How Stablecoins Will Transform Banking

Charles W. Calomiris
Columbia University,
Heritage Foundation,
and NBER

Banks are losing market share to Fintech in core businesses of lending and payments

- Personal loans originations and outstandings show trending FinTech share (reflecting efficiency gains from a combination of physical costs and information costs to originating loans in new ways).
- Similar rapid growth in new payments processors, as well as whole new payments network technologies.
- Stable coin (outstandings now at around $200 billion) is clearly the most interesting of these in the long term, because of its great promise for efficiency, inclusion, security, and reduced systemic risk, and because it is a realistic alternative for payment *accounts*).
- Payments *accounts* vs. Bitcoin: stable value is necessary feature of where we keep our liquid balances.

Unbundles of Joy (no social cost from cream skimming)

- Bundling increased in 1980s and 1990s. But now a reversal, as FinTech entrants specialize in lending or payments, (and not underwriting, asset mgt, etc.).
- Cons of bundling loans and deposits (which have always existed):
  - Lack of managerial focus
  - Costs of organizational complexity (multiplied by regulatory costs)
  - Agency cost inefficiencies due to internal incentives to support losers
- Pros of bundling loans and deposits
  - Difficulty finding external funding sources (physical and/or information costs)
  - Synergies of loans and deposits: stories about asymmetric information processing of loans (Calomiris-Kahn, or Mester-Nakamura)
- Technological change lowers information costs and physical costs: **Loan intermediation doesn't need deposits!**
  - OakNorth SME lending by scraping internet to anticipate problems.
  - Rishabh (2025) on effects of open banking
  - Lenders to the unbanked or underbanked that overcome various information or transaction cost barriers, especially for smaller dollar loans.
  - Ease of accessing market funding to substitute for deposits.

Details on FinTech (and Stablecoin) Gains

- Lower physical costs of connecting customers and servers (no branch overhead), which is especially helpful for *small* lending and clearing transactions.
- Allows payments transactions to be finalized faster and at lower cost.
- Products can be more customized to particular needs. (For example, paycheck deposits or advanced access to wages for low-income people is now possible as an alternative to overdrafts or payday lending)
- Improved information processing lowers information costs for lending. For example, RiskView uses new kinds of information (not just FICO scores). FinTechs reduce language barriers, finds new ways to promote trust for customers (free mortgage counseling), which is especially relevant for financial inclusion.
- Unbundling also reduces systemic risk. Loan losses don't affect payments system. Payments (withdrawals of deposits) don't affect cost of lending.
- Future: Blockchain network security advantages (network hacking reductions), product richness (e.g., messaging), further gains from higher speed finality, further reductions in systemic risk associated with unbundling.

Chartered Stable Coins

- Stable coins today are operating as shadow banks, but legislation is coming.
- They evolved from preexisting familiar models (essentially money market mutual funds), to offer redemption on demand, but without clear and credible accounting. Tether is the prominent example.
- This is probably not the right long-run model (economically, or politically).
- A better approach would result if:
  - Reserve holdings were transparent and credible, and algorithms were transparent and credible, and committed to avoiding criminal activities.
  - Structures avoided risks of unpredictable regulation (e.g., deemed deposits).
  - If redemption were not needed to ensure stability of value (this avoids run risks), by committing to actions in secondary market for coins, and that may only be possible for unbundled stable coin provider.

  $\Rightarrow$Make stable coins a clear non-debt claim (to avoid runs, redemption risks, regulation risk that it will be deemed a deposit), and use an optional national or state charter to ensure credibility of reserves and algorithms, and low cost of supervision and licensing.

Chartered Stable Coins (cont'd)

- Stable coins could be issued by OCC national banks that have no risky assets such as loans, with claims that are only common equity and perpetual preferred stock (which would be held by the coin holders). (Charter is an option, not a requirement.)
- No redemption rights mandated, so no runs. Instead, algorithmic commitment to buy at 0.99 and sell at 1.01.
- Algorithmic commitments to only engage in legal transactions.
- Reserves monitored by OCC examiners. No need to require 100% reserves (intangible assets associated with fee cash flows could lead to riskless or nearly riskless fractional reserve banking).
- Blockchain clearing at high speed, resilient network.
- Failure to honor purchase and sale algorithm could produce automatic restructuring, no illiquidity problems for coin holders.
- No systemic consequences of a failure (no asset sales or loan contraction, or payment network spillovers).

Incumbent Potential Losers Hate It But…

- To preserve their market shares in loans and deposits, big banks have opposed FinTech claiming it is all too risky, or try to have it regulated under the same (high-cost) regime as they face (including CRA, which does not apply to non-depository banks).
- Fed Board viewed its centralized payment system as key to its power, and has always been the arch defender of the largest banks (seeing its power as tied to theirs). But they just have withdrawn their guidance on stable coins!
- **Politicians are about to change course and allow stable coin chartering at state and national level, for banks and nonbanks.**

Near-Term Future of Stable Coins

Stable Coins and Networks

- How will competition proceed?
- Tether has a big first-mover advantage but two competitors are promising: Circle, and Global Dollar Network.
- Preexisting network advantage of Tether is non-trivial (bound up with Ethereum and Bitcoin on their block chains).
- Global Dollar Network has most obvious competitive path forward to bring retailers into their network and create the scale to oppose Tether.
- It could be helpful to clarify some regulations around now (like future common use regs) to facilitate the building of “rails.”

Distant Future

Stable Coin Units of Account

- Blockchain preserves transaction records, which can be used to observe consumption bundles.
- These can be used to define optimal (utility maximizing) units of account that are superior to the dollar (Fisher, Friedman, Hall)
- How many? Mundell optimal currency zones.
  - A national version and regional or even local versions (tradeoffs).
  - Representative agent vs. heterogenous agents when defining bundle.
- How to construct reserves for currency exchanges?
  - Tokenization of IOUs by local enterprises.
  - Beta optimization to span with small number (~1000) items.