



ARE STABLECOINS WINNER-TAKE-ALL?



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Stablecoins have the potential to significantly increase competition in payments and financial services, although achieving this is not certain. Success hinges on fostering a diverse ecosystem with multiple issuers and ensuring true interoperability among stablecoins to prevent them from becoming closed networks. Once regulatory uncertainty is resolved, much of the current stablecoin issuance business will be commoditized, and existing issuers will have to directly compete with the banks and financial institutions that currently allow them to deliver their services. This dynamic challenges the notion of an early-mover advantage for crypto-native issuers. Looking ahead, factors such as access to distribution networks, integration with existing banking and payment systems, brand strength, and technical capabilities for scaling networks will become increasingly critical, potentially leading to market concentration. This is likely to benefit banks, fintechs, digital platforms, and retail players that have not yet entered the stablecoin market. In a world with many interchangeable stablecoin issuers, wallets and payment service providers are likely to emerge as dominant players — or at least as the entities that capture the majority of the value generated by this innovation.

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Stablecoins hold the potential to significantly enhance competition and innovation within payments and financial services. But this outcome is far from guaranteed. The emergence of a few dominant players, mirroring the historical consolidation seen in card networks, could severely restrict competition and result in more, rather than less, concentration. This becomes particularly likely if stablecoin issuers leverage network effects to transform an otherwise fully interoperable system of blockchains into walled gardens. In such a scenario, consumers and businesses gain little, merely switching from familiar payment methods like Visa, Mastercard, Apple Pay, or PayPal to new brands.

To deliver on the potential of programmable money, and to reshape competition in payments and financial services, it is crucial that stablecoin issuance does not converge to a very small number of issuers. Indeed, the promise of the technology will be best met in a world with many issuers and true fungibility and interoperability between stablecoins — so that these instruments can be used efficiently as digital cash. In what follows, we explore the problems stablecoins may solve depending on how they are designed and regulated — from fully backed solutions to digital representations of tokenized bank deposits — and what may drive the market to support a healthy degree of competition between issuers.

While the first stablecoin was introduced in 2014² as a way to move stable-value funds quickly between cryptocurrency exchanges, the category gained mainstream attention because of its potential use in global payments. When Facebook’s Libra stablecoin project was announced in 2019, stablecoins were primarily used in cryptocurrency markets, and regulators paid little attention to what was a niche use case with a relatively limited number of coins in circulation. Since then, Libra was stopped from launching and we witnessed the failure of an algorithmic stablecoin worth billions of dollars (TerraUSD).

But the overall competitive dynamics in the stablecoin market are fundamentally unchanged. Tether (USDT) remains the leading stablecoin by far,³ followed by Circle-issued

USDC. While Tether’s market cap has increased by approximately 35 percent from 2022 — from \$83B to \$112B — Circle’s has almost halved — from a peak of \$56B to \$31B today. PayPal’s foray into the space is early and still a blip in comparison to the two stablecoin leaders, with under

\$500M of PYUSD in circulation. Overall, despite promises — or threats — of stablecoins taking over large portions of payments and financial services little progress has been made toward mainstream adoption. Usage has been mostly confined to the crypto sector, with decentralized finance (“DeFi”) applications driving most of the activity.

Why is this? The key reason is the lack of clear regulation for stablecoin issuance and for how these instruments can be used in payments in a safe and compliant manner. For stablecoins to be used beyond crypto, they will need to at least meet the standards we currently have in place for money movement. Some jurisdictions, like the EU, UK, and Singapore are addressing the regulatory gaps through new laws and requirements targeted at guaranteeing financial stability, consumer protection, and combating financial crime in this nascent market. Other jurisdictions — key among them the United States — have not yet finalized stablecoin legislation. Despite years of talks in Congress, and before that, calls from U.S. regulators and the Biden Administration for such legislation, the U.S. approach to stablecoin regulation remains in limbo.

