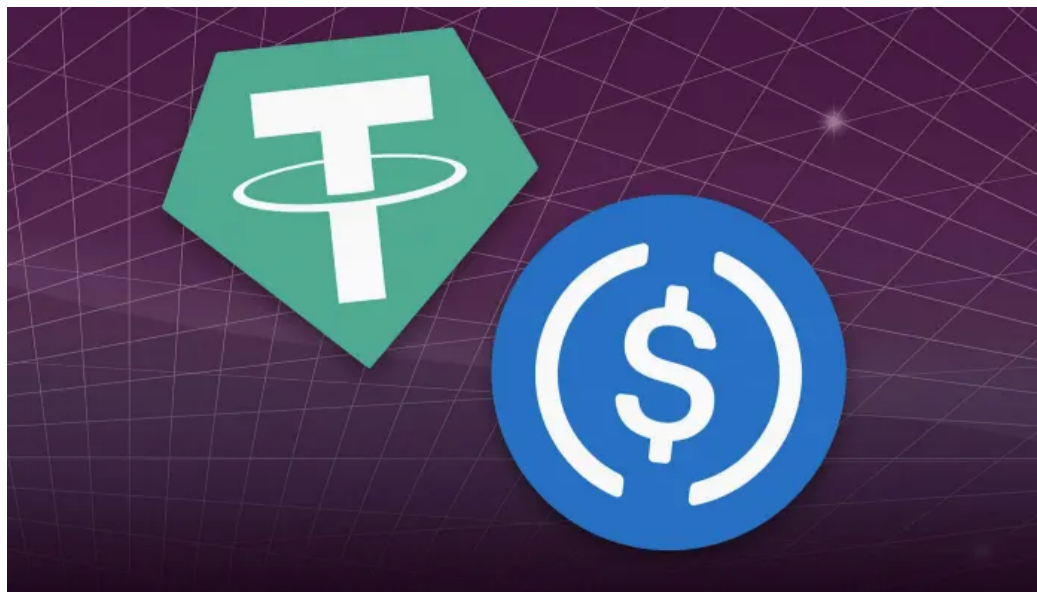


Stablecoins**Stablecoins could trigger credit market contagion, warns Fitch**

Rating agency says large reported reserves behind digital assets build case for tighter regulation



Rating agency Fitch warned that short-term credit markets could be destabilised in the event of a stampede to convert cryptocurrencies into traditional money © FT montage; Dreamstime

Eva Szalay in London JULY 1 2021

Stablecoins pose a growing systemic risk to financial markets, according to rating agency Fitch, which warned that short-term credit markets could be destabilised in the event of a stampede to convert cryptocurrencies into traditional money.

The warning comes as regulators have tightened their focus on the potential impact of digital assets such as tether, the most widely used stablecoin, on traditional financial markets. Boston Federal Reserve president Eric Rosengren said last month that stablecoins represent a “financial stability concern” unless regulators take steps to take control of the rapidly expanding market.

“The rapid growth of stablecoin issuance could, in time, have implications for the functioning of short-term credit markets,” said Monsur Hussain and Alastair Sewell at Fitch in a [commentary note](#). “Potential asset contagion risks linked to the liquidation of stablecoin reserve holdings could increase pressure for tighter regulation of the nascent sector,” they added.

Stablecoins are digital assets backed by or linked to other assets, frequently the dollar. Many providers say each stablecoin is backed one-to-one by a dollar’s worth of reserves. The coins facilitate transactions between different cryptocurrencies, bridging the gap between digital and traditional money. They also serve as collateral in the growing world of decentralised finance.

Many stablecoins, including tether, are not fully backed by cash but instead use a mix of short-term debt known as commercial paper and other less liquid assets. In May, tether said it [held about \\$20bn](#) in commercial paper at the end of March. “These figures suggest its commercial paper holdings may be larger than those of most prime money market funds in the US and [Europe],” Fitch said.

That means any rush of tether redemptions could easily trickle into the commercial paper market.

“A sudden mass redemption of [tether] could affect the stability of short-term credit markets . . . particularly if associated with wider redemptions of other stablecoins that hold reserves in similar assets,” said Fitch.

But while authorities would likely step in to help large asset managers in the event of a shock to short-term credit markets, they are unlikely to do the same for stablecoin providers, Fitch said.

“We believe authorities are unlikely to intervene to save stablecoins in the event of a disruptive event,” Fitch said. “Increased regulation could improve transparency and force a gradual migration of stablecoin collateralisation reserves to less risky assets.”

The overall market capitalisation of stablecoins is more than \$100bn, according to specialist cryptocurrency data providers, following a rapid increase in issuance since the start of the year. In June, the Basel Committee on Banking Supervision said stablecoins could slot into existing regulations for banks, but added that banks must ensure they were [backed effectively](#) “at all times”.

Despite increased regulatory scrutiny on its reserves, including [a fine](#) levied by the New York attorney-general in February, tether has continued to grow in popularity. The Fed’s Rosengren said in a speech on June 25 that stablecoins could “easily” become the trigger for a future crisis, unless regulators take steps to rein in bad practices and demand more transparency.

