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Terra Luna Stablecoin: What Exactly are 'Stablecoins' and How do They Remain Stable?

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It was a whirlwind month for the [cryptocurrency](#) market as the price of [TerraUSD](#) and [Luna](#), two [stablecoins](#), plummeted earlier this month. Volatility in [bitcoin](#) pricing is nothing new. Because [TerraUSD](#) is a so-called stablecoin, investors were surprised by the abrupt decline in the cryptocurrency's price. Stablecoins, as their name implies, are designed to maintain their value in relation to a fiat currency like the dollar or euro.

Before May 9, TerraUSD was practically exactly tied to the dollar, but now it's only worth about \$0.11 (€0.10). As of May 18, Luna's value had plummeted from more than \$80 (€76) a coin to less than a tenth of a cent.

Because of the ripple impact it had on other cryptocurrency projects and tokens, the fall of these two coins has been compared to a mini-financial crisis of 2008, wiping off billions of dollars from the market. Stablecoins raise the question: What exactly are 'stablecoins' and how do they remain stable?

What Exactly are 'Stablecoins'? Explained

Coins that are based on a fiat currency, such as the dollar, are called "stablecoins." Tether is the most well-known stablecoin, with a market cap of \$75 billion (€71.22 billion). As a result, it has surpassed Bitcoin and Ethereum in terms of market cap.

Tether's value is meant to be fixed at \$1 because it is pegged to the dollar. This allows cryptocurrency investors to trade cryptocurrencies like Bitcoin and Ethereum on exchanges without having to transfer their funds into a regulated fiat currency first.

Tether's price is expected to remain consistent at \$1, so investors can convert their less stable cryptocurrencies into Tether in order to preserve their dollar worth.



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How do Stablecoins Remain Stable?

Stablecoins can be held to a fiat currency in one of three ways.

With cash reserves as collateral to verify that each coin's corresponding quantity in dollars is backed by Tether, the dollar value of a Tether is fixed.

For the time being, Tether says that its tokens are tied one-to-one to a corresponding fiat currency and are fully backed by its cash and "cash equivalents" reserves.

Coins that are backed by cryptocurrency reserves maintain their stability. Coins must be supported by more than 100% of their value in order to preserve a one-to-one ratio because cryptocurrency prices can fluctuate wildly.

Last but not least, other stablecoins, like TerraUSD, are backed by an algorithm that increases or decreases supply in response to market fluctuations in order to maintain a fixed value.

Are Stablecoins Really Stable?

[TerraUSD](#)'s downfall has raised serious questions about this. Due to massive TerraUSD withdrawals, general cryptocurrency concerns, and a persistent decline in pricing, Terra's peg to the dollar was lost.

Terra's developers also invested billions of dollars in Bitcoin as a form of reserve. The price of Bitcoin has also been declining, and Terra's selling of its Bitcoin merely served to exacerbate the decline.


TerraUSD "was never really a stablecoin from the start," NiceHash's chief marketing officer Joe Downie said in an interview with Euronews Next. By using their own money to back their currency instead of US dollars as a kind of currency backing, "it was essentially a formula for disaster," stated the author.

According to him, "the ones we should be worried about" are so-called stablecoins like TerraUSD. "There's a danger this might happen again if they're not honest about what's being utilized to back the assets."

Changpeng Zhao, the CEO of Binance, the world's largest cryptocurrency exchange, may be regretting his decision to invest in TerraUSD. Luna was valued as \$1.6 billion (€1.52 billion) at its

peak in 2018, when Binance purchased \$3 million (€2.85 million). Because of this, it's now only worth about €2,851.

Poor again. <https://t.co/88v2U2vjfM>

— CZ  Binance (@cz_binance) [May 17, 2022](#)



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New Legislation

It's not just the [Terra Luna](#) meltdown that has caused people to lose large sums of money; a similar scenario with the other major stablecoins would be far more devastating.

It wasn't the first time that large-scale stabilized coins experienced unnerving spurts of volatility; the week of May 9 saw them trade between about \$0.95 and \$1.02, according to Coinmarketcap. According to Coinmarketcap's data, Tether and USDC's prices have fluctuated widely in recent years, climbing to as high as \$1.01 in 2021 and decreasing to as low as 97 cents in 2020.

Cryptocurrency's lack of regulation is a major selling point, but analysts believe that regulation is on the horizon for stablecoins. Reuters quotes Michelle Bond, CEO of the Association for Digital Asset Markets, as saying, "Stablecoins are low-hanging fruit, and I think we'll see some regulation for them."

"A number of questions must be answered: What are the permitted reserves? A stablecoin can be issued by anyone. An issuer and its reserves should be inspected in what manner? Is there a certain type of disclosure that is made to customers?"

When it comes to whether or not investors can rely on stablecoins, Downie reaffirms a cryptocurrency community mantra: Do your own homework. According to him, "a lot of people do invest based on excitement in the crypto markets; it is simple to hype anything up, but hype is just marketing, but a lot of that is concealing the fundamentals behind it," he stated.

In order to determine what it is, look at its technical foundations. Cryptocurrency investors should be able to tell "what's a little more solid, and what's a little less." There have been more than \$10 billion in withdrawals by investors during the past two weeks. May 11's circulating supply was \$84 billion, while on May 23 it was around \$73 billion.

After Terra Luna's demise, this class of cryptocurrency saw its most turbulent week ever. For this reason, "any influence on the value of one or more stablecoins is likely to impact the system as a whole," said Hagen Rooke, a financial regulation partner at Reed Smith in Singapore, according to Reuters.

Currently, stablecoins are not heavily regulated, which is unusual because if you break down how a centralised stablecoin works, it is basically the same as a bank deposit.