While we are seeing green shoots of new stablecoins being developed and launched in regions with new rules, there are still significant obstacles to overcome before stablecoins can credibly be used by consumers and businesses on a regular basis.⁴ The absence of clear regulation, whether due to new laws that have yet to be made practical or the absence of laws that are widely considered necessary, will continue to slow down progress. It is simply not worth it for new issuers — particularly those that are regulated financial institutions — to enter until there is enough clarity for them to operate.

“But the overall competitive dynamics in the stablecoin market are fundamentally unchanged”

Legal uncertainty favors existing stablecoin issuers, who have recently launched ambitious new initiatives to strengthen their market positions..⁵ However, it also has

2 <https://tether.to/en/about-us/>.

3 <https://coinmarketcap.com/view/stablecoin/>.

4 For example, in implementing the Markets in Crypto Assets (“MiCA”) legislation in the EU, regulators have yet to release guidance on how stablecoins can comply with both the new regulations as well as requirements for “funds” under the older EU payments directives.

5 See <https://www.bloomberg.com/news/articles/2024-06-11/tether-to-invest-more-than-1-billion-in-deals-over-next-year>, <https://www.circle.com/en/pressroom/circle-brings-the-era-of-open-money-to-life-with-new-brand-campaign-money-is-now-open>, and <https://www.coindesk.com/business/2024/06/17/tether-debuts-new-synthetic-dollar-backed-by-tokenized-gold-in-tokenization-push/> for a few recent examples.

negative effects on competition in this nascent market. This lack of experimentation could undermine the very problems stablecoins are designed to solve. It also moves us away from a market where issuers actively compete on use cases, cost, and functionality rather than on simply securing a first-mover advantage. Consumers and businesses will benefit from stablecoins only when these new instruments are actually safe, easy to use, compliant, and able to deliver money movement at a lower cost and faster speed relative to the status quo. As a result of heavy fragmentation across several closed systems, payments today are expensive, and incumbents such as the card networks are able to extract significant rents from the merchants they support.

Can the stablecoin market break out of this mold? At a first glance, stablecoins seem to exhibit the same winner-take-all dynamics as existing payment services. After all, stablecoins are networks of senders and receivers that are willing to transact using the same asset. Past networks of this type, from telephone to card and social networks, ended up being very concentrated. A possible outcome is therefore one in which one or two dominant issuers control global stablecoin supply and achieve significant economies of scale. In such a scenario, being a stablecoin issuer will likely be a very profitable activity with high barriers to entry.

However, the reality is more nuanced, and the way network effects will play out is deeply intertwined with regulation and the vested interests of existing players in the payments industry. Today stablecoins differentiate themselves with respect to their reserve transparency and design (namely, what assets are used to back issued stablecoins, and what auditing and reporting is performed to reassure the public), attention to compliance, and overall operations. But with clear and consistent legal frameworks, these dimensions of differentiation will disappear, and issuers will need to compete on actual functionality, distribution, and use cases.

To complicate matters further, these assets move on networks that enable new and deeper forms of interoperability between wallets, financial institutions, and other types of tokenized assets such as securities. On a blockchain, crossing from one stablecoin to another is trivial, so if one stablecoin were to reach scale it would still be technologically and economically compatible with smaller stablecoins issued by new entrants and competitors. As a result, new challengers with better pricing and features will always be able to enter and capture market share from the leading issuers.

This is not the case in payments today: you cannot send or receive money between different, competing digital wallets (e.g. PayPal and Cash App), merchants are locked into one or more card networks (typically Visa and Mastercard), and

mobile payments give a significant home-field advantage to Apple and Google — although the European Union is trying to undo that.⁶ Even commercial bank deposits are interoperable only because central banks stand ready to clear deposit liabilities across the banks they regulate, and when depositors themselves have the same rights (e.g. FDIC deposit insurance).

Of course, stablecoin issuers, like the tech giants before them, could introduce measures to undermine interoperability and turn an open protocol into something they control. For example, they could promote activity within their ecosystem and discourage multi-homing by offering incentives, reward points, and interchange fees, or by employing the same anticompetitive contractual clauses that card networks currently use to restrict merchants from pushing lower-cost options to consumers.

