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Stablecoins: An introduction

Key takeaways

- Wells Fargo Investment Institute is producing a new educational report series on various digital assets.
- In this report, we discuss stablecoins. We believe stablecoins have the potential to reshape the financial landscape in the years ahead. By understanding their fundamentals, risks, and benefits, you can be better informed about challenges and opportunities in this fast-changing landscape.
- For an introduction to digital assets in general, please see our four-part series “Intro to digital assets”.

Stablecoins have emerged as a key innovation in the digital asset landscape, attempting to bridge the gap between traditional digital assets, such as bitcoin and ethereum¹, and fiat currencies. Often backed by high-quality assets such as government securities, stablecoins are designed to attempt to maintain a stable value to a fiat currency like the U.S. dollar, while utilizing the security and transparency benefits of digital assets.

Stablecoins, especially those backed by high-quality assets, usually don't pay interest. Stablecoins can help facilitate efficient transactions, foreign currency transactions, and integration into decentralized finance (DeFi). According to Coinmarketcap.com, as of August 2025, the global stablecoin market capitalization² stood at approximately \$280 billion, roughly a 50x growth in global stablecoin market capitalization since late 2019 due to institutional adoption and regulatory progress.

What are stablecoins?

Stablecoins can be viewed as “digital cash alternatives.” They can offer liquidity and convenience and less friction in a borderless economy. As with many digital assets, stablecoins are digitized tokens that can be exchanged on blockchain³ systems. Unlike bitcoin or ethereum, which can be speculative and volatile, stablecoins typically backed by high-quality assets such as U.S. Treasuries, are managed in an effort to minimize volatility and maintain a consistent value, usually at a 1:1 ratio with a fiat currency (such as the U.S. dollar).

Investment and Insurance Products: NOT FDIC Insured ► NO Bank Guarantee ► MAY Lose Value

1. Ether, the token on the Ethereum network, commonly referred to as Ethereum.

2. Global stablecoin market capitalization accounts for the largest 248 stablecoins by market capitalization compiled by Coinmarketcap.com

3. Blockchain is a decentralized digital ledger that records transactions across a network of computers in a secure and transparent manner. Common blockchains are Bitcoin and Ethereum. For a complete introduction to digital assets please see our four-part introductory series of reports, “Introduction to digital assets and the next digital era”.

Stablecoins enable user-to-user transfers with minimal intermediaries. They operate on various blockchain networks. This allows for near-instantaneous, low cost-transactions — often under \$.01 per transfer — much cheaper than the cost of traditional fees for international wire transfers.⁴

A shifting landscape

The regulatory landscape for stablecoins has seen significant advancements globally in 2025. Many of the advances aim to address risks like peg instability⁵, money laundering, and systemic risks. In the European Union, the Markets in Crypto-Assets (MiCA⁶) regulation classifies stablecoins as e-money tokens or asset-referenced tokens, requiring issuers to obtain licenses, maintain segregated reserves, and adhere to strict redemption and disclosure rules.

In Asia, Hong Kong's Stablecoin Ordinance, enacted in May 2025, mandates licensing for issuers, full reserve backing, and regular audits.⁷

In the U.S., President Donald Trump recently signed the Guiding and Establishing Innovation for U.S. Stablecoin Act (GENIUS Act). The legislation establishes the first comprehensive federal framework for stablecoins⁸ pegged to fiat currencies. Key provisions of the GENIUS Act include:

- **Issuer requirements:** Only “permitted payment stablecoin issuers” — such as the subsidiary of a federally chartered banks, state-licensed entities, or newly authorized non-bank issuers registered with the Office of the Comptroller of the Currency (OCC) — may issue stablecoins. Issuers must maintain 100% reserves in high-quality liquid assets, including cash, U.S. Treasuries, or equivalents, held in segregated accounts.
- **Operational limits:** Activities are restricted to issuing and redeeming stablecoins, managing reserves, and providing custody services.
- **Risk management and oversight:** Issuers must comply with capital and liquidity standards similar to banking regulations, conduct regular audits, and implement Know Your Customer (KYC) protocols. Markets must avoid misleading claims about Federal Deposit Insurance Corp. (FDIC) insurance, as stable coins are not federally insured.
- **Innovation and integration:** The GENIUS Act permits banks to custody stablecoins, utilize blockchain technology for operations, and issue tokenized deposits. It is important to note that banks are not required to implement any of these now-allowed activities.
- **Enforcement:** The Federal Reserve, Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA) and the Department of the Treasury , share oversight, with provisions for penalties, including fines and cessation orders. Additionally, state-licensed issuers are overseen by their state regulators which play a role in the oversight and enforcement of smaller stablecoin issuers with no more than \$10 billion in total outstanding issued stablecoins.

4. “Payment Processing Fees: Stablecoins, Credit Cards, Debit Cards, and BNPL. The Motley Fool, Jack Caporal, July 24, 2025.

5. Peg instability refers to a situation where a stablecoin fails to maintain its fixed value—usually pegged to a fiat currency like the U.S. dollar. For example, if a stablecoin that's supposed to be worth \$1.00 fluctuates significantly above or below that value, it's experiencing peg instability.

6. European Securities and Market Authority, as of August 21, 2025.

7. Hong Kong Monetary Authority, as of August 21, 2025.

8. Payment stablecoins are digital assets designed to be used as payment or settlement and maintain a stable value relative to the pegged asset. Non-payment stablecoins are stablecoins with a primary purpose beyond payment or settlement.

