Understanding Stablecoins:
The Steady Side of Crypto

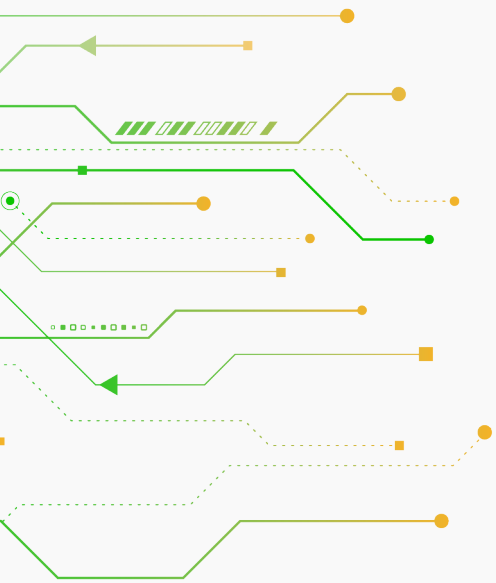
Payments Innovation Alliance®

What Are Stablecoins?

Stablecoins are a type of cryptocurrency designed to maintain a stable value that is pegged to a reserve asset, such as a fiat currency like the U.S. dollar, or commodities like gold. Pegging refers to the process of linking the value of the stablecoin to another asset, but it does not guarantee that there is a reserve in place to cover that value.

While fiat currencies like the U.S. dollar are issued and controlled by governments, and traditional digital currencies like bitcoin and ethereum are issued and controlled by fully decentralized software systems, stablecoins are created and controlled by the businesses and financial institutions acting as the issuers.

Unlike other cryptocurrencies such as bitcoin or ethereum, which can experience significant value volatility, stablecoins remain stable in value, making them more suitable for everyday transactions, remittances, and as a method to store value. They achieve this stability by holding equivalent reserves in U.S. currency or short-term U.S. Treasury instruments.



Types of Stablecoins

- **Fiat-Collateralized: Backed 1:1 by fiat currency (e.g., USDC, USDT).**
  - » Alternative: Fiat Stablecoin – Pegged to fiat currency.
- **Commodity-Backed: Backed by other assets (e.g., gold).**
  - » Alternative: Commodity Stablecoin – Pegged to a commodity.
- **Crypto-Collateralized: Backed by other cryptocurrencies (e.g., DAI).**
  - » Alternative: Crypto Stablecoin – Pegged to other cryptocurrencies.
- **Algorithmic: Uses smart contracts to control supply (e.g., Frax).**
  - » Alternative: Algorithmic Stablecoin – Uses Smart Contracts (e.g., UST) and may be pegged to fiat, commodity, and crypto.

This document focuses specifically on fiat-backed stablecoins, as defined under the GENIUS Act, which recognizes them as payment instruments rather than investment securities.

