22 billion. The collapse of UST, however, made the entire market share of algorithmic stablecoins plummet.

UST's market share fell from 10.3% of all stablecoins down to ~0.2% in just a few days. This lost market share was captured almost entirely by fiat-backed stablecoins, taking their market share back to the levels seen before the rise of UST in November 2021. As seen in the graph below, the market share curves of fiat-backed and algorithmic stablecoins are near mirror images of each other:



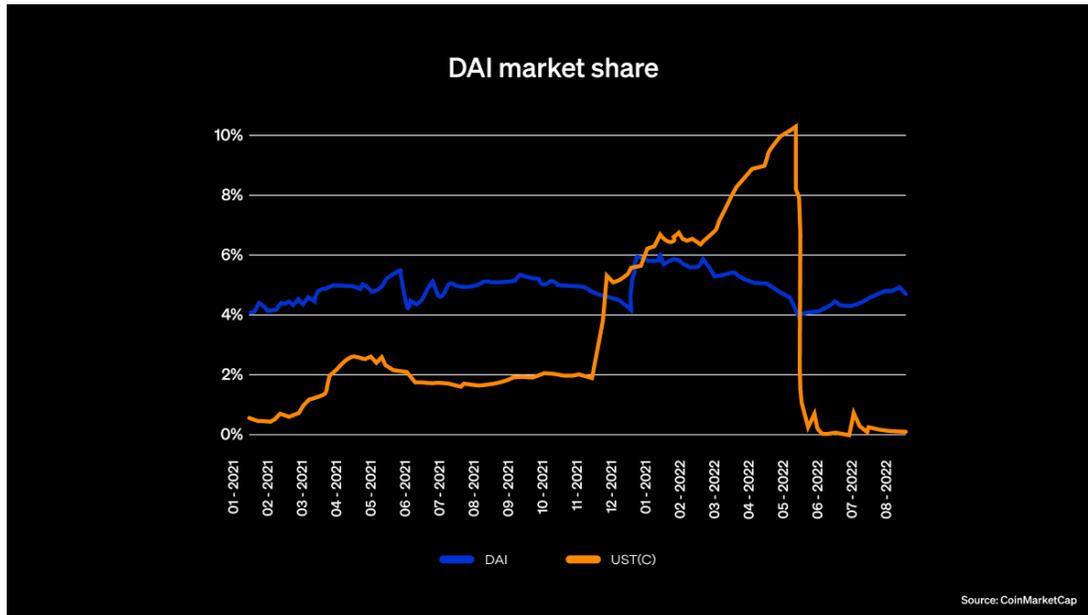
Frax, another algorithmic stablecoin, also lost relatively significant market share (from 1.5% ~0.9%) that has yet to be recovered:



Crypto-backed stablecoins, on the other hand, have experienced different dynamics.

4. The crypto-backed stablecoin rebound

Following the collapse of UST, we saw a slight decrease in the market share of the crypto-backed stablecoin DAI. However, since then, it returned to around 5% of total market share, similar to its historical average over the past few years.



This ties in with the hypothesis that investors flocked to the assets they perceived as safest during the crisis. If UST's collapse had led to an even greater collapse within the crypto ecosystem, holding value in anything not backed by cash in a bank might have felt risky to some investors. However, the greater crypto ecosystem did not implode and the rebound implies that some investors still view crypto-backed stablecoins with confidence.

