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After a Summer of Stablecoins, What's Next?

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Allison Nathan: It's been the summer of stablecoins. The GENIUS Act that recently became law in the US has created the first federal regulatory framework for stablecoins, digital currencies whose value is typically pegged to fiat currencies, most often the US dollar. The Act requires stablecoins to be fully backed by high quality assets such as US Treasury bills. So, does the stablecoin summer have staying power? And what could that mean for existing payment systems and financial stability more broadly? I'm Allison Nathan and this is Goldman Sachs Exchanges.

Each month I speak with investors, policymakers, and academics about the most pressing market moving issues for our Top of Mind report from Goldman Sachs Research.

This month I spoke with two people on opposite sides of the stablecoin debate. Brian Brooks is former acting Comptroller of the Currency, the CEO of Meridian Capital Group, and sits on the board of Strategy. Barry Eichengreen is a professor of economics and political science at the University of California, Berkeley.

I started by asking Brian how stablecoins are being used today and why they could become more useful and popular in the years ahead.

Brian Brooks: The three most interesting uses of stablecoins in real life are, A, dollar savings products outside of the US. Many people believe that is the single largest ultimate use case of stablecoins. So, on that front you've got savers or even institutional investors in countries where dollar bank accounts are not widely accessible. And this is a dollar equivalent product that expands demand for the dollar and creates price stability in otherwise volatile or inflation-ridden economies. Classic

example would be people in Argentina wanting to hold USDC as opposed to holding Argentine pesos. And there are lots and lots of businesses in both Latin America and Africa that are built on that assumption. A lot of the BRICS countries have startups that are allowing retail users who don't want to be trapped in an anti-dollar economy to hold dollar equivalence through stablecoins. So, I start with that.

The second is remittances. So, the idea here is this is a convenient way to avoid foreign exchange by not really transacting in a domestic currency anywhere. But it's having a cross-border token. And then being able to cash that out directly into a local fiat currency or into a crypto account. If the only savings was that you did not have to pay the MoneyGram fee or the Western Union fee, that alone would be enormously valuable. Okay? If you think about the average, what is it, a 7 percent transaction fee.

And then last and probably least important, but it's the thing that gets all of the headlines, is it's a payment instrument. So, if you think about it today, most people think, well, why would stablecoins ever replace Venmo and Zelle or whatever? Well, with universal interoperability and

everything, you can use stablecoins to break down the silos that currently divide, if you think about it, your Apple Cash wallet, your Starbucks wallet, your Amex membership rewards wallet, all of which are dollar equivalent, non cash payment instruments that you currently use, but you don't probably think about them fungibly the way that you think about money.

Stablecoin is designed to break down and commoditize all that so that there's a single universal interoperable wallet-based payment functionality. That's a smaller market in the developed world because most people in the developed world are already reasonably well served with their existing tools. They don't feel like there's a crisis the way that like an Argentine saver does think that there's a crisis. But still, over time, one would expect this to get transaction as a faster payments tool, a tool that doesn't have interchange fees associated with it and the like. So, I would say those are the three main uses on the user side.

Allison Nathan: Let's talk about the GENIUS Act. How do you think this changes the landscape? What does this really mean for the future of stablecoin?

Brian Brooks: Well, at a high level, for the very first time you actually have a specific supervisory system for stablecoins that mimics and mirrors the supervisory system for national banks. And the reason that more people have not adopted stablecoins over the past five or ten years is largely that they feel safer at the bank. They can go into a bank branch. They see the FDIC insurance sign. They know that their cash is not at risk. They know if the bank is robbed, their money will still be accessible to them. There's a feeling of safety. And there's been a feeling for the whole existence of crypto that crypto is not like that.

We don't really know who we're dealing with. We don't really know what the safety layer looks like. Etcetera.

So, what the GENIUS Act does is it says, listen, all issuers of stablecoins in the United States will be supervised. They will either be supervised by one of the three national bank regulators. Or they'll be supervised by a state banking agency subject to a set of specific legislative requirements. And we know what the reserve requirements for stablecoins will be, meaning that if you ever want to convert your stablecoin into fiat currency, you now have the same assurance that the currency will be there as if you were

withdrawing from your checking account. That was never the case before. Okay?

