

Tutorial 5: The USDC Depeg

When “Safe” Isn’t Safe

ECOM215: Blockchain Economics and Digital Assets

Week 6 | Stablecoins and Central Bank Digital Currencies

Semester B, 2025/2026

CASE BRIEF FOR STUDENTS

Please read before the tutorial. Estimated reading time: 15 minutes.

Background

By early 2023, USD Coin (USDC) had established itself as the “safe” stablecoin. Unlike Tether (USDT), which faced persistent questions about its reserves, USDC was issued by Circle—a US-regulated company with monthly attestations from major accounting firms. Its reserves were held in cash and short-dated US Treasury bills at regulated financial institutions.

USDC was the backbone of DeFi. It served as the primary stablecoin for lending protocols, DEX liquidity pools, and cross-border payments. Its market capitalisation exceeded \$40 billion. It was, by design, boring and reliable.

Then, on a Friday evening in March 2023, USDC dropped to \$0.87.

The Silicon Valley Bank Collapse

Silicon Valley Bank (SVB) was a mid-sized US bank specialising in technology startups and venture capital. It was the 16th largest bank in the United States.

What went wrong at SVB:

- SVB held large amounts of long-dated government bonds and mortgage-backed securities
- When interest rates rose sharply in 2022, these bonds lost value (bond prices fall when rates rise)
- SVB had \$17 billion in unrealised losses on its bond portfolio
- On March 8, 2023, SVB announced it needed to raise \$2.25 billion to shore up its balance sheet
- Depositors panicked; \$42 billion was withdrawn in a single day
- On March 10 (Friday), regulators seized SVB—the second-largest bank failure in US history

The USDC Connection

On the evening of Friday, March 10, Circle disclosed that **\$3.3 billion of USDC's cash reserves**—approximately 8% of total reserves—were held at Silicon Valley Bank.

The immediate market reaction:

- USDC began trading below \$1 within minutes of the announcement
- By Saturday morning, USDC had dropped to \$0.87–\$0.90 on major exchanges
- Crypto markets broadly sold off; Bitcoin dropped 8%
- DeFi protocols faced stress as USDC collateral lost value
- DAI, which uses USDC as partial backing, also briefly lost its peg

The key question: If Circle couldn't access \$3.3 billion of its reserves, could it honour redemptions at \$1?

48 Hours of Uncertainty

Friday evening, March 10:

- Circle's disclosure was transparent but alarming
- Traditional banking was closed for the weekend—no clarity on whether SVB deposits would be recovered
- USDC redemptions require banking infrastructure; weekend = no redemptions possible
- Holders could only sell on secondary markets, driving prices down

Saturday, March 11:

- USDC traded between \$0.87 and \$0.95 across different venues
- Arbitrage was impossible without redemption access
- Rumours and speculation dominated crypto social media
- Some DeFi protocols paused operations; others faced liquidation pressure

Sunday, March 12:

- US Treasury, Federal Reserve, and FDIC issued joint statement
- **All SVB depositors would be made whole**—including uninsured deposits above \$250,000
- Circle confirmed it would have full access to its SVB funds
- USDC began recovering toward \$1

Monday, March 13:

- Banking resumed; Circle processed redemptions normally
- USDC returned to \$1 peg
- Crisis over—but lessons remained

Why Did the “Safe” Stablecoin Depeg?**1. Counterparty risk from banking partners**

- USDC’s reserves were held in banks, not directly in Treasuries
- Bank deposits above \$250,000 are not FDIC-insured
- Circle had \$3.3B at SVB—all uninsured

2. Weekend liquidity mismatch

- Crypto markets trade 24/7; banks operate on business days
- Redemptions were impossible over the weekend
- Arbitrage (buy cheap USDC, redeem for \$1) couldn’t function
- Market price reflected uncertainty, not fundamentals

3. Transparency as a double-edged sword

- Circle disclosed the SVB exposure promptly—arguably the right thing to do
- But the disclosure triggered the panic
- Tether (less transparent) saw inflows as a “safe haven” during the crisis

The Government Backstop

The US government’s decision to guarantee all SVB deposits—not just the FDIC-insured \$250,000—was extraordinary.

The rationale:

- Prevent contagion to other regional banks
- Protect payroll and operations of thousands of companies
- Maintain financial stability

The controversy:

- Was this a bailout? (Officials insisted it was not—shareholders and bondholders lost everything)

- Moral hazard: Does this encourage risky behaviour by banks and depositors?
- Should crypto companies benefit from government safety nets they often criticise?

For USDC: The government backstop saved Circle from a potential crisis. Without it, USDC might have faced a genuine solvency problem.

Aftermath and Changes

Circle’s response:

- Diversified banking relationships (no single bank holds large share)
- Increased allocation to Treasury bills (held at BNY Mellon)
- Reduced reliance on cash deposits
- Launched “Circle Reserve Fund” with BlackRock

Market impact:

- USDC market cap declined from \$43B to \$25B over following months
- Tether (USDT) market cap increased—perceived as less connected to US banking
- Some DeFi protocols diversified stablecoin holdings

Regulatory implications:

- Renewed focus on stablecoin reserve requirements
- Questions about whether stablecoins should have direct central bank accounts
- Debate over 24/7 redemption requirements

Key Facts Summary

| Item | Detail |
|-------------------|---|
| Date | March 10–13, 2023 |
| USDC market cap | ~\$43 billion |
| SVB exposure | \$3.3 billion (~8% of reserves) |
| USDC low price | ~\$0.87 |
| Duration of depeg | ~48 hours |
| Resolution | US government guaranteed all SVB deposits |

Questions to Consider

1. Was Circle's immediate disclosure the right decision? What are the trade-offs between transparency and stability?
2. Should stablecoin issuers be allowed to hold reserves in commercial banks? What alternatives exist?
3. The government backstop saved USDC. Is it appropriate for crypto to benefit from traditional financial safety nets?
4. How should stablecoin reserves be structured to avoid this type of risk?
5. Does this case change your view of "fiat-backed" stablecoins as the "safe" option?