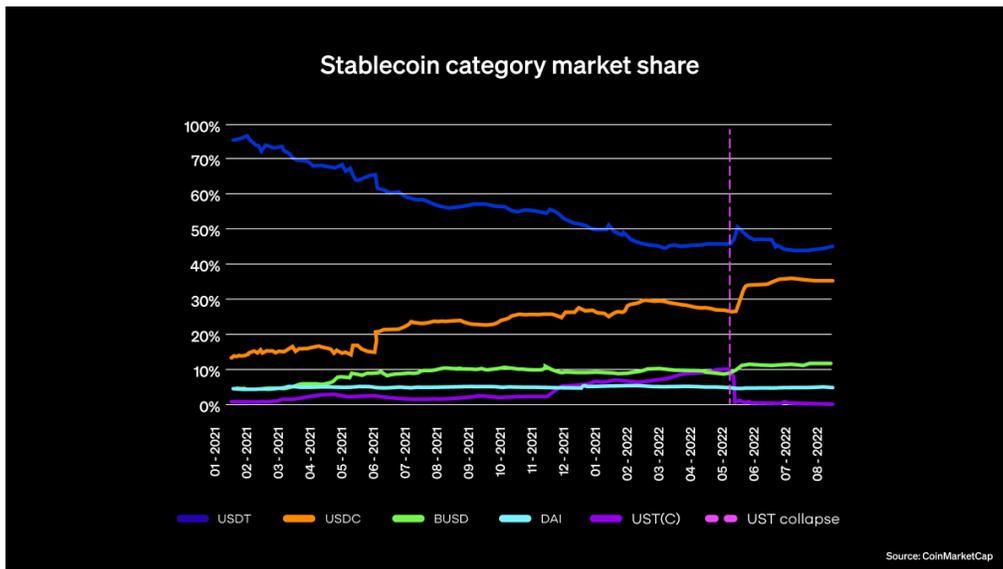
With their rebound, crypto-backed stablecoins might face a new type of problem. This one is not coming from overly risky algorithms but rather from their dependence on risk-averse financial institutions. DAI's issuer, MakerDAO, received lots of criticism for the large amount of centralized USDC it uses to back DAI's peg. So much so that the founder of MakerDAO recently suggested to completely depeg DAI from the USD, in order to free DAI from the influence of USDC and by extension from the control of the US government.

Whatever happens to DAI's peg, these debates are a testament to the mixed feelings the crypto ecosystem has around the rise of USDC's influence.

5. The rise of USDC

USDC's and USDT's different risk profiles

Although their redemption mechanics are similar, there are some key risk differences between USDT and USDC, and trends indicate that the market has picked up on them. Following the collapse of UST, nearly all of its lost market share was absorbed by USDC.



To understand why sentiment towards these two coins might differ, we have to ask: What exactly is the *fiat* currency that is *backing* these stablecoins?

For USDC, the backing is pretty straightforward. For every USDC coin in circulation, Circle (the organization behind USDC) holds \$1 worth of cash or U.S. Treasury Bills in various bank accounts. These may be some of the safest investments. Circle is extremely transparent about their backing and operations, with monthly attestations by Grant Thornton LLP and annual audits.

Weekly USDC reserves breakdown

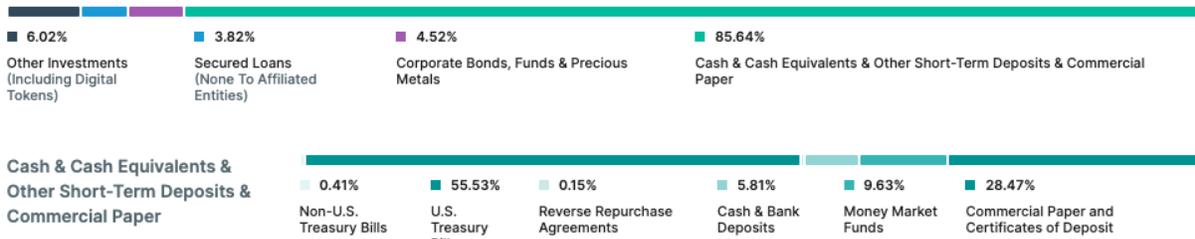
Balances

	JULY 22ND, 2022	JULY 29TH, 2022
USDC in circulation	\$55.0B	\$54.6B
USDC reserves ²	\$55.1B	\$54.7B
Cash	\$12.7B	\$12.3B
Short-duration U.S. Treasuries	\$42.4B	\$42.5B

Source: Circle

USDT and its managing organization Tether, on the other hand, have come under fire for how some of their fiat reserves are invested. In their reserves breakdown, they group A) Cash, B) Cash equivalents, C) Other short-term deposits, and D) Commercial paper into one bucket that holds 85.6% of reserves. However, those reserves can hardly be considered to have comparable levels of risk. Only 52.5% of their reserves are held in risk-free assets such as cash and U.S. Treasury Bills.