And we know what the permissible assets are that can be used to back these stablecoins. We know where they have to be held. We know how frequently reserve disclosures have to be made. There's just a sense that supervision equals safety. And as a former bank regulator myself, I think there's a lot of value in that.

It also makes it much more likely now that the regulatory framework exists that many, many more issuers will come to market. So, right now you really, in this country, only have one at scale, which is USDC. As soon as you have mass market adoption of this, the monopoly will go away. And that will be good. So, those are some ways that I see it changing the landscape.

Allison Nathan: How confident can we be that federal, and especially state agencies, have the expertise to be able to supervise this, especially when you think about the actual language of the act, which says disclosure once a month and an external audit once a year. How confident can we be that there is more safety off the back of these

provisions?

Brian Brooks: Yeah. If the only thing happening in the GENIUS Act was a requirement of a monthly audit, I would say that doesn't make me feel a lot better. That's mostly sort of optics and window dressing.

What makes me feel better is that these things have to be issued inside of a bank subsidiary. Or if it's a non-bank subsidiary, it has to be supervised by a state banking agency. There's a flock to national bank charters right now, occasioned by the GENIUS Act. I mean, lots and lots of companies that are in the crypto space are now applying for national bank charters.

So, national banks are subject to something called continuous supervision. It's the continuous supervision that really matters. That is not a monthly or annual thing. Bank examiners are there all the time and they conduct targeting exams on short notice all the time, 365 days a year. And at the big banks, they're on site 365 days a year. So, that's where the confidence comes from.

Now, your expertise question I think is maybe the bigger

concern. Do we think that bank examiners know enough about stablecoin custody and private keys and blockchain transmission and those kinds of things to be able to adequately supervise this? And I think the answer is they know more today than they knew yesterday. And they'll know more tomorrow than they know today.

Banks have accommodated technology developments a lot over the decades. And there's always been a front end where the regulators are playing catch up. And I think it's a fair comment to say that they're playing catch up today. But it's better that they start playing catch up and learning than not, right?

And so, as national banks start issuing these tokens, exam teams will arise that will scrutinize and learn these things better than they have in the past. And I would note, by the way, it's kind of the same thing with the big audit firms. Virtually none of the big four audit firms would agree to audit a crypto company ten years ago. But now, they all have crypto practices. And it's just because the activity became large enough that it was worth their while to learn it. And they now have a set of audit procedures and other things. And the government agencies will be the same.

Allison Nathan: Right. Although, I think there is just sort of a scale issue here because, I mean, the goal is hundreds or thousands of issuers of stablecoins active in the ecosystem.

Brian Brooks: I would disagree with you slightly on the idea that it's going to be such a huge scale. I think what we currently think of as stablecoin, that market, the crypto-native stablecoins, USDC and Tether, those are overwhelmingly likely to be the dominant ones. And these banks that are looking to issue stablecoins, I think they have a very different business in mind. I don't think they're looking to launch a $100 billion market cap stablecoin for people to participate in, like, global remittances or de-fi protocols. I'd say this because I advise a few of these banks.

What these banks are looking to do is to, A, lower their funding costs. And if they have people holding stablecoins, there are reasons to think that that can be cheaper than having to hold an actual bank deposit. And B, they're looking to create customer stickiness by having a tool through which they can run discount programs, rewards

programs, and other kinds of loyalty features. And it's easier to do that with an electronic token.

So, I think the banks that are going to issue their own tokens, those tokens will be converted into USDC or Tether for the other uses. So, I think there'll be two kinds. There will be the two or three biggest ones in the world. And then there will be much more locally based tokens that are much more easy to deal with.

Allison Nathan: Barry Eichengreen has a more concerning take on the potential impact of the GENIUS Act. Barry, you actually wrote recently that the GENIUS Act would unleash economic chaos, if I remember correctly. So, what is it about the legislation that is so worrying to you?

Barry Eichengreen: I do worry about a proliferation of currencies and quasi-currencies that may not be interoperable and interchangeable. And that may end up creating at different prices. So, an analogy would be every dollar bill might not be worth a dollar depending on the number imprinted on the front, the Federal Reserve bank that had happened to issue it.