How They Work

Figure 1: Direct Purchase of Stablecoin

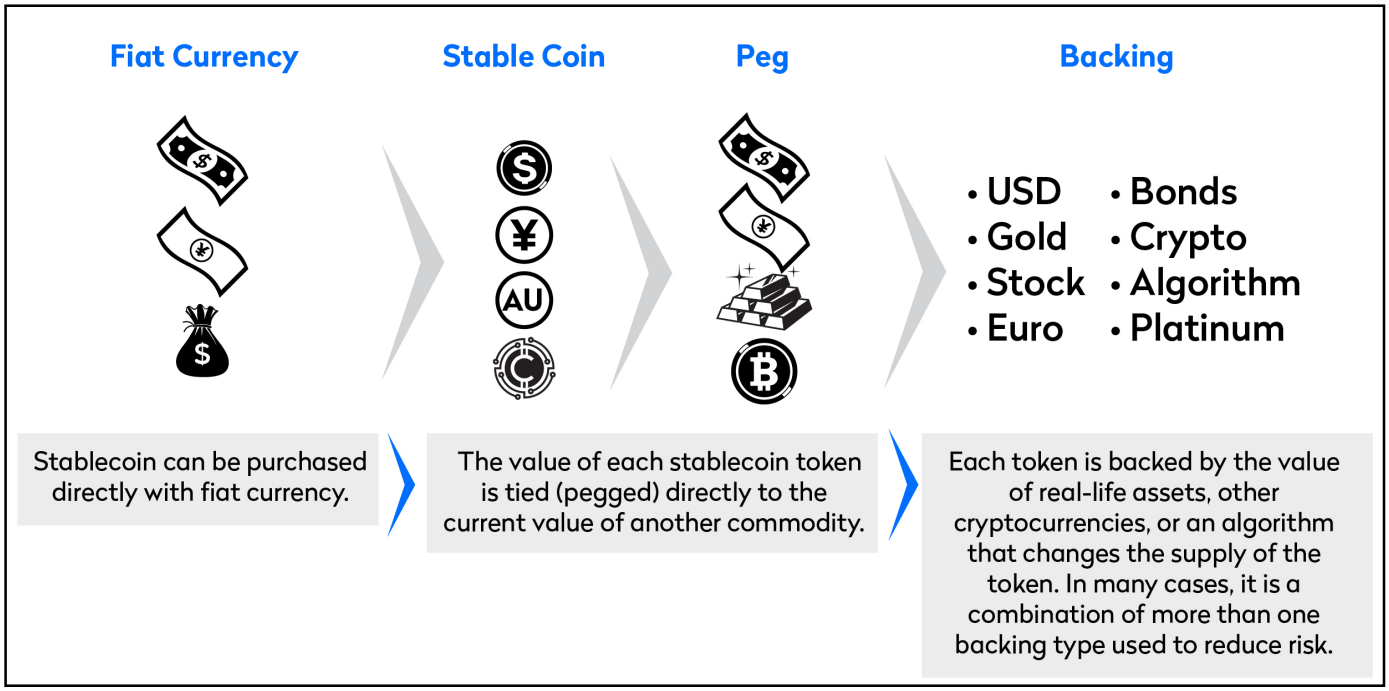
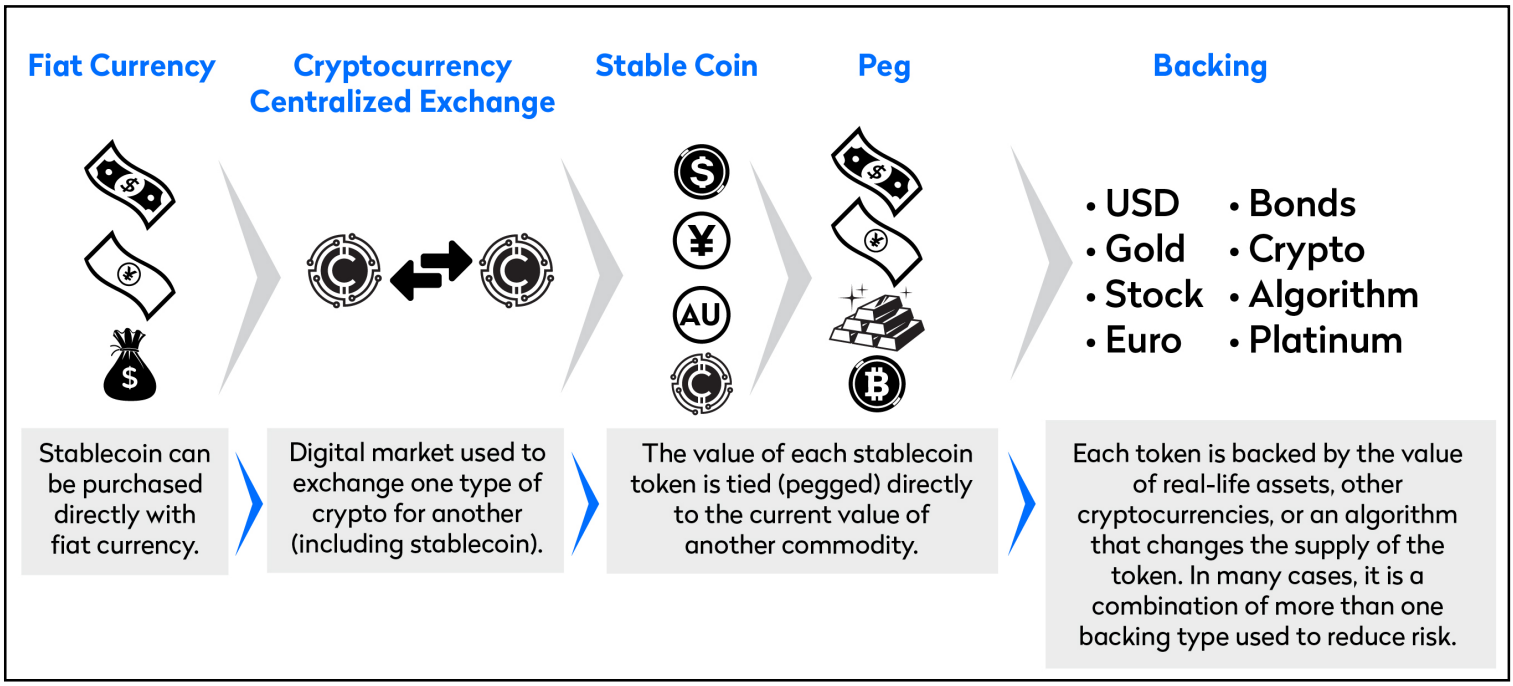


