

Wrapped Tokens Explained

Wrapped cryptocurrencies are a type of cryptocurrency token that represents a cryptocurrency from another blockchain on a different blockchain with the same value. The main idea is to create interoperability between different blockchains, allowing for the exchange of assets across various blockchain networks without the need for traditional exchanges. Wrapped tokens enable a wide range of blockchain applications, including decentralized finance (DeFi), by making it possible to use assets from one blockchain in the ecosystems of another.

Here's a simplified explanation of how wrapped tokens work:

- Creation**: To create a wrapped token, the original cryptocurrency is locked in a digital vault or smart contract on its native blockchain. For example, Bitcoin can be locked to create wrapped Bitcoin (WBTC), which operates on the Ethereum blockchain.
- Issuance of Wrapped Tokens**: After the original tokens are locked, the corresponding amount of wrapped tokens is minted on the target blockchain. These wrapped tokens are pegged to the value of the original cryptocurrency. So, 1 WBTC should always be worth the same as 1 BTC.
- Use on the Target Blockchain**: The wrapped tokens can now be used on the target blockchain just like any other token on that blockchain. This allows for the use of the wrapped tokens in smart contracts, DeFi applications, and more, leveraging the capabilities and ecosystem of the target blockchain.
- Redemption**: If the holder of the wrapped tokens wants to convert them back into the original cryptocurrency, they can redeem the wrapped tokens. The process involves sending the wrapped tokens to a smart contract, which then unlocks the original tokens from the vault and returns them to the user's control. The redeemed wrapped tokens are usually burned or taken out of circulation.

Wrapped tokens maintain their value against the original cryptocurrency through a combination of collateralization (the locking of the original cryptocurrency), market mechanisms, and, in some cases, trust in the entity facilitating the wrapping process. Entities that issue wrapped tokens typically provide transparency through audits and verifications to ensure that the equivalent amount of the original cryptocurrency is indeed locked and available for redemption.

Revision #1

Created Fri, Mar 8, 2024 8:00 AM by Aaron Malone

Updated Fri, Mar 8, 2024 8:02 AM by Aaron Malone