I think there is a lot of history suggesting that private monies, which is what we're talking about here, do not always function perfectly. So, what's at risk is what economists refer to as a singleness of money. That every dollar bill is worth a dollar, so that you don't have to scrutinize it. If you're the owner of a coffee shop, you accept it in payment. If you have to scrutinize it, all kinds of additional costs, inefficiencies, and risks can be introduced into the payment system.

Allison Nathan: Can you go into some details about when this has failed? The episodes that you are concerned about repeating?

Barry Eichengreen: Well, most direct historical precedent for this kind of problem would be during the free banking period in the United States from the middle of the 1830s up to the early days of the Civil War when in many states, individual banks were free to issue their own proprietary bank notes. When they made a loan, they would pay out the balance of the loan in the form of those bank notes. They were, in principle, obliged to redeem a dollar bank note for a dollar's worth of gold. Which they held as reserves. Or alternatively, they could hold state

government bonds or sometimes state railway bonds as collateral that they could then convert into gold and pay out to whoever ended up with their notes.

But as we know from ample historical experience, a bond with a nominal value of one dollar may, on occasion, trade for less than one dollar depending on redemption risk and other things. So, banks did not always have the collateral to pay off their note holders. Different notes therefore traded at different prices if there was redemption risk.

And when there were serious worries about whether the bank would be able to redeem its notes, there could be a rush to the till, if you will, to the teller's cage. A banking panic, in other words, and that could spill over from one bank to another.

So, that gives you an idea of the kind of problems that can arise. So too does the performance of money market funds in 2008. You'll recall there was a big one that broke the buck that was supposed to be holding bonds to fully back the claims of people who held money market shares. When a dollar money market share went down to 97 cents, all kinds of chaos broke out. People began to worry about

other money market funds and contagion. And the government stepped in and guaranteed the value of money market funds.

So, do we want the government to be on the hook for stablecoin redemption? Which is a scenario here. Silicon Valley Bank in 2023 had extensive, un-hedged bond portfolios that lost value when interest rates went up. And again, because of fears that problems in an individual bank would infect large parts of the financial system, the government stepped in and guaranteed the entirety of their depositors.

US government regulators, the comptroller of the currency or the Fed, are going to be licensing and lending legitimacy to these stablecoins. Are they, and in turn the taxpayer, going to be on the hook for standing behind these funds if problems arise?

I would remind you that in the case of banks, the banks pay into an insurance fund at the FDIC so that if problems arise, in principle, the banks pay the price of making the depositors whole up to the insured limit. There is nothing like a deposit insurance fund for stablecoins. Taxpayers

will be directly implicated.

Allison Nathan: But of course, I mean, the GENIUS Act does require that stablecoin issuers hold collateral against these coins. And it has to be high quality. And the vast majority is basically going to be held one for one to Treasuries. So, does that give you any comfort?

Barry Eichengreen: It gives me a modest amount of comfort. But again, the money market fund example is directly analogous. The free banking era, again, the notes were supposed to be fully collateralized by high quality assets. And we know from many, many historical examples that what is a high-quality asset on one day can be lower quality on the next.

If you look at the balance sheets that are released by big stablecoins like Tether, some of their assets are held in the form of bank deposits. But those bank deposits can be held at places like Silicon Valley Bank. Right? So, when Silicon Valley Bank had trouble, some of the big stablecoins had their reserves there. Their shares went to a discount. I don't see what in principle will guarantee that that can't happen again.

Allison Nathan: However, Brian Brooks takes issue with the comparison to the free banking era, also know as the wildcat banking era.

Brian Brooks: I don't see this as feeling anything like the wildcat banking era, in part because the binding constraint on the ability to issue stablecoins is still bank focused. It is how many bank deposits are available to back these things? Or how many Treasury securities are available to back these things?

So, the thing about the wildcat banking era, which was the era before the OCC was created, that's before the National Bank Act, really, the wildcat banking era was based on the idea that every bank issued its own bank notes. And they called them all dollars. But the underlying reserve assets differed from bank to bank. Right? So, a dollar at this bank was not worth the same as a dollar at that bank.

