



EPISODE 4 | Webinar Recap & Discussion

Stablecoins Fraud and Regulation

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Jeff Welcome to “What the F Happened? Fraud and Financial Crime Deconstructed”, a DEFEND podcast where we break down what's actually happening across fraud, scams, AML, and financial crime.

Emily Each episode cuts through the noise to explain the tactics, trends and real world impact behind the headlines so you're better prepared for what comes next. Let's get into it.

Emily Today we are looking at the piping, the, uh, the actual plumbing of the future financial system. Um, and I know usually when people talk about crypto or they want to talk about bitcoin, the rock star. The rebel.

Jeff . . Bitcoin is the headline grabber for sure. It's the brand everyone knows exactly.

Emily But today we're ignoring the rock star. We're talking about the bridge, the, you know, boring, stable, massive bridge that connects the old world of banks and fiat currency to the wild west of Web3.

Jeff We're talking about stablecoins.

Emily We are.

Jeff And don't let that name stable fool you into thinking this is a sleepy topic.

Emily Not at all.

Jeff This is where the real battle for the future of money is actually happening.

Emily I was just looking at the numbers and the research stack you sent over, and the scale here is genuinely hard to wrap your head around. I mean, we aren't talking about some niche internet experiment anymore. We are talking about a market capitalization sitting somewhere between, what, three hundred and ten billion and 314 billion dollars.

Jeff To put that in perspective, that is larger than the GDP of a country like Finland or Portugal. It's a massive amount of liquidity and it's moving fast. The market surged by, well, essentially fifty percent just last year.

Emily That's wild growth for something that's supposed to be boring. So okay, here is our mission for today. We need to unpack this beast. We're going to look at what stablecoins actually are. You know beyond the buzzwords right. We need to understand why they are suddenly eating the financial world and the absolute cat and mouse game happening underneath the surface.

Jeff Because where there's three hundred billion dollars moving around, there are going to be people trying to steal it. And the methods they're using are incredibly sophisticated.

Emily Precisely. We've got regulators scrambling to pass things like the Genius Act, we've got security architects fighting fraudsters, and we have the ghosts of past failures like the Terra Luna collapse still haunting the machine.

Jeff You really can't understand the risk here without looking at Terra Luna. That's the cautionary tale. It proves stable is just a label. Until the market tests it.

Emily We are definitely going to dig into that wreckage. But let's set the stage first to understand why stablecoins matter. We have to zoom out to the environment. They live in Web3.

Jeff Right.

Emily The sources describe this as the next generation of the internet.

Jeff It helps to think of it in phases. Web1 was read only static pages, like a digital phone book, right? Web2 was read, write, think social media where you create the content. But a centralized company owns the platform and your data.

Emily And Web3 is about read, write own.

Jeff Exactly. It's about decentralization, using blockchain technology to distribute control away from central authorities like banks or governments.

Emily And Bitcoin was the first real proof of this. Right back in two thousand and eight.

Jeff It was the proof of concept, the decentralized digital currency for peer to peer transactions.

Emily But Bitcoin has a fundamental flaw if you're trying to use it for actual commerce, right? If I'm buying a cup of coffee or paying my rent.

Jeff You don't want the value of your payment to drop twenty percent in the ten minutes it takes for the transaction to confirm.

Emily Or worse.

Jeff Or worse. Yeah, you agree to pay rent in Bitcoin and by the time the landlord cashes it out, it's worth half as much. Bitcoin is great as digital gold, a store of value. It is terrible as a medium of exchange for daily life that volatility is a killer.

Emily So enter the stablecoin the solution to the volatility problem.

Jeff It's the holy grail. Really. The core concept is simple. It's a cryptocurrency that lives on a blockchain. So it moves with the speed of the internet.

Emily It's programmable like software right.

Jeff But and this is the key. It maintains a stable value relative to a specific asset usually the US dollar.

Emily So it's the best of both worlds. You get the speed of crypto without the roller coaster.

Jeff That's the promise. Digital cash. It allows you to move a million dollars across the world in seconds on a Saturday night without asking a bank for permission. And you know exactly what it's worth when it arrives.

Emily And looking at the leaderboard and the research, this isn't a winner take all market yet. But there are definitely heavyweights. We see USDC, USDS, USDE, DAI. But the king of the hill is still tether, right?

Jeff USDT oh, tether is the juggernaut. It holds the number one spot by market cap, significantly higher than USDC. It's the primary vehicle for moving that three hundred plus billion dollars around the global economy.

Emily It's really the lubricant for the entire crypto trading market.

