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# SVB insolvency leads to depegging of USDC stablecoin

**The collapse of Silicon Valley Bank (SVB), a US-based bank, has caused turbulence in the cryptocurrency market. In particular, the second-largest stablecoin, USDC, faced serious problems as approximately 8% of its reserves were stuck in the affected financial institution.**

With a market capitalization of $40 billion, the US dollar-pegged stablecoin $USDC has established itself as a base currency on DeFi applications alongside Tether's $USDT. As one of the most well-regulated stablecoins, the token is issued by the recognized US-regulated institution Circle Financial and enjoys a high reputation due to its comprehensive regulatory measures. The USDC reserves are deposited with reputable banks and are subject to annual audits by the well-known "Big Four" auditor Deloitte. Ironically, however, this high level of compliance has recently led to a market-wide loss of stablecoin value worth billions of dollars, raising questions about the credibility of the industry. The question of how stable stablecoins actually are had to be answered by the counterparty risk of the involved banks and remains a hotly debated topic in the new financial world.

*Figure 1: USDC/USD Chart | Source: Tradingview*

## 8% of USDC reserves held at Silicon Valley Bank

Last week, Circle took measures to minimize its banking risk. The issuer deposited $5.4 billion of its cash reserves with BNY Mellon, one of the world's largest financial institutions, known for its solid balance sheet as a custodian bank. Another billion of Circle's cash reserves is held by the private bank Customers Bank, and the remaining $3.3 billion was held by Silicon Valley Bank (SVB).

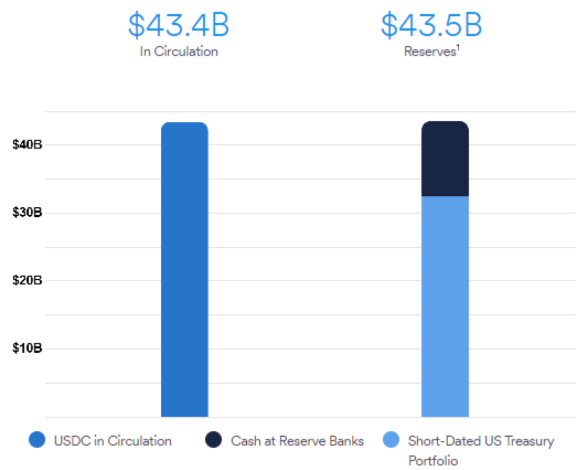


*Figure 2: Breakdown of USDC reserves | Source: Circle*

On Thursday, Circle initiated the transfer of funds from SVB to other bank partners but did not receive them before the close of business. The uncertainty surrounding these nearly 8% of USDC reserves sparked panic in the market over the weekend. Although Circle acted quickly, the question of the reliability of cash holdings with banking giants like SVB remains a central factor in the debate over the stability of stablecoins.

## SVB: largest bank failure since 2008

In recent years, Silicon Valley Bank invested heavily in long-term mortgage-backed securities with a

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maturity of more than 10 years. This was a risky strategy, as it led to a classic mismatch between assets and liabilities instead of investing in shorter-term treasuries or mortgages with a maturity of less than five years. With the inversion of the yield curve in the US, there was a billion-dollar rush on banks and ultimately a liquidity crisis that prompted the FDIC to take over the financial institution's deposits and close it down.

This collapse of Silicon Valley Bank was the largest since the 2007-2008 financial crisis and the second-largest in US history after the collapse of Washington Mutual. Fortunately, US authorities acted quickly to prevent further escalation. On Sunday evening, a joint statement by the US Treasury Department, Federal Reserve, and FDIC announced that all SVB customer deposits are guaranteed. As a result, Circle was able to transfer its reserves to custodian BNY Mellon, successfully restoring the USDC stablecoin's peg.

This case has shown that it is important for banks to pursue a balanced investment strategy when selecting their assets and that authorities must act quickly to prevent further escalation.

### Domino effect in the DeFi markets

In the world of decentralized finance applications, also known as DeFi, there are several types of stablecoins. While centrally-backed stablecoins such as USDT and USDC are widely used, protocol-based overcollateralized dollar coins such as MakerDAO's DAI and Frax Finance's FRAX have also established themselves. These enable the creation of stablecoins in exchange for the deposit of cryptocurrencies as collateral. In the event of a decline in the value of the collateral, the credit is programmatically liquidated, creating a robust system.

However, the largest decentralized stablecoin protocols have also introduced competing stablecoins as collateral to stabilize the system. Since USDC has been regarded as the most regulated blockchain dollar, many of these protocols have developed dependencies on Circle's stablecoin. For example, the market leader DAI is backed by USDC by over 60%. The depegging thus dragged the "decentralized" alternatives into the abyss.

As a result, turbulence occurred in the decentralized markets. Regulators quickly recognized the problem and issued a statement to calm the situation. Since then, the leading stablecoins have stabilized and are again traded at a 1:1 price to the US dollar. However, the incident has shown that trust in a centrally held stablecoin carries risks, which should drive the development of decentralized alternatives forward.