Reserves Breakdown

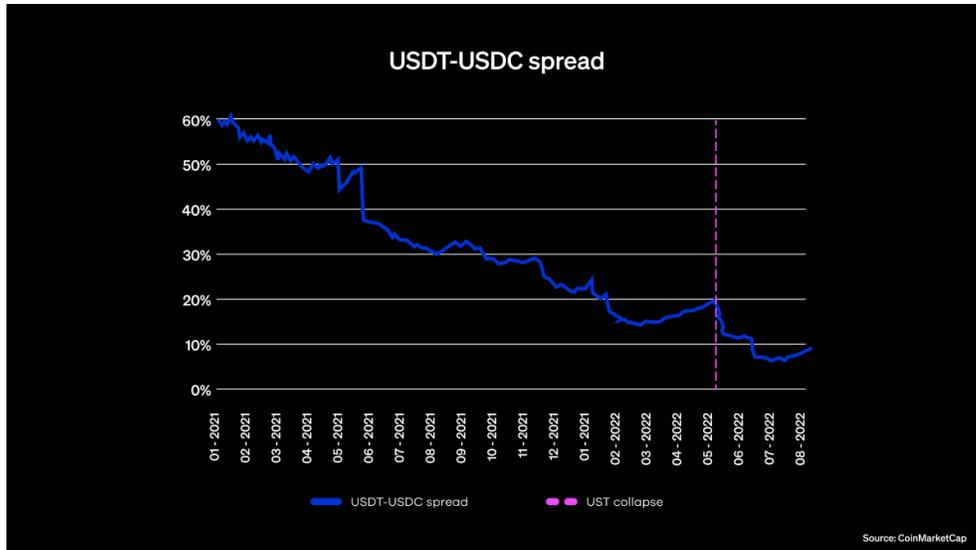


Source: Tether

Although certificates of deposit (CDs), money market funds, and some commercial paper are considered relatively safe, Tether’s reserves provide much less confidence than USDC’s. There are also some other concerns. According to some allegations, USDT might be backed by billions in [Chinese commercial paper](#). Tether also settled with the New York Attorney General’s Office to pay an [\\$18.5 million fine](#) following allegations that Tether commingled client and corporate funds with an \$850 million cover up.