Figure 2: Purchase of Stablecoin Through Other Cryptocurrency



Use Cases

Cross-Border Payments and Remittances

Stablecoins enable fast, low-cost cross-border payments without the need for intermediaries and other associated friction points typically found in traditional payment methods. This can be particularly beneficial for underbanked populations that need a way to transfer funds.

Decentralized Finance (DeFi)

In DeFi ecosystems, stablecoins serve as a foundational asset for lending, borrowing, and yield farming. Their price stability allows users to interact with smart contracts without the volatility risks associated with other cryptocurrencies.

E-Commerce and Merchant Payments

Merchants can accept stablecoins as a means of payment because their value is not volatile like other cryptocurrencies. To be successful, an ecosystem must be established, often by leveraging mobile applications and other systems that facilitate transactions. While there are examples in the U.S. today, the maturity of this payment option has yet to fully materialize.

Private Settlement Networks

Stablecoins can also serve as the foundation of closed-loop settlement networks. When groups of businesses or banks use U.S. dollars to exchange funds, those transactions settle through the Federal Reserve, limiting the ways and times they can move money. If such a group needs more flexibility, they can leverage stablecoins operating on a permissioned blockchain to move funds instantly whenever they choose.

Pros & Cons

Stablecoins offer certain advantages and disadvantages, especially as organizations consider their many different customers and potential use cases.

Pros:

1. **Price Stability:** Relative to traditional cryptocurrencies, stablecoins are designed to maintain a stable value by being pegged to assets like the U.S. dollar or commodities such as gold.
2. **Efficiency and Speed:** Stablecoin transactions are typically fast, often resulting in near-instant settlements, due to operating on blockchain platforms and the ability to bypass multiple intermediaries.
3. **Cost-effective:** Particularly for cross-border payments, stablecoins enable direct peer-to-peer transfers, minimizing intermediary fees[1].

[1] https://www.muralpay.com/blog/benefits-of-stablecoins-advantages-and-disadvantages-explained

4. **Global Accessibility:** Individuals and businesses in areas with limited access to traditional banking, or those who choose not to participate in mainstream financial services, can engage in the global financial system with just a smartphone and internet access. While some parties choose options like crypto due to mistrust of traditional systems, others might be more apt to leverage stablecoins solutions directly controlled by a trusted financial institution partner.
5. **Integration:** Stablecoins can be integrated into existing financial systems allowing organizations to use blockchain benefits without completely changing their infrastructure. Additionally, they can power various DeFi applications, such as lending and liquidity provisions, making them the preferred collateral and unit of account in DeFi[2].
6. **Enhanced Transparency and Security:** Leveraging blockchain technology allows users to independently verify activity, minimizing the risk of fraud or manipulation.
7. **Programmability:** Stablecoins can operate on blockchains that support smart contracts, where instructions or terms are embedded within the transactions themselves. This is helpful in the automation of payments, escrow arrangements, or even compliance requirements[3].

Cons:

1. **Regulatory Considerations:** Stablecoins operate in a complex regulatory landscape, with regulatory examination and enforcement varying across global jurisdictions. Regulatory frameworks continue to evolve in all aspects, including for stablecoins, in the crypto space.
2. **Issuing Bodies:** Stablecoins are issued by businesses or financial institutions, creating single points of failure and concentration of power. Potential risks include account freezing, regulatory penalties, and potential manipulation of the stablecoin's value.
3. **Reserve Management (Transparency):** The management and auditing of reserves are crucial; users must trust the issuer to maintain adequate reserves. If confidence is lost, or if the issuer's reserves are illiquid or insufficient, redemption may be delayed or impossible, causing losses for users.
4. **Security and Technical Risks:** Smart contract vulnerabilities which can lead to theft or loss of funds and network congestion, particularly on high-traffic networks where high transaction fees during peak times can negate the cost benefits of stablecoins. Additionally, stablecoins face challenges similar to traditional financial systems – cyberattacks, fraud, and security breaches.
5. **De-pegging Risk:** While the GENIUS Act requires stablecoin reserves to maintain a 1-to-1 value with their underlying asset, external forces such as market crashes or liquidity issues can cause them to lose their peg.

