



Tether: The (Un)stable Cryptocurrency

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Having both a personal and professional curiosity about cryptocurrencies, I am often asked, “Should I buy Cryptocurrency ‘X’?”, or more broadly, “Should Cryptocurrencies be a part of my investment portfolio?”. I have always been reluctant to answer for a litany of reasons, and today I will explain my rationale.

If you had to guess which cryptocurrency accounted for the highest 24-hour trading volume in April 2020, I suspect many of you would guess Bitcoin. However, despite representing greater than 60% of the total value of all cryptocurrencies, Bitcoin’s volumes have been surpassed by another, lesser-known, cryptocurrency for quite some time now: Tether.

Top 100 Cryptocurrencies by Market Capitalization

#	Name	Market Cap	Price	Volume (24h)	Circulating Supply	Change (24h)	Price Graph (7d)
1	Bitcoin	\$123,419,166,901	\$6,734.51	\$34,160,617,835	18,326,387 BTC	-2.26%	
2	Ethereum	\$17,302,930,977	\$156.55	\$14,991,379,281	110,528,868 ETH	-1.26%	
3	XRP	\$8,085,218,661	\$0.183450	\$1,976,686,455	44,073,177,235 XRP *	-1.89%	
4	Tether	\$6,354,749,945	\$0.999012	\$42,553,072,950	6,361,032,509 USDT *	-0.20%	
5	Bitcoin Cash	\$4,053,502,102	\$220.53	\$3,051,673,683	18,380,713 BCH	-1.74%	

Source: coinmarketcap.com - April 15, 2020

So what is Tether? Tether is the most widely used example of a ‘stablecoin’. Stablecoins are cryptocurrencies or cryptocurrency tokens that attempt to minimize price volatility – a major criticism of ‘traditional’ cryptocurrencies – through pegs or reserves.

When Tether launched, the principle was relatively simple: For each US Dollar they held in reserve, they would issue a Tether token, thus maintaining a 1-to-1 peg. Therefore, while Bitcoin’s supply is predetermined and released algorithmically, Tether’s reserve-based supply requires an entity to manage and be a custodian of the reserve US dollars. In theory, stablecoins such as Tether could become critical to the cryptocurrency ecosystem as they can limit exposure to volatility. With that said, let’s briefly review some of the major red flags that have emerged to date with respect to Tether.

One of the key features of cryptocurrencies that sparks excitement and curiosity is their ability to function without the coordination of a central entity. However, this feature does not apply to Tether. As noted above, Tether's reserve-based structure necessitates such an entity. A cryptocurrency that requires a middleman defeats the whole value proposition of decentralized currencies. Why would a crypto investor avoid government powers only to trust a tech company?

Now let's take look at who actually controls Tether. Tether tokens are issued by a Hong Kong-based private company whose proprietors also own the cryptocurrency exchange Bitfinex. While in and of itself this may not be an issue, the ownership structure could raise potential conflicts of interest.

In fact, in April 2019, New York's Attorney General filed a suit accusing Bitfinex of comingling corporate and client deposits with Tether's reserves. Specifically, it is alleged that Bitfinex lost access to \$850 million, when their makeshift banking partner (a Panamanian payment processor) absconded with the funds. In order to cover this loss and remain solvent, it is alleged that cash from Tether's reserves was transferred over to Bitfinex in exchange for a bogus receivable.

New York's Attorney General stated that in effect, Bitfinex executives "fraudulently shifted most or all of Bitfinex's risk of loss of several hundred million dollars onto Tether's balance sheet, but continued to represent to the market that Tethers were fully 'backed' by U.S. dollars sitting safely in a bank account. They were not."¹



Tether's lack of transparency as it relates to its reserves has been a source of controversy from inception. Even with allegations of unaccounted funds, to date, Tether has been unable to produce a single audit report to confirm their stated reserves and financial position.

