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How Crypto's $83 Billion Rebel Is Crushing the Competition

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How do you make $6 billion a year in crypto? Trading Bitcoin could work, but it's dicey. A better way: Act like a bank. Take people's cash, stash it in reserves such as Treasuries, and sit back while the money earns a cool 5%.

The company playing the bank is Tether Holdings, issuer of the largest and most widely used "stablecoin" on the market. Stablecoins are like crypto cash; they typically hold a $1 price, backed 1-to-1 by reserves. Tether is now the king, towering over the market with $83 billion in deposits.

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While rising rates have depressed Bitcoin and crypto broadly, they have turned Tether into perhaps the world's most profitable digital asset. Its corporate parent says its excess reserves hit an all-time high of $2.44 billion in the first quarter, including a $1.48 billion net profit. Tether says most of its reserves are in U.S. Treasury bills, whose yields have surged to around 5%. The company doesn't break out the source of its profits, and its asset prices could fall, blowing a hole in earnings. At its latest rate, however, Tether could pull in nearly $6 billion this year.

The profits make it a financial giant, not just in crypto. The firm could earn more than BlackRock (ticker: BLK) this year, forecast to report $5.5 billion of net income. If it were a bank, its deposits would exceed those of Comerica (CMA). And Tether Holdings should be far more profitable than Coinbase Global (COIN), the crypto exchange that has racked up billions of dollars in losses and is expected to post a $564 million loss in 2023.

Yet Tether's success seems possible only in the opaque, alternative universe of digital assets. And it illustrates a crypto Catch-22: The more companies try to play by traditional finance rules, the more they may lose out.

For a while, Tether was going head to head with USDC, a stablecoin issued by Circle Internet Financial, with supporters including Coinbase and BlackRock. Tether, operating offshore, long had a reputation for being far less transparent about its reserves and corporate structure, while USDC wove itself into the U.S. banking and financial system. The bet by USDC's backers: It would be the trusted and more successful stablecoin while Tether, far more opaque, would suffer from its lack of transparency and lose market share.

Yet the crypto crash only accelerated Tether's rise. Major "algorithmic" stablecoins like Terra went bust last year. And Tether put more distance between itself and USDC, which has dropped to $28 billion in coin issuance from $44 billion in March.

USDC now looks less competitive. Circle sought to portray itself as a model crypto citizen, with more disclosures and ties to U.S. banks and financial firms—even keeping $25 billion of reserves in a money-market fund run by BlackRock. Circle also tried to go public and filed audited financial statements, though the Securities and Exchange Commission didn't approve the application.

Yet USDC's reputation for stability suffered in March when banks that held some of its reserves, including Silicon Valley Bank, failed. USDC slipped to 88 cents and Coinbase paused redemptions briefly, before the government stepped in with bank bailouts. Circle said that its coin remained fully collateralized and that it processed minting and redemption requests on Monday morning after the weekend panic over SVB. Its token has since held its peg at $1.

The episode highlighted the drawbacks for crypto companies of being tied to the U.S.—the world's largest capital market but one where crypto is in the crosshairs of regulators, including recent SEC actions against Binance and Coinbase.

"In this climate, where the U.S. is now very antagonistic to crypto, being a U.S.-based entity isn't seen as something that will be safe," says Stephane Ouellette, CEO of FRNT Financial, a crypto platform based in Toronto. "There's a lot of trust in Tether internationally."

How Tether Vaulted Ahead

Like banks that issued their own currencies in the 1800s, crypto companies crank out stablecoins pegged to traditional currencies, gold, or other assets. Stablecoins form the bedrock of crypto activity, helping traders get dollar liquidity on and off of exchanges and put up collateral for loans—since you can't trade dollars against tokens.

Tether, in many ways, is now inextricably woven into the crypto ecosystem. Through widespread use, it is the third-largest digital asset by market capitalization, after Bitcoin and Ether, with daily volumes that are often double or triple that of Bitcoin.

Tether built its $83 billion asset base in a few key ways. It was the first major stablecoin on the market, in 2014, and it has long been associated with Bitcoin, riding that token's rise. "They basically invented stablecoins and they're the default option for liquidity," says Ouellette, whose firm offers Tether derivatives to institutional investors. The coin trades against every major token on exchanges, and it's used for lending in "smart contracts" or buying Bitcoin on margin, with Tether as the collateral.

Tether also has a reputation for survival. The coin has occasionally broken its peg slightly on exchanges during periods of extreme volatility. But it has persevered as Bitcoin and other tokens crashed and huge crypto players like FTX collapsed.

One of its strengths, ironic in decentralized crypto networks, is that Tether relies on trading firms, including market makers, to help maintain the token's peg. These firms can redeem coins directly with the company and can quickly arbitrage away price discrepancies when the token slips below a dollar on exchanges.

One such firm is Dexterity Capital, a proprietary trading firm focused on high-frequency, market-neutral strategies. "I can't tell you we're best buddies," says co-founder Michael Safai. "We have done minting and redeeming when we've needed to," he adds, saying there are maybe three or four times a year when Dexterity will swing into action in a Tether arbitrage trade.