[2]https://www.gemini.com/cryptopedia/pros-and-cons-of-stablecoins-benefits-and-purpose

[3]https://www.bitwave.io/blog/stablecoin-benefits

Future Outlook

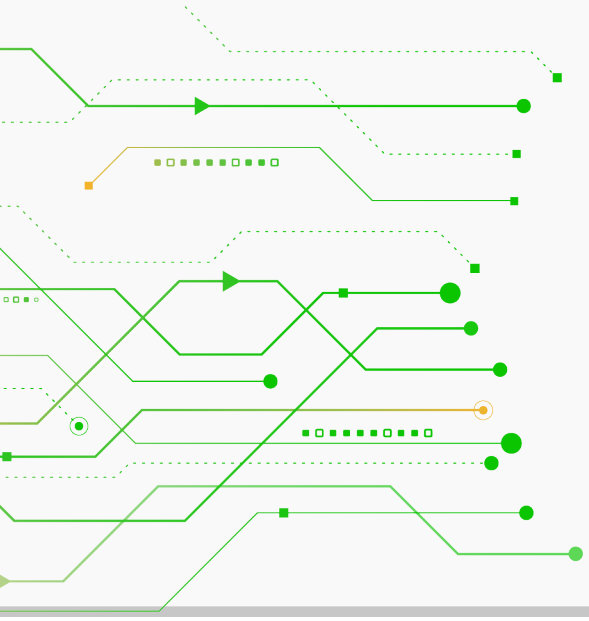
As the financial landscape continues to evolve, stablecoins are no longer just a technological curiosity; they are a strategic imperative. They offer financial institutions a powerful means to capture and preserve both existing and emerging markets while diversifying non-interest income streams. In the payments sector, stablecoins are rapidly becoming a foundational infrastructure, enabling faster, cheaper, and more inclusive transactions.

In the U.S., legal and regulatory frameworks are advancing with the GENIUS and CLARITY Acts. Some financial institutions intend to issue their own stablecoins, and recent announcements of payment providers partnering with stablecoin providers indicate investments are being made to support new, emerging use cases.

Global frameworks like the European Union's MiCA and the U.K.'s forthcoming rules are setting high standards for transparency and reserve quality. Forward-thinking firms are already adapting and aligning with these benchmarks to unlock global market access and build long-term trust. There are broad implications of how the U.S. environment will impact global companies that operate in this space.

Meanwhile, adoption is accelerating across industries. Financial institutions are pioneering real-time settlement through blockchain platforms, such as deposit token by Kinexys by JP Morgan, demonstrating how stablecoins can streamline everything from payroll to cross-border trade.

As blockchain infrastructure matures, stablecoins are also becoming the connective tissue for integrating real-world assets—tokenizing commodities, real estate, and more. With the global stablecoin market projected to surpass $500 billion by year-end, potentially reaching $2 trillion by 2028, the window for early-mover advantage may be closing if providers and financial institutions don't start to strategize soon.



Industry Opportunity

Financial institutions can benefit from integrating stablecoin strategies into their operations today, unlock new value streams, enhance customer engagement, and secure their place in a programmable, borderless, and inclusive financial future. Waiting to act risks falling behind in a rapidly digitizing economy.

Three key steps your institution can take today!

1. **Awareness and Education.**
2. **Internal Strategic Planning.**
3. **Industry Collaboration and Business Innovation.**

Other Resources

Top Stablecoin Tokens by Market Capitalization | CoinMarketCap

Cryptocurrency Prices, Charts, and Crypto Market Cap | CoinGecko

Stablecoins explained: A primer on these digital assets

Payments Innovation Alliance®

This document was developed by the Navigating Through Digital Payments Project Team of Nacha's Payments Innovation Alliance.

The Payments Innovation Alliance is a membership program that shapes the future of the payments industry and develops thought leadership relevant to financial service institutions. The Alliance established the Navigating Through Digital Payments Project Team to explore the digital and physical world implications of money and asset movement. Visit the Navigating Through Digital Payments Project Team page to see more resources they developed.