The whole point of the GENIUS Act is to require that all stablecoins, however they're titled, are backed by the same set of assets. You know, when the National Bank Act was passed in 1863, the main thing it did at that time was

require all banks to hold Treasury securities. And to hold them in a certain ratio. That's what ended the wildcat banking era. And that's all the GENIUS Act does. So, it doesn't feel like wildcat banking to me.

Allison Nathan: Given the debate around the risks of privately issued stablecoins, I then asked Brian and Barry whether central bank digital currencies would be a better alternative. Here's what Barry had to say.

Barry Eichengreen: Well, I think central bank digital currencies have more promise because they don't threaten the singleness of money and the central bank can stand behind them in the same way that it can stand behind deposit accounts at the Federal Reserve.

And I think it's not a coincidence that the United States is going down this stablecoin road because there is opposition in Congress, in part fueled by deep and abiding suspicion of ceding more power to the central bank. You know, the kind of suspicion of concentrated financial power that goes back to Andrew Jackson in the 1830s. That means we are unlikely to have a central bank digital currency in the United States any time soon.

Allison Nathan: And here's Brian's take. Why aren't central bank digital currencies better than stablecoins?

Brian Brooks: Well, it depends on if you trust your betters or if you'd rather be free. This is an ideological question. I don't want the government to get to approve or disapprove every transaction that I personally enter into. I don't want to live in that world. This is where there is a bit of an ideological split in this country. Some think that in the wrong hands, that power will be used to cut people off from the financial system that they don't like. So, do you want that to happen at scale? And I don't.

Stablecoins are based on decentralized consensus mechanisms that nobody's in charge of. So, there's nobody you have to trust.

Allison Nathan: I closed my conversations with Barry and Brian by asking them about what stablecoin proliferation could mean for the asset most widely used to back them, Treasuries. Here's what Barry had to say.

What could the implication be for Treasuries? We're

running a big deficit. And is this a way to find another marginal buyer of Treasuries?

Barry Eichengreen: Yeah, I think marginal is the right word here. Scott Bessent has spoken about how stablecoin capitalization, stablecoin circulation could rise to $2 trillion or something along those lines. Where there are, what, some $30 trillion worth of Treasuries out there in the market. So, this is not going to transform the demand for Treasuries or radically reduce the required rate of return. But it is potentially another marginal source of demand.

If you subscribe to the argument I made before about how there can be runs on stablecoins if people worry about whether the collateral is there, then there can be rapid liquidation Treasuries and more instability in the market as well.

Allison Nathan: Brian, unsurprisingly, sees it differently. Do you think this will be a meaningful source of demand for Treasuries?

Brian Brooks: For sure. I absolutely do because I mean, obviously, by definition, anything that increases demand

for dollars increases demand for Treasuries, right? Because that's the way the dollars are created. And the way I think about it is as we've discussed, there are a lot of uses for stablecoins. But the killer use case for stablecoin is the ability of foreigners to hold US dollar equivalents.

And so, the more that people in South Africa, India, China, Brazil, the more they realize that they don't have to be exposed to their political currencies locally or their inflationary currencies locally and they can actually hold their wealth in dollar equivalents, the more they will want that. And every time a new token is issued, another dollar of Treasury securities has to be bought to back it.

So, I think that's one of the best things about the GENIUS Act, is it will unleash demand for the dollar at levels that were never previously possible because no matter how much you wanted a dollar in South Africa, you just jolly well couldn't get one. Now you can. You can hold it in your Coinbase wallet. And every time you buy one, there's a dollar of Treasury credit created.

So, if there are, to be conservative, let's say that there are 2 billion adults living outside the US that would rather hold

their entire net worth in dollars than anything else and currently don't hold any dollars. And if you just attribute 5,000 dollars per person across 2 billion people annually, if you just start doing that math, that becomes material pretty quickly.

Allison Nathan: So, Barry and Brian disagree on many aspects of stablecoins. But my main takeaway from these discussions is that stablecoins aren't going away any time soon. So, we'll continue to watch them closely.

Let's leave it there. My thanks to Brian Brooks and Barry Eichengreen. And thank you for listening to this episode of Goldman Sachs Exchanges. I'm Allison Nathan.

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