Jeff That's a great way to put it. When traders want to step out of a volatile asset like Bitcoin, they don't usually sell to cash. They sell to tether.

Emily Okay. So we have these massive digital dollars. People feel safe because it says stable right in the name. But this is where the research gets interesting and frankly, a little terrifying. Uh, just because something is pegged to the dollar doesn't mean it is a dollar.

Jeff This is the nuance that people miss a dollar in your hand is a dollar. A stablecoin is a promise that you can redeem this token for a dollar. And the quality of that promise depends entirely on how the coin is built.

Emily Which brings us to the ghost in the room. Terra Luna.

Jeff The collapse that changed everything.

Emily For those who weren't watching the tarts meltdown when this happened, this wasn't just a bad week. This was an extinction event. We're talking about forty five to fifty billion dollars of wealth just evaporating.

Jeff In a matter of days. It was faster than almost any bank run in history.

Emily So how did it happen? I mean, Terra's stablecoin, UST, was supposed to be worth a dollar. How does something worth fifty billion go to zero?

Jeff It all comes down to the mechanism. See USDC or tether? They generally claim to work on a reserves model. You give them a dollar, they put that dollar or a Treasury bond in a vault and they issue you a digital token.

Emily So it's fully backed one to one.

Jeff The idea is if everyone wants their money back, the money is theoretically in the vault.

Emily Like a coat check. You give the coat, you get a ticket, you give the ticket back, you get the coat.

Jeff Precisely. But Terra Luna was different. UST was an algorithmic stablecoin.

Emily Algorithmic always sounds like magic in finance.

Jeff In this case, it kind of was. There was no dollar in a vault. Instead, the system relied on a relationship with a sister token called Luna. It used market incentives to keep the price at a dollar.

Emily Okay, let me see if I can break this down from the notes. Basically, if the stablecoin UST dropped to ninety nine cents.

Jeff Right.

Emily The algorithm would let you trade that ninety nine cents UST for one dollar's worth of Luna. So you make a guaranteed penny of profit.

Jeff Exactly. You burn the UST taking it out of supply, and you mint new Luna. That reduction in UST supply creates upward pressure on the price, pushing it back to one dollar. It's a brilliant mechanism as long as people want Luna.

Emily So it works on vibes. It works as long as the market believes that Luna has value.

Jeff Correct. But what happens when confidence breaks? When ust drop below a dollar and didn't bounce back. Immediately. Panic set in. People realized there was no vault.

Emily They rushed for the exit.

Jeff They rushed for the exit. They minted trillions of Luna tokens trying to get out of their stablecoin positions.

Emily Which just dilutes the value of Luna.

Jeff To virtually zero. It's called a death spiral. Hyperinflation of the backing asset. And since there was no external collateral, no real cash to act as a backstop, the plummet was total. It proved a fundamental point that regulators had been screaming about.

Emily What's that?

Jeff You cannot algorithmically wish value into existence.

Emily And that fifty billion dollar crater in the ground is usually the signal for the government to show up.

Jeff That's the bat signal for Congress.

Emily Which leads us to the regulatory landscape. The sources highlight a major piece of legislation called the Genius Act. I love the humility in the naming conventions of Congress, by the way.

Jeff It's certainly ambitious, but the Genius Act is actually a very significant attempt to bring order to the Wild West. It's the government realizing that if they ignore this, it doesn't go away. It just gets riskier.

Emily So what does it actually do? Is this just the government trying to ban crypto?

Jeff No. And that's key. It's not a ban. It's a framework. It's the government saying, okay, if you want to play with the big boys, you have to wear a suit.

Emily So first and foremost, it establishes licensing rules for US stablecoin issuers.

Jeff Right. No more "trust me bro" banking.

Emily Yeah.

Jeff You have to prove you have the reserves. It also sets standards for foreign issuers who want to operate in the US, which is crucial because this is a global market, right?

Emily You can't just incorporate on a tropical island and pretend US laws don't apply if you're soliciting US customers.

Jeff Exactly.

Emily But perhaps the most interesting part mentioned in the research is how it handles the turf war.

Jeff Ah, the eternal struggle. The battle between the SEC and the CFTC, right? For anyone who doesn't follow D.C. politics, the SEC, the Securities and Exchange Commission generally wants to regulate everything as a security, like a stock.

Emily Which comes with incredibly strict reporting rules.

Jeff Rules that many crypto projects say are impossible for them to follow. The CFTC, on the other hand, treats things like commodities like wheat or corn or oil.

Emily And the crypto industry generally prefers the CFTC approach.

