
Discussion Points: Potential Points of Failure of Stablecoins and DeFi

Decentralized Treasury Working Group

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The Global Network for Blockchain Stakeholders™

This study is a work product of the Decentralized Treasury Working Group of BGIN.

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1. Effect on Stablecoin and DeFi. Risks.

(What happened after the Silicon Valley Bank Collapse?)

1–1. What happened to stablecoins and DeFi after the Silicon Valley collapse?

- Understanding what happened and the root cause.
- Direct and spillover effect and risk through stablecoin.
 - Banking and stablecoin/DeFi interaction.
 - Depegging of stablecoins (USDC).
 - The domino effect on non-USDC stablecoins which were collateralized on the USDC such as DAI.
 - Huge trading volume which stopped Central Exchange (Coinbase, Binance restricted redemption).
 - Other spillover channels.
- Market response and panic.
- Emergency measures.
- Outcome and ongoing situation.

1–2. What is classic and what is new about the incident from the perspective of stablecoins and DeFi?

- Acknowledging that there is classical/historical context in the problem.
- The perfect “safe money” mechanism is difficult to build. Our past bitter experience in the financial industry has led to the introduction of various safeguards as regulations (including self-regulation), to ensure financial stability and consumer protection. It is time to reflect on the initial purpose and implementation of these measures. We should avoid the “re-inventing of the wheels”.
- Asset-backed financial products and bank deposits are exposed to risks that are not novel. However, where was the risk, and were necessary and effective steps taken to mitigate these risks?
- Discuss whether these measures built on experience are applicable or how they are applied to stablecoins and DeFi.
- At the same time, we will identify new risks and vulnerabilities that were revealed after the depegging of USDC.

2. Potential Point of Failure on Stablecoin and DeFi

- We will list the Trust Point (centralized elements that users and others are forced to trust unconditionally)/Chain of Trust (a chain of dependencies that includes a trust point) and its related risks/problems that were revealed in the incident.
- Some of the critical questions we hope to discover are as follows;
 - Where and what is the Trust Point/Chain of Trust in stablecoins and DeFi?

- Why did the holders/users of stablecoins and DeFi products have to bear the counterparty risk?
- What was lacking in consumer protection?
- Were classical risks (market volatility risk, credit risk, maturity mismatch risk, liquidity risk, counterparty risk, reputation risk, etc.) perceived fully by the stakeholders, and were measures to prevent that implemented by the stakeholders?
- What was the interconnectedness that caused the spillover/domino effect? Is there any route that would have stopped these effects?
- Does it have the possibility to cause a potential systemic risk?
- We will analyze using the framework recommended by the Financial Stability Boards' "Assessment of Risks to Financial Stability from Crypto-assets" (February 2022).
 - Vulnerability: leverage, liquidity mismatch, interconnections with the traditional financial system, technological and operational fragility
 - Transmission Channel: wealth effects, confidence effects, use of payment and settlement, financial sector exposures to crypto

3. Implication

- Rethink and acknowledge existing past instruments and experience. At the same time, does technology provide a different way to avoid risk transmitted to users and economies? If so, in what way?
- Fundamentally question whether stablecoins and DeFi replicate the same problems and risks that Satoshi Nakamoto tried to address.
- Explore the potential for more decentralized and robust stablecoin designs to minimize reliance on trust points and centralized elements.

4. The role of BGIN

- BGIN is a multi-stakeholder think tank. Its mission, role, and approach are to contribute to ongoing efforts to promote stability, security, and innovation in the blockchain ecosystem.
- BGIN also explores potential future developments and various initiatives to address emerging risks and promote stability in the DeFi ecosystem.
- This BGIN paper aims to analyze the instability event in question and to identify possible recommendations to mitigate such events in the future.
- Ultimately, humanity dictates how technology is used. There is a need for open discussion. It is also necessary to learn from different stakeholders and their past experiences.

Appendix – Acknowledgement

(Informative)

(Note) The views expressed in this report are based on the personal views of the authors and not the views of the organizations to which they belong.

A.1 Editors and Co-editors

- Michi Kakebayashi (University of California, Berkeley)

A.2 Contributors

- Ali Nejadmalayeri (University of Wyoming)
- Gary Weinstein (Electric Coin Co.)
- Leon Molchanovsky (Galaxy Innovation Ltd.)

Blockchain Governance Initiative Network (BGIN) aims at providing an open and neutral discussion platform for all stakeholders to deepen common understanding and to collaborate to address issues they face in order to attain sustainable development of the wider blockchain community. As an open network, we are now actively and widely seeking interested parties to join this initiative, so as to accommodate diverse opinions from a wider range of blockchain stakeholders.