Digital Assets Education

Digital Assets
Global

Stablecoins in a nutshell

- Stablecoins are a programmable cryptocurrency whose value is pegged to another asset, often the USD
- "Tether" and "USD Coin" currently dominate the market
- Stablecoins are the cash equivalent of digital assets, which can be used for payments, trading on exchanges, and remittances

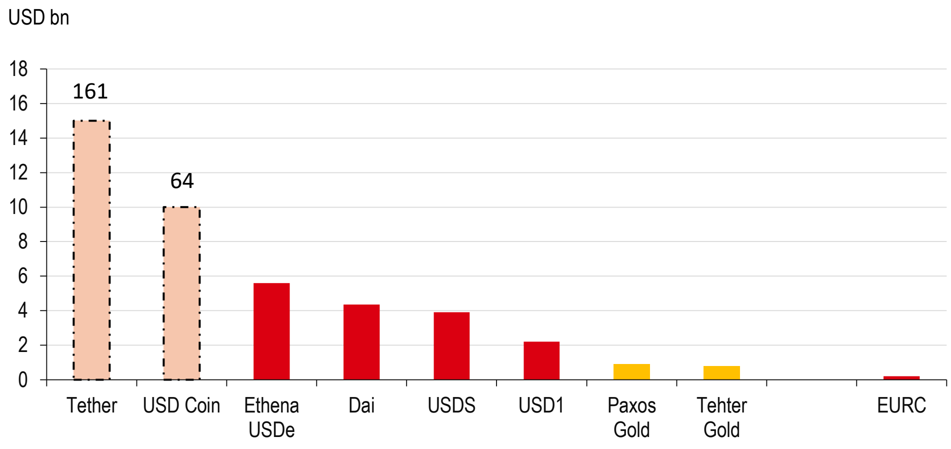
What are stablecoins?

A stablecoin is a programmable cryptocurrency whose value is pegged to another asset, most often the USD or other currencies, but there are also other real world assets, such as commodities (e.g. gold) and other financial assets (e.g. US Treasuries). Issuance of a stablecoin can be either centralised or decentralised in nature, while the supply of a stablecoin can rely on some form of reserves in either real world assets or cryptocurrencies to sustain the peg, or can be controlled by an algorithm or formula. **Pure algorithmic stablecoins are relatively rare**, with hybrid models (i.e. a mix of algorithms and some form of reserves) more evident.

Algorithmic stablecoins are effectively banned by European regulators and Hong Kong regulators (given the reserve asset management requirements). In the US, the GENIUS Act currently in the legislative process proposes a two-year moratorium on their issuance.

What are the most popular stablecoins?
Two stablecoins, **Tether (USDT)** and **USD Coin (USDC)**, currently dominate the market (see the chart below). Both are tied to the USD, with a ratio of 1 to 1.

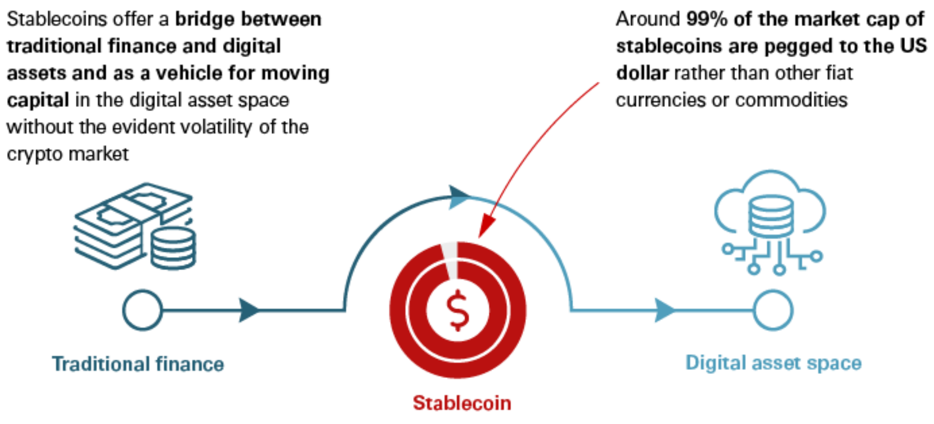
Stablecoin market capitalisation (USDbn)



Source: DefiLlama.com (18 July 2025)

Yellow columns are pegged to gold, all others are pegged to the USD, apart from EURC which is pegged to the euro. The Tether and USD Coin columns are not scaled to the left-hand scale as they would dwarf all other stablecoins.