Tether has also bucked pressure to open its books and reveal more about its business. With corporate entities in Hong Kong and the British Virgin Islands, Tether looks nothing like a regulated U.S. bank or publicly traded company. Its ownership structure remains a tangle of opaque offshore subsidiaries. There is overlap in Tether's ownership with the Bitfinex exchange, an offshore crypto brokerage run by Tether's CEO, Jean-Louis van der Velde, and other senior executives. Bitfinex and Tether are owned and operated by iFinex, a company registered in the British Virgin Islands.

Tether has had run-ins with regulators. The group settled charges in 2021 with the New York state attorney general over an undisclosed loan to Bitfinex, and paid a fine to the Commodity Futures Trading Commission over allegations it broke U.S. laws over reserves and disclosure practices. Tether didn't admit wrongdoing in the New York case and said that the CFTC found no evidence that its coins were not fully backed at all times.

The episodes pushed Tether to be more transparent. In its settlement with New York state, Tether agreed to disclose more information about its reserves. The firm now releases quarterly "assurance" reports from accounting firm BDO Italia.

Tether declined an interview request. The company said in a statement to Barron's that it "is committed to continue being a transparency leader in crypto."

Still, its corporate structure, ownership, and full set of liabilities remain far less transparent than public companies. And some financial experts say Tether doesn't come close to the comprehensive disclosures of public companies.

"It's astounding how sketchy they are in terms of details," says Eswar Prasad, an economist at Cornell University and expert on digital money. "They wouldn't pass any formal auditing and accounting standards, but the remarkable thing is that the market seems to take them mostly at face value."

One nagging concern: whether Tether has enough high-quality, liquid assets to handle a run on its coins. The company has gradually sold its commercial paperand added more Treasuries to its reserves. But it still keeps about 15% of its assets in noncash holdings, including Bitcoin, precious metals, secured loans, and "other investments," according to its latest report. Tether says it has a reserve surplus of $2.4 billion and has committed to taking its secured loans to zero. "The truth is that Tether maintains a robust, cautious, and liquid portfolio, prioritizing the safeguarding of its reserves," says Tether's spokesperson.

Circle has tried to distance itself from Tether by working within the U.S. banking and regulatory system. Based in Boston, Circle is regulated by states as a licensed money transmitter. An independent auditor, Deloitte, vouches for its reserves. Circle even worked its way into the World Economic Forum at Davos as a "partner" company.

The attitude at Circle is that it isn't in competition with Tether, which mostly dominates as a trading pair with Bitcoin on centralized exchanges, and that inflows to Tether represent "crypto serving crypto," according to a person familiar with the matter.

Yet Circle's ties to U.S. banks and regulators may be holding it back, as traders gravitate to a stablecoin that has kept its distance from the U.S. "It is an unfortunate paradox that U.S. regulators' hostility toward stablecoins has ended up hurting the one stablecoin that seems more willing to play by the rules, and benefited the stablecoin that has chosen to ignore them," says Prasad.

Crypto participants say they remain confident in Tether. Safai says Tether's lack of transparency and offshore entities would "be a nonstarter" in traditional finance, but in crypto, "that weakness has been what has made them strong."

In the absence of real competition, the greatest risk to Tether remains regulation. The European Union this year passed legislation for stablecoin issuers, aiming to limit the use of non-euro backed coins, among other measures. Crypto rule making continues to be a grind in the U.S., but the Biden Administration has made clear that it wants stablecoin issuers to be regulated similarly to banks. Draft legislation introduced in the House of Representatives would be the biggest step yet in that direction, with rules for reserves, redemptions, and registration of issuers—including those outside the U.S.

Circle isn't the only one trying to knock Tether off its perch by sticking to standard business practices. An industry group called the Stablecoin Standard is offering a "quality badge" to coin issuers that meet minimum standards for transparency, reserves, and audits. So far, however, only about $2 billion worth of coins meet its standards, less than 2% of the total market.

Tether's legal troubles aren't over. The group is currently locked in a lawsuit in the United Kingdom with the issuer of Poundtoken, which alleges that Tether infringed on its intellectual property by trying to launch a token with the same name—GBPT. Tether is countersuing. Both parties declined to comment on the case.

For now, Tether is such a money maker that it's expanding beyond stablecoins. The firm said in May that it would begin allocating up to 15% of net operating profit toward purchasing Bitcoin, of which it already holds some $1.5 billion. That puts one of crypto's most important players on track to be one of its biggest investors. Tether is also moving into Bitcoin mining, or processing transactions for fees, investing in facilities in Uruguay.

Tether still has detractors who think it's only a matter of time before the token breaks down. Traders often attack it, trying to force the coin to break the buck—to capitalize on short positions or a broader downturn in crypto that Tether's demise could trigger. In one such attack last week, Tether fell just below $0.999, but rebounded within a few hours. Paolo Ardoino, Tether's chief technology officer, said on Twitter that it was "easy for attackers" to capitalize on an edgy market. He also issued a challenge: "Let them come. We're ready to redeem any amount."

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