But most of these attempts are unlikely to succeed. With proper regulation, stablecoins would have to follow a similar reserve design, consumer protection rules, and compliance obligations. This would rapidly turn them into commoditized businesses. Ironically, the greatest strength of stablecoins — their value tied to widely adopted fiat currencies — also represents their biggest weakness, as in the end consumers and businesses will transact in dollars, euros or pounds, and may not care much about who tokenizes them on a blockchain.

There's an analogy here with commercial bank deposits, where the vast majority of depositors do not think of them as dollar-denominated liabilities of Bank of America or Chase, but as dollars — thanks to deposit insurance and bank regulation. (The exception of course being extreme events like the recent run on Silicon Valley Bank, where depositors became very aware of the actual, underlying legal differences.) If stablecoin issuance is commoditized through regulatory standards, then from a business perspective access to distribution, brand, and being able to monetize complementary services and products will become a lot more important.

“However, the reality is more nuanced, and the way network effects will play out is deeply intertwined with regulation and the vested interests of existing players in the payments industry”

So are pure-play stablecoin issuers doomed to become indistinguishable, regional players in a crowded market?

⁶ https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/europe-fit-digital-age/digital-markets-act-ensuring-fair-and-open-digital-markets_en.

If that is the case, then the entities with the ultimate “issuance” advantage, i.e. the banks, will prevail, and we will have gone through a long detour to simply replace one technology stack with another. Banks with a large retail or institutional base will have thriving stablecoins (or interoperable deposit tokens)⁷ in the market, and existing issuers will either be absorbed or be pushed out. Banks would have to adjust their business model to properly support stablecoins, and risk cannibalizing their returns from maturity transformation if stablecoin adoption becomes a significant part of their business. Stablecoin issuance is expensive, particularly when compared to simply tokenizing existing deposits, as full reserves — rather than fractional ones — must be held in the most liquid and credit-worthy assets. As a result, proceeds from stablecoin issuance generate little return relative to traditional deposit proceeds, which can be invested in a wider range of assets, including mortgages, credit card loans, and corporate debt. Bank customers may also prefer tokenized deposits over stablecoins, as the former may pay some level of interest.

The exception to banks taking over stablecoin issuance would be a scenario in which a fast-moving tech company — whether an existing tech giant, a pure-play stablecoin issuer, a crypto-exchange, fintech or neobank — leveraged its brand, distribution, speed to market, and integrations with legacy payment rails to rapidly scale a new payments ecosystem. As it often happens, once a network reaches scale, it becomes much easier to introduce small changes that stifle interoperability and increase switching costs for participants. Lock-in, while not a feature of the underlying blockchain technology, could then emerge as a result of the speed of execution of an issuer.

Interestingly, this seems difficult for the tech giants to pull off, as regulators have made it clear with Libra that they will face significant obstacles when entering payments and financial services directly. Neobanks and fintechs might be in a slightly better position: they already engage in regulated financial activities, understand tech, and have been rapidly stealing business from legacy financial institutions. Leading cryptocurrency exchanges also have the capabilities to rapidly reach global scale in the stablecoin market, but do not currently have direct strategic bets in this market, have been mostly partnering with pure-play issuers, and have failed at building successful payments operations.

Last, there are the existing leading issuers: Tether and Circle. Their key challenge is that they have limited distribution outside of crypto use cases and applications, and it is unclear they will be able to effectively compete under new regulation with tighter reserve, compliance controls, and consumer protections. Furthermore, once there is regulatory clarity, existing opportunities for regulatory arbitrage on compliance standards and capital controls will disappear, and these issuers will face competition from the very same

financial institutions that they currently rely on for delivering their services.

To complicate matters further, a significant part of the resulting market structure will be defined by regulation, and in particular by the business models stablecoin issuers will be able to avail themselves of. The two main drivers of revenues for stablecoin issuers are yield on the reserve assets (stock of coins), and fees on transactions (flow of coins). Historically, and even more salient in the recent high interest rate environment, issuers have narrowly focused on yield income. But the reasons why issuers such as Tether and Circle have been able to keep the yield for themselves and run lavish activities on the side are unlikely to persist in equilibrium.