Dollar as a stablecoin



Source: HSBC

But why not just hold and use actual fiat currency (i.e. USD or other currencies), instead of stablecoins?
For a fiat currency, like the USD, it is clear and accepted by all that a dollar is a dollar. It can also be in a bank account which pays interest and can be covered by some regulatory insurance (e.g. Federal Deposit Insurance Corporation (FDIC) insurance in the US, Deposit Protection Scheme (DPS) in Hong Kong).

Stablecoins, basically the cash equivalent of digital assets, can provide the means to engage seamlessly in the digital assets space, or 'on-chain'. They are the reference or base currency for nearly every crypto asset. They can also be used for transferring money using blockchain pay rails, rather than traditional banking methods. They operate 24/7 and settle quickly. Where a traditional SWIFT transfer can take 2-3 business days, a stablecoin transaction can settle within minutes. They can also generate yield, for example by lending them onwards through central exchanges, or deploying them into decentralised finance (DeFi) lending protocols. Stablecoins can be moved between parties without the need for intermediaries, like banks or traditional financial institutions. Overall, the growing and dominant share of stablecoins in on-chain transactions reflects their role as the lowest friction transaction vehicle.

What is the mechanism behind a stablecoin?
The mechanism behind a stablecoin could vary. Let's take a closer look at the most popular stablecoin, Tether, as an example.

To buy a Tether stablecoin, one has to send US dollars to Tether's bank account. Tether would mint the equivalent number of stablecoins, delivering them to the purchaser's blockchain address. The process also works in reverse. For example, a holder of USD Coin stablecoins could redeem them with the issuer, who would then return the US dollars and 'burn' the USD Coin stablecoins.

This mechanism also means that if a stablecoin's price drops below parity with the US dollar, then you would redeem your stablecoin at whatever sub-parity price (say 99 cents), and get a dollar in return. The supply of stablecoins would be consequently lower, pushing the price back up towards parity with the US dollar.

Clearly, a key requirement for success is that the issuer has sufficient reserves to back up the stablecoins in issue. It is also a centralised model, with issuance controlled by a single entity (be it Tether or Circle, for example).

What are the advantages, disadvantages, and crime-related issues for stablecoins?

The Good. Stablecoins have less volatility than unpegged cryptocurrencies (such as bitcoin). This makes them more attractive as a means of payment and for remittances. These payments and remittances may also be faster and cheaper than traditional finance pay rails. Stablecoins are available to anyone with an internet connection, democratising access to US dollars (and other pegged assets), which can be an especially attractive prospect in high inflation economies, or those with stringent capital controls. Stablecoins also offer a low-friction means of transacting in digital assets, including in DeFi.

The Bad. Stablecoins face credit risk, as the peg relies on there being sufficient quality reserves to sustain the peg. Transparency failures around reserves, and questions over the quality of those reserves could cause the peg to be pressured. Stablecoins also face the risk of a 'run', not necessarily triggered by the stablecoin, but by contagion from other events (e.g. a bank failure where reserves are held). Regulatory credibility for stablecoins remains a work in progress globally, with different approaches, and sometimes uncertain requirements. Stablecoins could also undermine monetary policy functioning if the bulk of transactions move to a non-native digital currency.

The ugly. In 2020, stablecoins accounted for 20% of illicit activity on the web, with bitcoin accounting for close to 75%. In 2024, this had nearly flipped the other way around. Stablecoins accounted for 63% of all illicit transactions, whereas bitcoin was closer to 20%, according to Chainalysis[1]. Stablecoins have also become the digital vehicle of choice for evading sanctions.

[1] *The 2025 Crypto Crime Report*, Chainalysis, February 2025

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