In fact, the closest Tether has come to an 'audit' is a June 2018 report by the law firm Freeh, Sporkin & Sullivan LLP (FSS), which appeared to confirm that the issued Tether tokens were fully backed by dollars. However, FSS stated, "FSS is not an accounting firm and did not perform the above review and confirmations using Generally Accepted Accounting Principles" and "The above confirmation of bank and tether balances should not be construed as the results of an audit and were not conducted in accordance with Generally Accepted Auditing Standards."²

¹ Source: <https://www.bloomberg.com>

² Source: <https://tether.to>



According to their website, Tether’s reserve and transparency claims have also evolved over time. As noted in the website excerpts below, Tether originally claimed to hold traditional currencies in reserves on a 1-to-1 basis, with their issued Tether tokens subject to ‘frequent’ audits. In response to growing criticism over the lack of formal audits, all claims referencing external reviews were removed. Finally, even the 1-to-1 US dollar backing claim was revised to include other assets and receivables arising from loans made by Tether to third parties, as illustrated by the following:

 <p>100% Backed Every tether is always backed 1-to-1, by traditional currency held in our reserves. So 1 USD₯ is always equivalent to 1 USD.</p>	 <p>Transparent Our reserve holdings are published daily and subject to frequent professional audits. All tethers in circulation always match our reserves.</p>
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Date: Jan 26, 2018





Source: web.archive.org

 <p>100% Backed Every tether is always backed 1-to-1, by traditional currency held in our reserves. So 1 USD₯ is always equivalent to 1 USD.</p>	 <p>Transparent Our reserve holdings are published daily. All tethers in circulation always match our reserves.</p>
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Date: Jan 1, 2019



Source: web.archive.org

 <p>100% Backed Every tether is always 100% backed by our reserves, which include traditional currency and cash equivalents and, from time to time, may include other assets and receivables from loans made by Tether to third parties, which may include affiliated entities (collectively, “reserves”). Every tether is also 1-to-1 pegged to the dollar, so 1 USD₯ is always valued by Tether at 1 USD.</p>	 <p>Transparent The value of our reserves is published daily. The value of our reserves matches or exceeds the value of all tethers in circulation.</p>
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Date: April 15, 2020

Source: tether.to

It is also alleged that Tether was involved in price manipulation of cryptocurrencies. Independent research conducted found that half of the increase in Bitcoin's price in 2017 could be traced to the hours immediately after Tether flowed to Bitfinex and a handful of other exchanges, generally when the price was declining³.

It is noteworthy that in 2017, Bitcoin's price went from under \$1K to its all-time high of just under \$20K. During this same period, Tether's circulating supply increased from under 10 million tokens to approximately 1.4 billion tokens⁴.

Tether's supply has continued to steadily increase and as of the date of this article, there are currently in excess of 6.4 billion Tether tokens circulating. In fact, more than 1.5 billion tokens were issued since March 2020⁵, following Bitcoin's rapid decrease in price from \$9K to \$4K.

Given how illiquid cryptocurrency markets are, it is fair to assume this injection of Tether has helped support the subsequent price recovery of Bitcoin, which raises some obvious questions. How much of this value was created out of thin air versus being properly reserved? What impact will there be on the entire crypto-sphere if Tether, the number 4 cryptocurrency by market cap, goes bust? These are the questions that keep me – and invariably other crypto investors – up at night...

By now it should be abundantly clear why I am reluctant to respond to the loaded question, 'should I invest'. However, as an enthusiast and a forensic accounting professional, I encourage everyone to acquire a base level literacy on cryptocurrencies and distributed ledger technologies.

Cryptocurrencies have become more accessible and mainstream over time, including gaining widespread use in the world of white collar crime. It is for this very reason that we added a diverse range of [crypto advisory services](#) as one of the core areas of our forensic practice.

Check out our website for our [Introduction to Cryptocurrency](#) webinar (under 'Upcoming Training'). *Note: This webinar will take approximately one hour to complete, and may be eligible for continuing professional development (CPD) credit. Be sure to check the specific CPD requirements that apply to your industry or designation. Upon successful completion of this webinar and a brief quiz, you will receive a certificate of completion.*

³ Source: <https://www.nytimes.com>

⁴ Source: <https://coinmarketcap.com>

⁵ Source: <https://coinmetrics.substack.com>