Types of stablecoins

Not all stablecoins are created equal. They are categorized by their stabilization mechanisms that are used to maintain their value, offering trade-offs in security, decentralization, and complexity. The following table summarizes key types:

Type	Description	Pros	Cons
Fiat-collateralized	Backed by off-chain reserves of fiat currency or equivalents (e.g., Treasury securities) held by custodians. Stable value is maintained through redemption/arbitrage.	High stability, easy to understand, more regulated	Centralized, potential reserve shortfalls
Crypto-collateralized	Over-collateralized with cryptocurrencies (e.g. 150%-200% value locked in smart contracts ⁹). Liquidation protocols attempt to enforce a stable value.	Decentralized, transparent, on-chain	Underlying crypto holdings can cause volatility and, liquidation risks. Higher risk that the stablecoin will trade below the fiat value during crypto market declines.
Algorithmic	Supply adjusted via algorithms/smart contracts ¹⁰ ; no or partial collateral backing. Burns/mints tokens on demand.	Scalable, low collateral needs	Prone to instability in highly volatile markets.

Source: Wells Fargo Investment Institute, August 2025.

Fiat-collateralized stablecoins dominate the stablecoin market, with over 90% market share. Coinmarketcap.com data as of August 8, 2025, show that USDT and USDC have \$164 billion and \$64 billion in stablecoin circulation, respectively.¹¹

Use cases and benefits

Stablecoins have potential for numerous applications beyond traditional finance and investment including:

1. **Payment and remittances:** Enable fast, borderless transfers at a fraction of traditional wire costs.
2. **Decentralized Finance (DeFi) participation:** Users can lend stablecoins on blockchains in search of yield, appealing to digital asset investors who are focused on yield generation.
3. **Self-custody management:** Digital asset traders can manage their own digital asset wallets, and convert other volatile digital assets to stablecoins to seek a reduction in volatility, especially during market downturns.
4. **Corporate treasury management:** Some firms may consider using stablecoins for more cost efficient cash management, especially those with multi-national operations. Some companies use stablecoins for vendor remittances, which may help to cut costs. Companies can also use stablecoins to help reduce currency-exchange volatility, converting currencies with less friction, as there is no need for an intermediary, and

9. Smart contracts are programs that automatically execute the terms of an agreement when conditions are met without the use of an intermediary.

10. Smart contracts and algorithms can be used to automatically execute complex functions necessary to consistently maintain the stablecoin's peg or value.

11. Coinmarketcap.com, as of August 8, 2025.

reducing settlement times from days to seconds. Benefits include 24/7 availability and programmability (via smart contracts), which can enable programmable payments and help automate processes like payroll or vendor settlements.

5. **Financial inclusion for unbanked populations:** This may be particularly useful in developing nations where many lack traditional banking services. Stablecoins can enable smartphone-based transactions via simple digital wallets. The ability to send and receive payments without fees or paperwork can help empower underserved communities to participate in the economy. We believe stablecoins' stable value (depending on how they are collateralized) has the potential for reliable daily use, and may be effective in injecting capital into financially excluded regions of the world.

Evolving challenges

While stablecoins have many uses and potential benefits, they are not without challenges.

- **Instability:** Despite being designed to maintain a stable value, a stablecoin market value may drop below the fiat currency value that it is pegged to during times of extreme volatility or external events. For fiat-collateralized stablecoins, the issuer will seek to respond reactively to restore the stable value. However, when these situations arise, it may erode confidence.
- **Regulatory and legal challenges:** The recently signed GENIUS Act provides additional regulatory clarity for payment stablecoins, but the lack of a comprehensive regulatory framework for digital assets still leaves room for uncertainty.
- **Operational challenges:** Some stablecoin issuers have been tested in various environments by regulators, but newer issuers are more likely to experience smart contract vulnerabilities, which can result in losses. Centralized issuers can face potential insolvency if the collateral backing the stablecoin loses value unexpectedly or if the collateral does not have sufficient market liquidity for redemptions. This is a greater risk for stablecoins that are crypto-collateralized or algorithmic.
- **Large energy consumers:** Blockchain energy consumption may raise sustainability issues, although some of this risk is mitigated as certain blockchains have moved from a proof-of-work to a, typically less energy intensive, proof-of-stake platform.¹²

Stablecoins are likely to continue to evolve within the financial landscape in the years ahead. By understanding their fundamentals and potential risks and benefits, investors can be better informed about challenges and opportunities in this fast-changing landscape.

12. Proof-of-work and proof-of-stake are consensus mechanisms used to validate transactions and support network security.
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Digital assets are not a physical currency, nor legal tender. Investors must have the financial ability, sophistication/experience and willingness to bear the risks of an investment, and a potential total loss of their investment. An investor could lose all or a substantial portion of his/her investment. Digital assets have limited operating history or performance. Digital Assets are sometimes exchanged for U.S. dollars or other currencies around the world, but they are not backed or supported by any government or central bank. Their value is completely derived by market forces of supply and demand, and they are more volatile than traditional fiat currencies.

Cash alternatives typically offer lower rates of return than longer-term equity or fixed-income securities and provide a level of liquidity and price stability generally not available to these investments. Some examples of cash alternatives include: Bank certificates of deposit; bank money market accounts; bankers' acceptances, federal agency short-term securities, money market mutual funds, Treasury bills, ultra-short bond mutual funds or exchange-traded funds and variable rate demand notes. Each type of cash alternatives has advantages and disadvantages which should be discussed with your financial advisor before investing.

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