First, in the nascent crypto and DeFi use cases, participants are seeking extremely high-yield returns from crypto speculation and are therefore indifferent — or do not have any alternatives — to leaving a few percentage points to the issuers. As the market matures and institutional players play an increasing role, this is unlikely to hold true. We have seen early evidence of this as interest rates have increased and crypto participants have become more sophisticated about reducing their stablecoin holdings. Second, while regulation has historically limited the ability of issuers to compete on sharing all or part of the yield with stablecoin holders, this is rapidly changing as issuers devise new structures and approaches to do so. Third, as **reserve design** improves and regulators force a substantially less risky reserve composition, yields will come down — whether eaten away by bank-like regulation or competition.

As a result, if revenues from yield decay, issuers will be able to compete — and stay in business — only by leveraging fees on transactions or by building added-value payments experiences and services. Assessing transaction fees may not always be possible, especially as blockchain scaling solutions such as rollups become mainstream. This was well understood during the design of the Libra stablecoin ecosystem, and it is the reason why the project kept the issuance and payment rails as part of the same project. Furthermore, issuers will not be able to capture any fees from transfers happening between customers of the same business. If large wallets such as the ones from PayPal, Google, Apple or Meta capture significant market share, stablecoin issuers will struggle to charge them for any money movement happening within their user base. The card networks monetized payments by placing most of the burden on merchants, and if the same happens here stablecoin issuers will end up running the stablecoin as a loss leader to make fees on traditional payment service provider (“PSP”) or card network-like activities. This is a market dominated today by Visa, Mastercard, Stripe and Adyen, and one in which pure-play stablecoin issuers will struggle to compete.

⁷ <https://hbr.org/2021/08/stablecoins-and-the-future-of-money>.

While incumbents may not always be able to introduce their own stablecoin — for example it might be difficult for Visa or Mastercard to impose their own stablecoin on network participants because of antitrust concerns — they will happily support a world with many commoditized issuers because it is significantly less threatening to them. Banks will also favor this outcome, as it is one that preserves their role rather than forcing them to negotiate with large-scale, global stablecoin issuers. Having many competing issuers also pushes to a world where these issuers, and the services built on top of stablecoins, have to compete for better customer experiences, innovative payment services, and lower overall costs.

Overall, from a competition perspective, there are clear advantages to a world with many competing issuers rather than one or two concentrated ones. Regulators can level the playing field and facilitate this pro-competitive outcome by ensuring that issuers follow key consumer protection, financial stability and financial crime compliance standards. At the same time, they also need to make sure that such standards do not excessively limit entry and experimentation. If regulation sets overly conservative standards for stablecoin reserve design (e.g., only central bank reserves), it could inadvertently limit both the types of viable business models as well as stablecoin applications. In general, very restrictive requirements will empower larger institutions that have the funding to meet them. And if it is difficult for stablecoin issuers to be profitable, the activity will land in the hands of issuers that are monetizing through other activities, including access to payment data. Similarly, when closing the gap between the compliance requirements of stablecoin networks and traditional payment networks, it will be important to identify solutions that do not collapse these novel open networks back into closed ones. While this does not mean relaxing financial crime requirements, it will require new approaches to identify verification and compliance that do not force stablecoin issuers to operate like the legacy financial institutions they are trying to compete with.

The potential of stablecoins to transform financial markets hinges on effective regulation that prevents market dominance by a few players and ensures broad competition and innovation. Regulation must not only safeguard against risks but also encourage a diverse ecosystem of stablecoin issuers. This will allow stablecoins to truly enhance financial services by improving transaction efficiency and accessibility, rather than merely replicating traditional financial structures. To achieve this, regulators need to provide clear guidelines that support multiple issuers and enforce true interoperability between them. The future of stablecoins depends on our ability to implement policies that foster both security and innovation, ensuring that these new technologies benefit the entire financial system. ■

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