Jeff Generally, yes. So the Genius Act tries to clarify these lanes. It carves out a specific regulatory path for payment stablecoins so they don't get caught in limbo. It says, "If you are a stablecoin, here are your rules." Rather than forcing them into a box made for nineteen forties stock markets.

Emily It's trying to build a fence that is safe enough for grandma, but open enough for innovation.

Jeff That's the balance, because if you build the fence too high, the innovation just moves offshore to jurisdictions that don't care about safety at all.

Emily Speaking of moving offshore, let's talk about the people who don't care about the Genius Act, the people who aren't trying to follow the rules at all.

Jeff The dark side of the ledger.

Emily The source material goes deep into how criminals are using stablecoins. And there is a bit of a paradox here, isn't there? We always hear that blockchain is transparent, public ledger. Everything is trackable.

Jeff That's the irony. In theory, blockchain is the worst place to commit a crime because every transaction is written in permanent ink. We have tools called blockchain explorers where anyone you, me. The FBI can see that wallet A sent ten million dollars to wallet B.

Emily So if I'm a drug cartel or a scammer, that sounds terrible. Here is a permanent receipt of my illegal activity.

Jeff Which is why the bad actors have developed sophisticated tools of obfuscation. And the most notorious of these are Mixers.

Emily Mixers. It sounds like a kitchen appliance.

Jeff It's effectively a digital money laundering machine. Imagine a giant pot. You throw your dirty crypto into the pot along with crypto from one thousand other people. The protocol shakes it all up.

Emily It mixes the inputs and outputs mathematically, right?

Jeff And then it spits the money back out to new, clean addresses.

Emily So it breaks the chain of custody. You can't trace the coin back to the crime because it's been co-mingled with everyone else's money.

Jeff It mathematically severs the link. Tornado cash was the most famous example of this. It makes the follow the money strategy incredibly difficult for law enforcement, because the trail just hits a dead end.

Emily And once they've mixed the coins, they need to cash out. That's where the no KYC exchanges come in.

Jeff Correct. KYC stands for Know Your Customer. It's the rule that says a bank has to see your ID before they open an account for you.

Emily The selfie with the driver's license we all have to do now.

Jeff Exactly. But no KYC exchanges operate in the shadows. They prioritize privacy or negligence, depending on your view. They don't ask for ID, they'll usually limit the trade amounts to fly under the radar. But if you do enough small transactions, you.

Emily Can wash a lot of money.

Jeff You can move millions without anyone knowing who you are.

Emily That's the high tech Mission Impossible side of fraud. But what really struck me in the research was the human element. The sources talk about affinity fraud. And this. This is just mean.

Jeff It's insidious.

Emily This isn't hacking code. This is hacking people.

Jeff It is affinity fraud relies on the psychological principle of shared identity. Fraudsters don't just cold call random people. They target specific groups, religious communities, ethnic groups, veterans associations, the elderly.

Emily They infiltrate the circle.

Jeff They weaponize the trust gap. The scammer creates a persona on one of you. I go to your church. I serve to your battalion. I speak your language. And once that trust is established, the skepticism just disappears.

Emily So when they say, hey, I found this great stablecoin investment yielding twenty percent. The victim believes them not because they understand the math, but because they trust the person.

Jeff Exactly. The crime happens in the real world emotionally, before a single cent moves on the blockchain. And because there is a knowledge gap, people know crypto is the next big thing but don't understand how it works. They rely on that trusted guide.

Emily And that guide walks them right off a cliff.

Jeff And by the time they realize the money is gone, it's already been through a mixer and sits in a wallet in a non-extradition country.

Emily That is heavy. So okay, we have the scale of the problem. We have mixers effectively laundering the money. We have affinity fraudsters preying on trust. How do we stop this? Wait. The expert. Our source material talks about a very specific strategy.

Jeff The choke point.

Emily The choke point. Break that down for us.

Jeff So think about the flow of money once the funds are inside the crypto ecosystem. Once they are on the blockchain, they are permissionless. You can send them anywhere instantly. Detecting crime there is, according to the source, ten times more difficult.

Emily Because of the mixers and the anonymity.

Jeff Right. If you're chasing them on chain, you're always one step behind. So the strategy is to move the defense line back. You have to catch the fraud at the on ramp.

Emily The on ramp being the moment I take my regular US dollars from my boring bank account and try to turn them into crypto.

Jeff That is the moment of vulnerability for the fraudster, because to do that, they have to interact with the traditional financial system and that system has gates.

Emily Let's walk through the process described in the notes. It's not just click buy. It's a sequence of events.

