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What Are the Risks with Stablecoins?

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The US Department of the Treasury just issued a report in which they urge lawmakers to set up rules for regulating stablecoins. These cryptocurrencies that are tied to "stable" assets like the US dollar have grown to have a market value of $130 billion, $100 billion more than at the beginning of the year. The companies that offer stable coins, Tether and Circle, fall into a grey area in that they are not tech companies and not banks but are operating like both. What are the risks of stablecoins? The folks at Treasury are concerned about things like fraud, mismanagement and bank runs if these growing assets are not regulated.

What Is a Stablecoin?

The chief argument against cryptocurrencies like bitcoin is that they have no basis for their value outside of what the market will pay. The rationale for stablecoins is that they are pegged to a "reserve asset" such as the US dollar or gold. Tether (USDTUSD) and TrueUSD are both tied to the dollar. They have dollar reserved that are kept by custodians separate from the companies and are audited regularly. There are also stablecoins that are pegged to other cryptocurrencies and ones that derive their value from computer algorithms (Basecoin).

Why Are Stablecoins Attractive?

Currencies are supposed to be stores of value. Cryptocurrencies like bitcoin function like commodities that double in price over a week or two and then collapse by half. Ten percent variations over a day are common. This feature makes trading bitcoin attractive and the fact that the overall trend is going up makes bitcoin attractive to some investors. But, if you are going to spend your cryptocurrency such as was intended when cryptocurrencies were first envisioned, a stablecoin would seem the better bet as the price does not fluctuate so severely.

What Is the Worry With Stablecoins?

Treasury Secretary Yellen said this about stablecoins:

> *Stablecoins that are well-designed and subject to appropriate oversight have the potential to support beneficial payments options but the absence of appropriate oversight presents risks to users and the broader system.*

Banks need to maintain reserves and are subject to oversight by regulators. Banking issues that came to light after the 1929 and 1968 market collapses showed the need for such oversight. The Treasury does not have a problem with the idea of stablecoins as a means of exchange or store of value. What they want is to bring this asset into the regulatory scheme that protects uses from malfeasance or simply from dumb mistakes as noted in an article in *The New York Times Dealbook* about stablecoins.

> *The working group determined that authority to regulate stablecoin issuers would have to come from an act of Congress and that the group could not currently mandate standards for digital payments reliant on stablecoins. That lack of authority, the report said, makes these types of crypto-based transactions more vulnerable to "human errors, management failures or disruptions" that could result in consumers losing money, becoming victims of fraud or being unable to get their money.*

A couple of months ago we asked if crypto banks were really pawn shops as they required a deposit of dollars to use their cryptocurrencies for loans, credit cards, or for deposits. Stablecoins are just one more iteration of cryptocurrencies, many of which may be very useful and some of which may be dangerous without proper oversight.

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