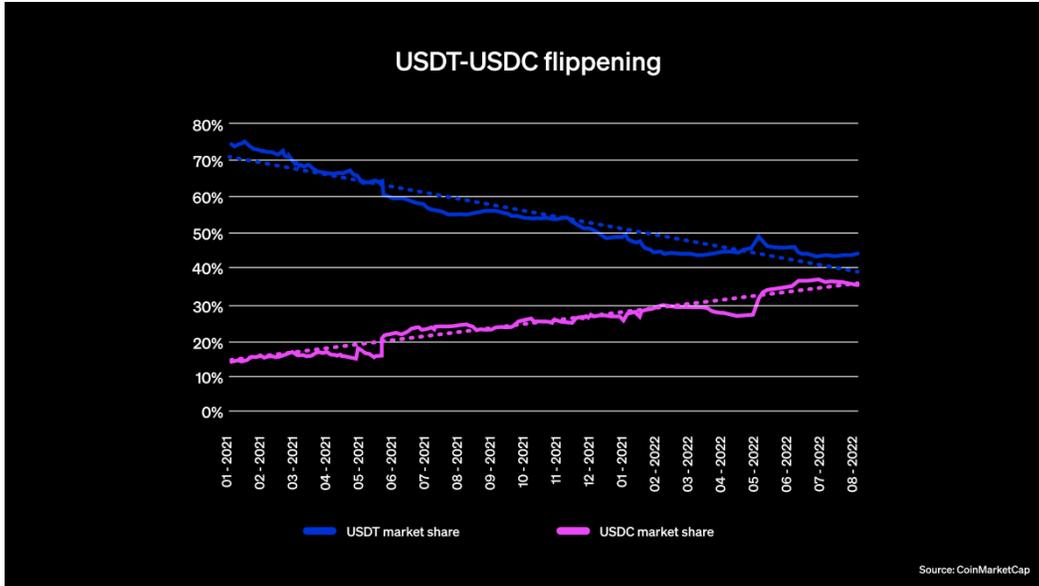
The USDC/USDT flipping

Our friends at Okcoin covered [what a USDT de-peg could potentially look like](#) and, although it probably wouldn't be catastrophic to the crypto ecosystem, investors are still wary of the risks. This is one of the reasons why we've seen a gradual decrease in the spread between the market shares of USDT and USDC over the past several years. This trend reversed slightly starting around February 2022 but the UST crash accelerated it further.



This shows that, **during the panic, investors preferred to move towards the stablecoin they perceived as safer. Accordingly, the flipping of USDT's market share by USDC could occur as early as Q4 2022.**

To accommodate this increasing demand, OKX has added over 100 USDC pair options, more than any crypto exchange.



Obstacles on the way to USDC supremacy

USDC’s road to potential stablecoin supremacy, however, comes with some obstacles.

First, the centralization trade-offs we mentioned earlier are particularly salient in the case of USDC. On August 8, the U.S. Treasury sanctioned the crypto mixing service Tornado Cash. In response, Circle [banned](#) addresses that had connections to Tornado from accessing USDC, drawing massive criticism from the crypto community. In fact, even wallets that have been unwillingly sent crypto using Tornado Cash are now finding their access to many DeFi apps blocked.

Circle has also stated that it [won’t support an Ethereum Proof-of-Work \(ETHPOW\)](#) fork if one is able to succeed post-Merge. Should a centralized stablecoin entity have that much power within the crypto ecosystem? If the USDC/USDT flipping happens, the crypto industry, which allegedly aims to make finance more decentralized and permissionless, might arrive at a crossroad.

The second challenge USDC might face is that keeping such large, risk-minimized, regularly- and professionally-audited fiat reserves ready for redemption at any time is a very resource consuming endeavor. USDT, on the other hand, may not appear as secure but might also, for that very reason, be more profitable. Whether USDC’s model is financially sustainable remains an open question at this stage.

Conclusion

The collapse of UST has had very large consequences on crypto. Some have been well identified already and some are still unfolding. A common theme among the three trends we've discussed is USDC's centralized and compliant nature.

As a reminder, these trends are:

- Algorithmic stablecoins only retaining minor market shares
- Crypto backed stablecoins having rebounded but being increasingly dependent on USDC
- USDC potentially about to take over USDT

All of these tend towards USDC gaining unprecedented weight over the stablecoin landscape. Add to this the fact that USDC's issuer, Circle, is not only highly centralized – USDT also is – but also highly compliant with the U.S. government's rules and regulations, and you start to see how the flipping might change the stablecoin game. Add, finally, crypto traders' reliance on stablecoins and you understand better our original question: Is USDC going to re-centralize all the things?

We say: **Maybe. By having indirectly pushed USDC's influence to an all-time-high, it is possible that the UST crash might well have spinned crypto into an increasingly centralized and U.S. compliant trajectory.**

Now, can decentralized finance and crypto at large flourish on this foundation? Should we expect, on the contrary, the pendulum to swing back in the other direction? Only time will tell. But as experience has shown time and again, in crypto, nothing is as stable as it seems.

Note regarding data: All stablecoin data was pulled from CoinMarketCap. In my analysis, I looked at stablecoins with over \$500 million in market cap which included USDT, USDC, BUSD, DAI, FRAX, TrueUSD, UST(C), Pax Dollar, and Neutrino Dollar.

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