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Financial Services Leadership Network

FSLN Briefing Note

Are stablecoins the future of money?

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Are stablecoins set to revolutionize payments, or are they just a “solution in search of a problem?” At recent meetings of Tapestry’s Financial Services Leadership Network in London and New York, leaders from global financial institutions debated whether stablecoins have the potential to transform the very nature of money or are just a way to avoid the regulated financial system. As one participant noted, the public conversation about stablecoins and cryptocurrencies vacillates between *“fear”* and *“curiosity,”* among incumbent financial institutions. These discussions were no different. One director said, *“I’m honestly a little unsettled by this stuff. But you talk to other people, and they're avid that this asset class is here to stay, and you can do it safely. So, I think it's worth having a conversation.”* Many directors and executives, some with backgrounds in risk and regulation, emphasized the risks and concerns about criminality, others were intrigued by the potential. There was a notable difference between the tone of the discussions in London and New York; the North Americans were generally more open to understanding the potential of stablecoins, tokenization, and digital wallets.

The case for stablecoins

The case for stablecoins is essentially this: they enable fast, always-on, and programmable transactions at low cost while avoiding the volatility of other cryptocurrencies. Stablecoins are typically backed by cash or government bonds and run on public blockchains. While the most prevalent current use cases are for crypto trading, i.e. enabling users to trade between cryptocurrencies and fiat currencies, stablecoins are also being used for cross-border remittances and expanding dollar access in emerging markets, since the vast majority of stablecoins are USD-denominated. One executive noted, for example, that there is a *“huge use case of basic dollar storage value, largely in small balances around the world, providing a hedge* *against local currency and dollar access. For example, [Brazilian neobank] Nubank is using stablecoins to create dollar access for the Brazilian market."* A bank executive noted that one of the bank's corporate customers in Mexico is paying its employees in USD-backed stablecoins in response to employee demand to be paid in dollars rather than pesos.

Proponents say this is just the beginning and that stablecoins are *"the next form factor of money."* Just as the financial system moved from cash to checks to credit cards, stablecoins are the next leap. One participant predicted that stablecoins will become *"so disruptive you don't notice them. You'll just use the apps and technology that make your lives easier."* Others emphasized the intersections between stablecoins and other technology advancements: *"AI-powered commerce is coming. We're going to have machine payments. AI would be much more powerful with wallets that can hold currencies and assets across the board. Rather than thousands of bank accounts, you can have one wallet."*

Questions about stablecoins and their potential

Despite the case made by proponents, stablecoins have not yet won the hearts and minds of many financial service leaders. In addition to basic questions about how and why stablecoins are a significant improvement over existing forms of payment – *"It's not completely clear to me why we need stablecoins or what stablecoins do for us that that the good old US dollar doesn't,"* said one director – leaders discussed several risks and concerns:

- **Illegal activity and fraud.** A number of leaders insisted that stablecoins are primarily used to facilitate money laundering, terrorist financing, and other criminal activity, avoiding the AML and KYC requirements of transactions conducted through regulated banks. *"I don't see how there's demand for these other than for those that want to fly under the radar,"* one director said, while another was even more blunt: *"Fundamentally that's the use case, that's the reason for [stablecoins]."* Other participants countered that traditional forms of payment are also vulnerable to abuse: *"Cash is one of the best ways to do things like terrorist financing and none of us are suggesting banning cash."* Some suggested, in fact, that the blockchain technology underlying stablecoins provides enhanced transparency and traceability: *"I'm not saying that criminals can't use it … but it's far more traceable than suitcases of cash."*
- **Financial stability.** Participants noted the risk of stablecoin "runs" akin to banking crises if there is a loss of confidence in stablecoins. Some stablecoins have de-pegged and traded at less than par or collapsed. Defenders were quick to distinguish between fully-reserved, regulated stablecoins backed by safe, highly liquid assets and stablecoins that maintain their peg through using smart contracts and algorithms that control supply and demand. But even stablecoins backed by safe assets pose risks — participants noted that the two largest issuers of stablecoins combined represent the tenth largest holder of US government debt. As stablecoins scale and issuers become increasingly important in the sovereign debt market, mass redemptions of stablecoins could lead to fire sales of government debt.

- **Security.** Quantum computing is raising concerns about the security of the technology underlying stablecoins and other cryptocurrencies. One participant acknowledged that *"the presumption of quantum resistance is a flaw"* faced by all cryptocurrencies, while another said that *"quantum would crack the blockchain immediately."* However, participants also pointed out that quantum-resistant forms of encryption are under development and that blockchains are no more vulnerable than other encrypted systems. *"With quantum becoming commercial grade, it's a problem,"* said one executive. *"But it's a problem for everything."*
- **Geopolitics and monetary policy**. Some participants pointed to the geopolitical implications of stablecoins, noting that President Trump's push for stablecoins aims to boost dollar dominance, drive up demand for US Treasuries, and lower borrowing costs. Whether that is positive or negative depends on perspective: *"In a world where other countries are trying to get away from the dollar, the U.S. will be happy to have new payment rails that are dollar denominated. It's a way to win the digital currency space race."* Others warn that Trump *"wanted to increase dollarization by pumping the world full of dollar-denominated stablecoins."* With the vast majority of stablecoins pegged to the dollar, dollarization in non-US markets is a risk—governments could lose control of their money supply if private actors flood the market with digital dollars.
- **Deposit flight.** A world in which stablecoins are ubiquitous and digital wallets supplant bank accounts could upend traditional banking. Deposit flight is a key concern, although one participant argued that most holders of stablecoins are not bank customers anyway: *"You can't complain about the flight of deposits you weren't in position to get. Most stablecoin users are net new."*

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Despite some skepticism and concerns about the risks stablecoins may present, participants recognized the need to explore the opportunities they present and prepare for the potential for broader adoption of cryptocurrencies and more tokenization of deposits and transactions. A director said, *"Like everything else, the banks have to play with it. If you don't play with it, you risk falling behind and never catching up. It's not clear whether these models will be successful, but as a bank, you have to engage with it."* A number of banks have recently explored issuing stablecoins or stablecoin-like products, but some participants suggested that the real opportunity lies in providing customers—both corporate and retail—with digital wallets to enable them to make and receive transactions in stablecoins and other cryptocurrencies. Some participants see corporate treasuries as the next frontier where the benefits of stablecoins will provide a pull from corporate clients that drives banks and other financial institutions to offer digital wallets alongside traditional bank accounts.

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