

## Stablecoin Safety Assessment

<b>Coin</b>	Tether (USDT)
<b>Date</b>	04-06-2023
<b>Overall Grade</b>	D

**Factor Scores:**

S. No	Factor	Score	Assessment
1	Stability	0.63	Unstable
2	Management	0.62	Moderate risk
3	Implementation	N/A	Not assessed
4	Decentralization	0.30	High risk (Not relevant to the grade)
5	Governance	0.29	High risk
6	Externals	N/A	Not assessed

**Summary**

- USDT is the longest surviving and largest stablecoin in circulation. It has lived through multiple stress tests, regaining its dollar peg each time it was tested. USDT's issuer has consistently fulfilled all redemptions, despite widespread accusations of USDT not being fully backed by reserves. It continues to hold its dominant position as the preferred stablecoin for trading.
- No stranger to controversy, USDT has been the subject of intensive regulatory scrutiny and penal actions from the likes of the New York Attorney General and the CFTC for falsely claiming that every unit of USDT is backed by a US Dollar. Instead, USDT is backed by a wide variety of assets held by the Tether Group, ranging from cash deposits to Bitcoin.
- Amongst the major fiat-backed stablecoins, USDT is less transparent and has inferior reserves due to the inclusion of reserve assets such as corporate bonds, secured loans, Bitcoin and miscellaneous investments whose exact nature and liquidity profiles are undisclosed.
- In our assessment, USDT is not a safe stablecoin. However, it may still be of interest to some users. It is most appropriate for institutional users, high net worth individuals and advanced traders who (a) rely on USDT's industry-leading liquidity depth, market share and breadth of trading pairs and (b) who have direct access to USDT's redemption mechanism. Most retail stablecoin holders and traders who tend to be less active market participants are better served by safer, more transparent and more regulated alternatives, both from the perspective of user protection and the comparatively limited monitoring effort required from holders.

## Evaluation

### 1. Stability [Score 0.63]

#### 1.1. Reserves [Score 0.43]

##### 1.1.1. Collateralization % and Type of Collateral [Score 0.95]

USDT is fully backed by the reserves of the Tether Group. As of March 31, 2023, the reserves comprise cash and bank balances (1%), US Treasuries (66%), Money Market Funds (9%), Overnight & Term Reverse Repos (10%) and a combination of corporate bonds, investments, secured loans and commercial papers (13%).

##### 1.1.2. Storage of Assets [Score 0.35]

For off-chain collateral, we rank storage methods as follows (highest to lowest)

- With regulated custodians in reputable jurisdictions
- With regulated custodians not in reputable jurisdictions (e.g, BVI, Bahamas)
- Others / Undisclosed

Others / Undisclosed

Tether refuses to disclose the names of banks and custodians it partners with for custody of reserves. Based on information available in the public domain, we know that Bahamas-based Deltec Bank & Trust, Ansbacher (Bahamas) Limited and Capital Union Bank, and Taiwan-based Far East International Bank, are or have been banking partners of Tether.

##### 1.1.3. Asset Segregation [Score 0.00]

Tether does not maintain segregated accounts for assets held on behalf of USDT holders. Tether's assets are distributed across several associated entities. These assets are not bankruptcy remote.

#### 1.2. Market Feedback [Score 0.95]

##### 1.2.1. Frequency of Deviation Below Peg [Score 1.00]

Number of Days where VWAP < Peg by 0.5% or more during the past 180 days = 0

##### 1.2.2. Max Deviation Below Peg [Score 1.00]

Biggest daily VWAP deviation below peg: 0.15%

##### 1.2.3. Volatility (% per day) [Score 1.00]

Daily volatility (%) over the past 180-day period: 0.06%

#### 1.2.4. Downside Volatility in a Market Downturn [Score 1.00]

Average deviation below peg during the 5 worst-performing days for BTC (DoD price change) in a 180-day period: 0%

#### 1.2.5. Liquidity Pool Imbalance [Score 0.75]

##### 3Pool (USDC/USDT/DAI)

- USDT Share of Pool - 25%
- Pool Type - 3 Token
- Optimal Share of USDT - 33%
- Deviation from Optimal Share - (25%)
- Non-USDT TVL in the pool - \$296,534,598
- Pool Score - 0.75

### 1.3. Stability Mechanism [Score 0.75]

#### 1.3.1. Core Mechanism [Score 1.00]

USDT relies on market participants to arbitrage differences between the market price of USDT and the net asset value of USDT (typically, \$1 if USDT is fully-collateralized). We believe this is the most effective price stability mechanism.

