Why would a traditional financial player be interested in issuing a stablecoin?

Explainer

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Increasingly popular and accessible, and expected to continue growing in popularity, crypto-assets have been available to buy for almost two decades. Nevertheless, the number of traditional players interested in a piece of the cake by developing their own crypto-assets or by allowing for the trading of crypto-assets on their platforms have remained limited. This approach to crypto might however be coming to an end, with two of the largest European banks publishing statements that they are entering the market by issuing stablecoins. But then what could be the reasoning behind this decision?

Before going into further details on the rationale, we need to define the main features of crypto-assets. While, crypto-assets are very heterogenous, they do however all share three common features: first, they are a digital representation of rights, second they are based on Distributed Ledger Technology (DLT), also known as blockchain technology, and third, they are decentralised, meaning that they do not count on the support of a central public or private authority.

A number of taxonomies try to fit crypto-assets into different categories. For the purpose of this ECRI Explainer, we will distinguish between traditional crypto-assets and so-called stablecoins.

Stablecoins peg their value to an external reference, usually major currencies like the dollar. They can be classified into different categories, depending on the type of mechanism used to ensure a stable value. Indeed, stablecoins can be backed by other cryptocurrencies, by cash, cash equivalent reserves and other types of financial assets (such as gold), or they can rely on algorithmic systems. Due to their nature of being directly linked to a currency, they are less volatile than traditional crypto currencies, hence their being labelled as 'stable'.

Since the publication of Bitcoin's Whitepaper in autumn 2008, the number of crypto-assets has dramatically increased, with more than 8 000 crypto-assets listed in CoinMarketCap in December 2023. Abrupt volatility episodes have led to the launch of 'stablecoins', with two of them (Tether and USDC) being among the world's largest crypto-assets by market capitalisation. However, there are several cases where stablecoins have not lived up to their name. A point in case was Terra Luna, an algorithmic stablecoin that collapsed in 2022.

The regulatory framework

The EU's Markets Crypto-Assets Regulation (MiCA) does not cover algorithmic stablecoins and in turn foresees two different types of cryptos backed by assets (it also foresees a third category of non-asset backed crypto assets).

The first type consists of Asset Referenced Tokens, which can refer to the value of several fiat currencies that are legal tender, one or several commodities, one or several crypto-assets, or a combination of all these assets. The second type consists of Electronic Money Tokens. These aim to maintain a stable value by referring to the value of a fiat currency that is an official currency, for which the proceeds will have to be legally invested in safe and low risk assets denominated in the reference currency, with at least 30 % of funds being held as deposits in credit institutions for non-significant Electronic Monetary Tokens (EMTs). Significant[1] EMTs are required to deposit a larger share in credit institutions.

Now traditional players are starting to issue stablecoins…

Crypto-assets in general – and stablecoins in particular – have until now been substantially delinked from traditional finance, with major financial actors playing a very marginal role in this field. Nevertheless, lately, traditional financial institutions such as Paypal, Société Générale-Forge (SG-Forge), and DWS, have announced that they have begun the process to issue their own stablecoins.

Paypal's case is somewhat less surprising as it has continuously shown a strong interest in crypto-assets. As early as October 2020, it announced that it would allow US users to buy, sell and hold certain cryptocurrencies, subsequently expanding this service to customers in the UK in 2021 and Luxembourg in 2022. In 2023, PayPal announced the launch of PYUSD, a dollar-denominated stablecoin available only to US-based customers.

The most striking case of a stablecoin being issued is the case of SG-Forge, linked to France's third largest bank, which announced in December 2023 that it would begin issuing its own stablecoin, Euro CoinVertible. As indicated in SG-Forge's Whitepaper, it will be pegged to the euro and backed by cash, and will be bought under the name EURCV.

Under MiCA, which will become fully applicable at the end of 2024, EURCV could be both an EMT, and a 'digital asset' (*'actif numérique'*) under French Law, though the French *Autorité de contrôle prudentiel et de résolution* (ACPR) has not yet classified it and changes to EURCV would probably be needed to make it fully in line with EMTs. The legal issuer would be SG-Forge, a licensed investment firm under MiFID 2 and a registered digital asset service provider in France. EURCV is based on the Ethereum public blockchain. The stablecoin is currently being restructured due to MiCA soon coming into force.

