Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

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In all of the reports on all of stablecoin's risks that so frighten central bankers and global finance ministers, none is as terrifying as whether the assets backing hundreds of billions of dollar-equivalent transactions are to be had when needed. And needed they will be – see not just all the ministerials on high, but also Gillian Tett's latest, compelling *FT* column. Without a meaningful reserve-currency reference, stablecoins are the equivalent of monopoly money without even the teeny little plastic hotels providing an illusion of wealth. Making stablecoins matter as real money requires meaningful reserves but meaningful reserves mean that stablecoin's gung-ho promoters won't get anywhere near as rich. The business model changes for the way-better, but the construct of stablecoins may be so altered as to make this looming systemic phenomenon only a passing fancy.

The set of difficult choices needed to realize stablecoin's promise to anyone but profiteers is detailed in our latest report on critical policy issues. In it, we analyze a set of systemic-risk principles recently proposed by the BIS's Committee on Payment and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO). As is usually the case with global-regulatory pronouncements, this proposal defines wide parameters for jurisdiction action, stating most clearly what's wanted, not what will happen if one were actually to get it.

The CPMI/IOSCO paper is even more hesitant than usual because reserve assets aren't stablecoin’s only tricky bit. For example, the paper describes a governance conundrum of formidable proportions due to the combination of decentralized transaction points, opaque and often inflexible software, dodgy domiciles, and complex interactions between a stablecoin's transfer and operational functions.

These governance risks make solving the reserve-asset question even harder. Without knowing who's in charge over what and when and where, ensuring that reserve assets are as represented, sufficient, and liquid under stress is unlikely, if not also impossible.

But even if governance is somehow solved, reserve assets are still the key to stablecoin's future because holding them makes the cost of capital look like chump change. Simply put, holding a real dollar or fiat-currency equivalent in a sterile reserve without credit or liquidity risk and with robust custody and operational safeguards takes a whole lot of money from any stablecoin that wants to be the equivalent of a whole lot of money.

This is as it should be for any stablecoin that serves as more than a self-interested speculative vehicle that makes its promoters super-rich before anyone catches on. And, not only is this as it should be, it seems more than likely that this is as it will be.

2101 L Street, N.W. – Suite 300
Washington, DC 20037
Phone: 202.589.0880

E-mail: info@fedfin.com
Website: www.fedfin.com

With sterile reserves, we have far safer stablecoins. Indeed, with sterile reserves, we also have a payment system that can be safely opened not just to stablecoins, but also to other non-bank payment providers. The cost of sterile reserves is so prohibitive that none may actually materialize, but this is one cost of innovation that's already overdue.