When USDT is trading away from its peg, any user who has a KYC'd account with Tether can mint or redeem USDT for US Dollars and make an instant profit. This risk-less profit opportunity attracts more participants and eventually pushes the market price of USDT towards its peg.

#### 1.3.2. Primary Liquidity Access [Score 0.50]

Only users who possess a KYC'd account with Tether can redeem USDT for US Dollars, subject to a minimum redemption value of \$100,000. This limits the redemption right largely to institutional users and high net worth individuals. By excluding most retail users from redemption and thus, fewer participants can engage in the stabilization process and users lose confidence during depegging events.

## 2. Management [Score 0.62]

### 2.1. Restrictions [Score 0.75]

#### 2.1.1. Known Core Teams [Score 1.00]

Tether's executive team consists of JL Van Der Velde (CEO + Founder, Bitfinex), Giancarlo Devasini (CFO + Founder, Bitfinex), Paolo Ardoino (CTO, Tether & Bitfinex), Claudia Lagorio (COO, Tether and Bitfinex) and Stuart Hoegner (General Counsel, Tether & Bitfinex).

#### 2.1.2. Jurisdiction Score [Score 0.50]

Our scores are derived from the World Justice Project's Rule of Law (RoL) Index – specifically the

factors of 'Regulatory Enforcement' and 'Civil Justice'.

The Tether Group comprises several entities registered in the British Virgin Islands (BVI), Hong Kong or Taipei City, Taiwan (China). The holding company is located in BVI but the primary operating entity (Tether Limited) is registered in Taipei City (China)

USDT's score is based on China being the country of operation (the United States' FinCen recognizes Tether's place of business as Taipei City, China).

## **2.2. Track Record**

### **2.2.1. Team's Background**

[Score 0.5]

Information about the team is scarce. Two Financial Times reports pertaining to the CEO and CFO of Tether & Bitfinex shed some light on potential causes of concern. These are linked below. The accusations therein, while difficult to prove with certainty, combined with Tether's history of misrepresenting its financial position and its consequent lawsuit settlement with the Attorney General of the State of New York, show some patterns that give us sufficient reason to be cautious about general management attitude

Links:

1. [FT Report on CEO](#)
2. [FT Report on CFO](#)
3. [Tether settles with NYAG](#)

Note: Track Record is not scored by default for most coins being rated. Scoring is done only when there are justifiable causes for concern.

## **3. Implementation**

[Score N/A]

Not assessed

## **4. Decentralization**

[Score 0.30]

### **4.1. Regulatory Oversight**

[Score 0.50]

Regulatory oversight increases the risk of censoring endpoints of the stablecoin's network (such as the issuer, banks and custodians) as well as users. A score of 0 indicates a high degree of government censorship risk.

USDT's issuer, Tether, is registered with the US FinCEN as a money service business. As an entity registered in the British Virgin Islands (BVI) with primarily BVI-registered banking partners, USDT is less prone to

censorship at the associate-level than USDC and other US-registered / regulated stablecoin issuers. However, Tether actively cooperates with US authorities for blacklisting users suspected of money-laundering or criminal activities.

Note: Censorship resistance is not a key objective common to all stablecoins. Consequently, a low score may not be a relevant source of concern to some types of stablecoin users. Furthermore, regulatory oversight can also be beneficial to some users as it entails more robust consumer protection mechanisms and increased transparency.

#### 4.2. Custodian Risk

[Score 1.00]

When evaluating custodian risk (i.e, credit risk of entities holding assets), we consider the distribution of assets between entities that hold the assets, such as the issuer, their banks, and custodians.

Tether is believed to hold its assets through Deltec Bank, Ansbacher (Bahamas) Limited, Capital Union Bank and Far East International Bank. The existence of other custodians, if any, is undisclosed.