SG-Forge's project is based on three key elements of, namely a clear legal structure, resilient collateral and financial mechanisms, and a robust technical framework. The legal structure relies on the full separation of collateral assets from the fiduciary's own assets and activities. The collateral's resilience will stem from the EURCV currently being exclusively backed by cash. EURCV relies on the CAST Framework, an open-source initiative, built and implemented by major financial institutions, and designed to foster the adoption of digital assets by providing legal, operational and technical frameworks. SG-Forge could accept a range of assets in exchange for EURCV. Since EURCV is a digital asset and not a debt instrument, the holder would only be able to make a claim against the fiduciary and would have no redemption rights against SG-Forge itself.

[1] 'Significant' Electronic Money Tokens are defined under MiCA, Article 43.

Just like SG-Forge, DWS published their intention to launch a euro denominated stablecoin in December 2023. To make the coin publicly available, DWS has entered into a joint venture with Galaxy Digital and Flow Traders under the name 'AllUnity'. DWS CEO, Stefan Hoops, has expressed that the new project 'will bridge the gap between traditional and digital finance ecosystems'. Some regulatory hurdles remain, however. The main challenge for them is to obtain an Electronic Money Institute licence. On top of this, under MiCA, they are required to publish a Whitepaper before making a stablecoin purchasable.

The benefits for issuers

Now reverting back to the title of this Explainer, why would a traditional financial player want to issue a stablecoin?

First, by issuing a stablecoin, both SG-Forge and DWS are showing leadership in innovation and digital trends, as traditional financial players have barely issued crypto-assets up until now. By issuing their stablecoin, they are hoping to gain access to a new client base, tapping into the crypto community and breaking silos.

Second, for the issuers, the stablecoin would offer added value in wholesale processes, such as corporate treasury, cash management, liquidity funding and refinancing solutions. Depending on their design, stablecoins could also be useful for Decentralised Finance (DeFi).

Third, by showing such a proactive and pioneering attitude, the issuing entity is trying to position itself to exert an influential role in ongoing and future policy decisions.

Fourth, the dialogue issuing entities have with regulators on the process behind issuing a stablecoin allows for clarifications to be made for both sides, which would then support other market actors in how they can develop a stablecoin. For instance, in their Whitepaper, SG-Forge calls for the creation of common operating standards, like the CAST initiative, on which EURCV is based, and defends a set of principles and goals for asset tokenisation.

Finally, depending on how the stablecoin works, the issuing entity could indeed make money out of it as capital gains stemming from deposits and securities could be kept by the issuer, with the stablecoin-holder exclusively receiving the initial value.

Consumer benefits

While the interests of traditional financial players in issuing a stablecoin appear to be clear, could the same be said about financial consumers? Here, the answer depends very much on whether we are talking about a professional or a retail customer. In the case of professional customers, properly designed stablecoins can bring added value along the lines of some of the use cases indicated above.

Nevertheless, as for retail customers, their interests do not seem so clear-cut and the use cases rather limited. In fact, if the stablecoin-holder replicated their collateral investment portfolio, instead of investing in the stablecoin, they would retain the proceeds of those investments. Moreover, irrespective of the transparency and high quality of the collateral, and even if the issuing entity is linked to a traditional bank, retail customers need to understand that they would not be covered by any Deposit Guarantee Scheme.

Anyhow, there could also be some cases where retail customers could be interested in stablecoins. This is especially the case of retail customers who live in jurisdictions with unstable fiat money as their currency and suffer administrative limitations to acquiring foreign fiat money. Another possible use case for retail investors could be inflation shielding, though this would be more in the case of stablecoins backed by commodities, i.e. Asset Referenced Tokens (using MiCA's categorisation) and not so much Electronic Money Tokens, which peg their value to a specific fiat currency.

In any case, it must be noted that EURCV is in principle addressed to professional customers with retail customers only having access to it on specific crypto-exchanges as a way of hedging against the volatility of traditional crypto-assets.

As the financial ecosystem is moving towards tokenisation, stablecoins allow for the transfer of value in a denominated currency using blockchain technology without having to pass from on-chain and off-chain multiple times. Traditional banks taking the leap into crypto could mean more trust in the system as the businesses managing crypto transfer have already proven their reliability through traditional finance.

Conclusion

In a nutshell, innovation, financial interests and the will to enlarge their customer base could be behind traditional market players deciding to issue their own stablecoins. As for customers, it is of utmost importance that they clearly understand what added value such an investment could bring compared to investing in traditional assets.

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