Further Reading (Optional)

- Circle's March 10 and March 11 public statements
- Joint statement by Treasury, Federal Reserve, and FDIC (March 12, 2023)
- "Lessons from the USDC Depeg"—Chainalysis blog

Session Timeline

| Time | Activity |
|-----------|---|
| 0:00–0:08 | Context setting: summarise the SVB collapse and USDC connection |
| 0:08–0:20 | Discussion Question 1: Transparency trade-offs |
| 0:20–0:32 | Discussion Question 2: Reserve structure |
| 0:32–0:44 | Discussion Question 3: Government backstops |
| 0:44–0:52 | Discussion Question 4: What is “safe”? |
| 0:52–1:00 | Synthesis and key takeaways |

Discussion Questions with Guidance

Question 1: Was immediate disclosure the right call?

“Circle disclosed its SVB exposure on Friday evening, triggering the depeg. Was this the right decision? Would delaying until Monday have been better?”

Arguments for immediate disclosure:

- Legal and ethical obligation to inform holders of material risk
- If news leaked through other channels, trust would be destroyed
- Transparency is Circle’s brand differentiator—silence would undermine it
- Markets will eventually learn; better to control the narrative

Arguments for delaying:

- Weekend timing meant no redemptions possible—panic with no relief valve
- By Monday, government response might have been known, reducing panic
- Disclosure without solution can cause unnecessary harm
- Ironically, Tether’s opacity shielded it from scrutiny

Key insight: Transparency is valuable but creates its own dynamics. In a 24/7 market with weekend banking closures, timing of disclosure matters enormously. There’s no clearly “correct” answer here.

Question 2: How should stablecoin reserves be structured?

“USDC was considered safe because it held cash and Treasuries. But the cash was in a bank that failed. How should reserves be structured to avoid this?”

Options to discuss:

- **100% Treasury bills:** Safe from bank failure, but requires custody infrastructure
- **Direct central bank accounts:** Safest possible, but Fed doesn’t offer this to non-banks

- **Multiple bank diversification:** Spreads risk, but increases complexity
- **Government money market funds:** Low risk, regulated, liquid
- **Full reserve banking license:** Become a bank, but heavy regulation

Trade-offs:

- Safety vs. yield (Treasuries pay interest; spreading across banks is operationally complex)
- Centralisation vs. resilience (fewer partners = simpler but riskier)
- Regulatory access (some safe options require licenses stablecoin issuers don't have)

Key insight: There is no perfectly safe option within existing infrastructure. Even “risk-free” assets require custody, which introduces counterparty risk. This is why some argue stablecoins need direct central bank access or should become regulated banks.

Question 3: Should crypto benefit from government safety nets?

“The US government’s decision to guarantee all SVB deposits saved USDC. Is it appropriate for crypto—which often positions itself as an alternative to traditional finance—to benefit from government backstops?”

Arguments that it’s appropriate:

- Circle followed the rules; it used the banking system as designed
- Backstop was for all depositors, not specifically for crypto
- Stablecoins serve real economic functions (payments, DeFi); their failure would harm people
- Crypto companies pay taxes and employ people—they’re part of the economy

Arguments that it’s problematic:

- Crypto’s value proposition includes avoiding government intervention
- Moral hazard: Crypto companies may take more risk expecting bailouts
- If crypto wants to be “outside the system,” it shouldn’t benefit from system protections
- Creates unfair advantage over truly decentralised alternatives

Key insight: This exposes a fundamental tension. Stablecoins like USDC are deeply integrated with traditional finance—they’re not really “outside the system.” The question is whether this integration should be formalised through regulation or remains an awkward hybrid.

Question 4: What does “safe” mean for stablecoins?

“Before March 2023, USDC was considered the safest major stablecoin. Does this event change your assessment? What should investors look for?”

Points to explore:

- “Safe” is relative, not absolute—all financial instruments have risks
- USDC’s risk was counterparty (bank failure), not fraud or design flaw
- The depeg was brief and fully resolved—arguably the system worked
- But: Resolution depended on extraordinary government intervention
- Transparency helped Circle recover trust, even if it caused short-term pain

What to look for in stablecoin safety:

- Reserve composition and quality
- Custodian and banking partner diversification
- Regulatory status and jurisdiction
- Track record through stress events
- Transparency and audit quality
- Redemption mechanisms and liquidity

Key insight: No stablecoin is perfectly safe. The USDC case shows that even well-designed, transparent, regulated stablecoins face risks from the financial infrastructure they depend on. Due diligence requires understanding the full chain of dependencies.

Extension Question (if time permits)

“Tether gained market share during and after the USDC crisis, despite being less transparent. What does this tell us about market preferences?”

This raises interesting questions about the value of transparency. USDT’s opacity meant it didn’t have to disclose exposure; investors fled to it as a “known unknown” rather than USDC’s “known risk.” Is this rational? What does it imply for optimal disclosure policy?

End of Tutorial 5 Materials