Jeff And each step offers a chance to catch the bad guy. First there's the signup and KYC. Is this user real? Is the driver's license a Photoshop job? Is this person on a sanctions list like OFAC?

Emily The are you a terrorist list?

Jeff Basically, but sophisticated fraudsters can buy real IDs on the dark web. They can steal identities. So just looking at the ID isn't enough anymore.

Emily So the next step is critical. The funding.

Jeff Exactly. They link a bank account. Does the name of the bank account match the name on the ID?

Emily If I'm claiming to be me, but I'm connecting a bank account that belongs to you.

Jeff Huge red flag. But again, accounts can be stolen. So the real magic happens in the behavioral analysis during settlement and purchase.

Emily This is what DataVisor specializes in, right? It's not just static checks. It's looking at patterns.

Jeff Real time signals. It's about how the user's behaving. For example, device intelligence is this account being accessed by a mobile phone in Ohio. But the device is configured with a keyboard layout from Eastern Europe. Are or is the GPS telling a different story than the IP address.

Emily Or velocity checks? That sounds like something from physics class.

Jeff It's simple, but effective. Is this a brand new account that was created five minutes ago, and it's immediately trying to buy the maximum daily limit of stablecoins.

Emily A normal user dips a toe in. They buy fifty dollars to see if it works. A fraudster tries to smash and grab.

Jeff Exactly. They know the account might get burned, so they try to maximize the extraction or look at the remote desktop signals. This one is really important for stopping those affinity frauds against the elderly.

Emily Oh, this is the tech support scam, right?

Jeff Is the user actually controlling the mouse or is their software running like any desk or team viewer that allows someone else to control the computer remotely. If you see a stablecoin purchase happening while a remote desktop application is active.

Emily That is a massive alarm bell.

Jeff A huge one. So the defense is really about aggregating all these tiny signals device location, behavior, speed, software, and making a decision. Before the crypto leaves the exchange.

Emily You have to stop them at the velvet rope, because once they get into the club, it's too dark, too loud, and too crowded to find them.

Jeff The on ramp is the only place where the fraudster has to take off their mask, even for a split second.

Emily It's fascinating because it feels like this constant arms race. On one side, you have the decentralization purists who want total privacy, zero censorship and tools like mixers.

Jeff And on the other side, you have the safety architects building higher and higher walls at the entry points. And right in the middle, you have three hundred billion dollars of stablecoins just trying to facilitate global commerce.

Emily So let's recap the journey here. We started with the sheer scale. Stablecoins are eating the world bigger than the GDP of entire nations, right? But they aren't without risk. We saw the algorithmic failure of Terra Luna wipe out fifty billion dollars, proving that stable is just a label unless it's backed by cold, hard assets.

Jeff And we discussed the regulatory response, the Genius Act, trying to define the lanes so that the industry doesn't collapse on itself.

Emily Then we looked at the underbelly, the mixers, the no KYC exchanges, and the affinity fraud that exploits the most vulnerable parts of human nature.

Jeff But we also know there is a shield. The focus on the fiat to crypto on ramp, that is the battleground where compliance teams and fraud detection systems are trying to filter out the bad actors before they can infect the ecosystem.

Emily It really is a battle between the philosophy of Web3 open, permissionless, private, and the safety standards of traditional finance.

Jeff As the technology matures. That friction is going to define the future of money. We are watching the gears grind together in real time. It's messy, but it's necessary.

Emily You know, it brings me to a final thought I've been mulling over since we started reading these sources. We are getting really good at stopping fraud at the entry point, at the on ramp. But as decentralized tools like mixers get better and as privacy becomes more absolute, are we eventually going to reach a point where total privacy and safety are mutually exclusive? Can you actually have a financial system that is both perfectly private and perfectly safe?

Jeff That is the question of the decade. If you have a system that is perfectly private, you have a system that is perfectly blind to crime, and if you have a system that is perfectly safe, you likely have no privacy. I don't think society has decided which trade off it wants to make yet.

Emily Something to think about. Next time you see a headline about Bitcoin or stablecoins, there is a whole world of plumbing policy and policing underneath that digital coin. Thanks for diving in with us.

Jeff Always a pleasure.

Jeff You've been listening to *What the F happened? Fraud and Financial Crime Deconstructed*, a DEFEND podcast by DataVisor. If you want to keep learning between episodes, check out DEFEND Training, a set of self-paced online courses for fraud and financial crime professionals practical and built around real world scenarios.

Emily And you can earn CPE credits through the ACFE San Francisco Bay Area chapter. You can find it at datavisor.com/defend-training. The links in the description.

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