



Stablecoins

Why in News

The US is discussing launching a **formal review into whether Tether and other [stablecoins](#) threaten financial stability.**

- The first stablecoin, created in 2014, was Tether.

Key Points

▪ About Stablecoins:

- A stablecoin is a type of [cryptocurrency](#) that is typically pegged to an **existing government-backed currency**.
 - A cryptocurrency is a **form of digital asset based on a network** that is distributed across a large number of computers.
- Stablecoins hold a **bundle of assets in reserve**, usually **short-term securities** such as cash, government debt or [commercial paper](#).
- Stablecoins are useful because they **allow people to transact more seamlessly in cryptocurrencies** that function as investments, such as [Bitcoin](#).
- They form a **bridge** between old-world money and new-world crypto aslo they **promise to function like perfectly safe holdings**.

▪ Types:

◦ Fiat-collateralized Stablecoins:

- They are **collateralized by fiat money**, such as the US dollar, euro or the pound, on a 1:1 ratio.
- **Examples:** Tether, Gemini Dollar, and TrueSD.

◦ Stablecoins Backed by Other Assets:

- There are a **few stablecoins**, which are **backed by a basket of multiple assets** (commercial papers, bonds, real estate, precious metals, etc).
- The value of these stablecoins can **fluctuate over time subject to movement** in commodity and precious metal **prices**.
- **Example:** Digix Gold, backed by physical gold.

◦ Crypto-Collateralized Stablecoins:

- Crypto-collateralized stablecoins are **more decentralised than their peers** and are backed by cryptocurrencies.
- The flipside is **price volatility** and to address the risk of price volatility, these stablecoins are over-collateralized.
- **Example:** Dai.

◦ Non-collateralized stablecoins:

- These stablecoins **do not have any backing and are decentralized** in the true

sense and the supply of **non-collateralized stablecoins** is governed by algorithms.

- **Example:** Basis.

▪ **Concerns:**

◦ **Related to Short term Debt:**

- Many stablecoins are backed by **types of short-term debt** that are prone to periods of illiquidity, meaning that they can become hard or impossible to trade during times of trouble.

◦ **Not all Stablecoins are Stable:**

- Not all stablecoins are really 100% price-stable. Their values are **dependent on their underlying assets**.

◦ **Asset Contagion Risk:**

- There are **potential asset contagion risks** linked to the liquidation of stablecoin reserve holdings.

- A **contagion** is the spread of an economic crisis from one market or region to another and can occur at both a domestic or international level.

- The risks are primarily associated with collateralised stablecoins, varying based on the size, liquidity and riskiness of their asset holdings, as well as the transparency and governance of the operator.

◦ **Risks to Financial Stability:**

- While stablecoins have the potential to enhance the efficiency of the provision of financial services, they may also **generate risks to financial stability**, particularly if they are adopted at a significant scale.

◦ **Lack of Accountability:**

- They are not **transparent or auditable by everyone** and are operated just like non-bank financial intermediaries that provide services similar to traditional commercial banks, but outside normal banking regulation.

◦ **Regulatory Challenge:**

- International coordination of regulatory efforts across diverse economies, jurisdictions, legal systems, and different levels of economic development and needs is another regulatory challenge.
- There is **not (yet) a uniform regulatory approach of regulators worldwide** relating to stablecoins.

Way Forward

- Stablecoins do not stand for a uniform category but represent a variety of crypto instruments that can vary significantly in legal, technical, functional and economic terms.
- So, in order to be **effective in limiting risks and not disturbing innovations** the stablecoin industry **must work together with the regulators** to come up with a framework that helps put them at ease while protecting this nascent industry from overregulation.

Source: [IE](#)