#### 4.3. Type of Collateral

[Score 0.00]

When evaluating decentralization, it is important to consider the extent to which the stablecoin's value is tied to a central authority or external fiat currency. Monetary policies / decisions taken by such authorities / central banks can have an impact on the purchasing power of the collateral.

USDT is fully backed by USD-denominated real-world assets which are subject to the monetary policies of the United States.

(Fiat currencies earn a score of 0 and decentralized cryptocurrencies earn a score of 1)

Note: Independence from a nation's monetary policies is not a key objective common to all stablecoins. Consequently, a low score may not be a relevant source of concern to some types of stablecoin users.

#### 4.4. Decision Making & Voting Power

[Score 0.00]

Fiat-backed stablecoins such as USDT are run by private corporations. As such, the absence of decentralized decision making and voting power is a feature, not a bug.

#### 4.5. User Blacklisting

[Score 0.00]

Tether can and has exercised its power to blacklist specific user wallets.

Note: Censorship through blacklisting helps prevent legitimate users from transacting with criminals. This is particularly relevant to institutional users who are obligated to report their transactions and activities.

## 5. Governance

[Score 0.29]

### 5.1. Holder Protection

[Score 0.25]

For holders of fiat-backed stablecoins, the best form of protection is the issuer being regulated as a stablecoin issuer. The next best option is being regulated as a financial institution. Tether meets neither of these criteria. Tether and its management personnel have claimed that Tether is a regulated entity but this claim arises from Tether's registration with FinCen as a 'money service business' (MSB).

As per FinCen, "The inclusion of a business on the MSB Registrant Search Web page is not a recommendation, certification of legitimacy, or endorsement of the business by any government agency".

In the event of Tether going bankrupt, USDT holders' assets are not bankruptcy-remote.

### 5.2. Periodic Reserves Attestations

[Score 0.75]

Our rating considers the type & frequency of reserves attestations.

Type [Score 1.00]

Attestations can be broadly classified into 2 categories based on the nature of the auditor's report. – 'Assurance Engagements' and 'Agreed Upon Procedures'.

Assurance Engagements are like audits in that the auditor determines the nature and extent of work required to express an independent opinion (provide assurance) on a particular matter. The auditor is free to conduct as deep an examination as they may deem appropriate to arrive at a reasonable conclusion. Assurance Engagements require the auditor to stake their reputation, and therefore carry more weight. Assurance Engagements provide either a 'reasonable level of assurance' (also called examinations) or a 'limited level of assurance' (also called reviews). The former is better and offers the same level of assurance that is provided in a full-fledged financial audit but with a comparatively smaller scope and subject matter.

Agreed Upon Procedures are engagements wherein the auditor is engaged by the issuer to perform specific tasks and report on factual findings. The auditor's scope of work is limited by the issuer and does not involve expressing an opinion. Instead, the auditor provides factual statements in his or her report and the users of such reports are expected to form their own opinions on the matter. In such cases, the auditor does not stake their reputation and provide an assurance of any sort. AUPs, while useful, are inferior to

Assurance Engagements.

Frequency [Score 0.50]

Reserves attestations can be monthly, quarterly, half-yearly or annually.

Since review procedures are performed on reserves data as of a particular day (typically, last day of the quarter), they do not consider transactions and events which occur in between reporting dates. Consequently, periodic reserves attestations provide a lower degree of assurance compared to a full scope financial audit.

Tether has engaged BDO, a CPA firm, to provide quarterly assurance opinions on its reserves.

**5.3. Financial Audits**

[Score 0.00]

Periodic Reserves Attestations alone are inadequate to ascertain the existence and adequacy of reserves, they need to be complemented by full scope annual financial audits. This is especially true in Tether's case since USDT reserves are commingled with Tether's corporate funds.

However, Tether is yet to produce a full audit report of its financial statements. Its reluctance to do so stands in stark contrast to other major fiat-backed stablecoins.

**5.4. Redemption Policy**

[Score 0.00]

Our scoring reflects whether stablecoin issuers have reasonable and transparent timelines for processing redemptions.

According to Tether's Terms of Service:

"Tether reserves the right to delay the redemption or withdrawal of Tether Tokens if such delay is necessitated by the illiquidity or unavailability or loss of any Reserves held by Tether to back the Tether Tokens".

Apart from the statement above, Tether makes no reference to redemption timelines.

