Bank Pulse: Stablecoins, the banks of tomorrow?

This week, US supervisors FDIC and OCC called for stablecoins to be regulated as banks. Does that make sense, and will the banking landscape indeed be enriched by stablecoin issuers in a few years?

In a report published this week by the US President's Working Group on Financial Markets, the FDIC and OCC call for stablecoins to be regulated as banks. The fact alone that this report is published, shows that the concept of "stablecoin" has come a long way. Stablecoins started life in cryptomarkets. Like on traditional financial markets, traders want to hold cash now and then, and like in traditional FX markets, a base currency is needed to intermediate trade between smaller cryptocurrency pairs. Yet the real dollar is not easily available, as crypto exchanges sometimes lack easy access to the traditional financial system, and real dollar transactions cannot be settled natively on blockchain. Stablecoins jumped into this gap in the market.

Beyond crypto markets, stablecoins can be a tool for platform companies to promote transactions on their platform, and to keep payment processing and the associated valuable transaction data in-house. Facebook's Libra, now called Diem, is the most prominent example of such a plan.

The need for stablecoin regulation has been recognised across the globe

On crypto markets or beyond, a stablecoin should fulfil some clear basic demands: it should be liquid, and it should keep its peg to the fiat currency (or currencies) it is based on at all times. That certainly sounds quite like what we expect from our bank deposits, so considering the bank regulatory framework makes sense! In the case of stablecoins, liquidity and stability of value are derived from the assets the issuer invests in. Those should be low-risk, and their markets should have deep liquidity, also in times when there would be a run on the stablecoin issuer. Prudential regulators worry that in the absence of any regulations, stablecoins so far have not always followed low-risk, high-liquidity investment policies.

Given the pivotal role stablecoins play in ever growing crypto markets, and the important role they in the future may come to play on other platforms, the need for regulation has been recognised across the globe. This week's US report is the latest instalment of the ongoing discussion in the US, while stablecoins are subject to the Markets in Crypto Assets Regulation (MiCAR) proposal launched by the European Commission last year.

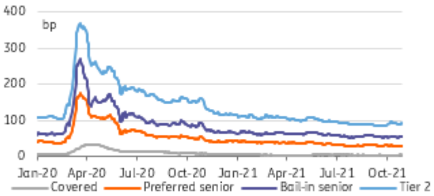
Stablecoins share some characteristics with bank deposits, but one could also imagine other regulatory regimes

Different ways can be imagined to regulate stablecoins. It may be no surprise that bank supervisors like the OCC and FDIC call for bank supervision including stablecoin "deposit" insurance. And while stablecoins certainly share some characteristics with bank deposits, one could also imagine other regimes. Stablecoins could also be regulated e.g. as supercharged e-money providers. Other options include regulation as money market funds or a whole new regime. An important choice to make is whether stablecoin holders have a claim on the issuer itself, as is the case with banks and e-money providers, or only on the underlying assets, as is the case with money market funds and the "Asset Reference Token"-regime the European Commission explores in MiCAR. At first glance, having a claim on the issuer seems the safer option from a user perspective. Yet this also depends on the issuer's investment policies and loss absorption capacity. A "deposit" guarantee scheme would further lower user risks, but comes at a price: guarantee schemes tend to be financed by participating institutions, hence stablecoin issuers will need to pay into the scheme, and will somehow need to recoup that cost.

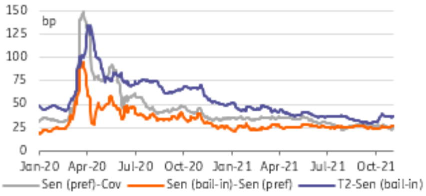
> Regardless of the licensing type chosen in the end, regulators are considering to impose on stablecoin issuers the use of liquidity buffers, the establishment of risk appetite policies, and capital buffers to absorb losses. While all these requirements will be considered cumbersome and unnecessary by some, the history of finance is littered with institutions and markets that functioned great for a long time, until they suddenly didn't, faced a run and collapsed, generating losses for their users and sometimes causing wider disruption in the financial system. It is precisely such a scenario that regulators seek to avoid.

Performance and supply

Bank bond index performance

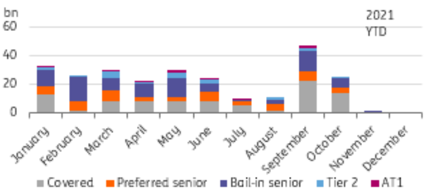


Relative performance of the indices

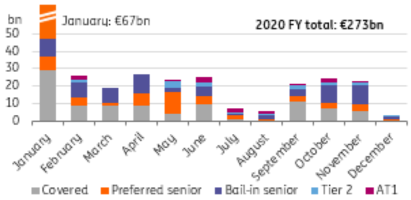


Source: Markit iBoxx, ING

Bank bond supply per debt category, 2021 YTD versus 2020 (€bn)*



*only includes public deals.Source: IGM, ING



*only includes public deals.Source: IGM, ING

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