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To the
European Banking Authority

Consultation on draft RTS on requirements for policies and procedures on conflicts of interest for issuers of ARTs under MiCAR: Consultation on draft RTS on requirements for policies and procedures on conflicts of interest for issuers of ARTs under MiCAR form

Navigating the Complexities of Stablecoins: Payment or Asset Management?

Let's delve into an intriguing aspect of the digital finance realm: the business model of stablecoins. These digital currencies, such as Tether and USDC, are reshaping how we think about payments and assets in the digital era. With their ability to enable digital payments across various sectors, from cryptocurrency transactions to automated machine payments and tokenization, stablecoins stand at the forefront of financial innovation.

A fundamental aspect of stablecoins is their pegging to fiat currencies at a 1:1 ratio, which ostensibly offers stability and reliability. However, beneath this surface of stability, lies a complex web of risks and challenges. The most significant of these is the risk of a "run" on stablecoins, where all holders simultaneously seek to redeem their digital currency for fiat money. This scenario tests the resilience of the underlying assets, often termed as "high quality liquid assets," which, despite their name, are not without liquidation risks.

The seemingly straightforward solution of holding all fiat reserves in cash opens up a Pandora's box of logistical and financial quandaries. Where should this cash be stored? Banks, the traditional custodians of money, come with their own set of credit risks. Large withdrawals could also precipitate liquidity crises at these institutions.

An alternative that emerges is storing these reserves with central banks. Simple, right? But this leads us to another critical question: Should central banks pay interest on the reserves of stablecoin issuers? The precedent set by the Bank of England is illuminating. In their approach to handling stablecoin reserves, they demand these be held in accounts at the bank but do not offer any interest on them. This stance is not unique; the European Central Bank (ECB) follows a similar policy, not paying interest on banks' required minimum reserves.

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This leads to an important crossroads in the stablecoin narrative. The role of central banks is pivotal, not just as custodians of cash reserves but also as enablers of payment technology, while the stablecoin issuers execute this technology. If central banks, like the ECB, are not inclined to pay interest on cash reserves held by stablecoin issuers, it raises fundamental questions about the sustainability and profitability of the stablecoin business model.

This situation brings us back to our original question: Are stablecoins primarily a payment mechanism or an asset under management business? As we continue to observe and participate in the evolution of digital finance, it's crucial to consider these underlying dynamics, which will undoubtedly shape the future of stablecoins and their role in our digital economy.

The risks associated with stablecoins as assets under management business let us recommend the payment business model, i.e. reserves will be held without interest at the central banks, and the issuer will profit only from transaction fees.