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Stablecoins - RBI Deputy Governor Cautions and Highlights Risks

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INTRODUCTION

In today's economic environment, marked by rapid technological advancement, multiple modes of payment continue to evolve such as electronic payments, UPI and digital wallets. Among these, cryptocurrency has emerged as one of the most widely discussed and debated forms of payment or virtual digital asset[1]. The use case of stable coins has been on the rise and countries such as United States of America have gone further and accorded statutory recognition[2]. In India, the Cryptocurrency, including stablecoins, are not per se regarded illegal, however the regulatory system has not been encouraging as can be realised from the high tax regime as well as stringent disclosure and compliance requirements.

Ever since its birth, cryptocurrencies have been one of the most discussed and debated topics with extreme and polarised views. Since its inception, they have experienced extreme volatility concerning their value unlike any other 'asset' class. Another controversial aspect concerning cryptocurrency has been the ambiguity or lack of transparency to the very basis of deriving its value. The proponents of cryptocurrency have always attempted to present a case for it to be treated as valid legal tender, more so relying on the technological backbone of Blockchain.

Recently, the Deputy Governor of the Reserve Bank of India – Mr. Rabi Sankar, delivered a keynote address on stablecoins[3], discussing their potential, associated risks, and prospects as valid legal tender in India.

STABLECOINS AND WHAT MAKES IT DISTINCT

Stablecoins are a type of cryptocurrency whose value is pegged to another asset, such as a fiat currency like the U.S. dollar or gold, to maintain a stable price. The primary goal of stablecoins is to provide an alternative to the high volatility of popular cryptocurrencies like Bitcoin, which can make these digital assets less suitable for common transactions[4]. Issuance of a stablecoin can be either centralised or decentralized in nature, while the supply of a stablecoin can rely on some form of reserves in either real world assets or cryptocurrencies to sustain the peg, or can be controlled by an algorithm or formula[5]. There are stablecoins which are fiat or crypto backed apart from algorithmic stablecoins[6] and commodity backed ones. Stablecoins are seen as a bridge between existing way of monetary transactions and the cryptocurrencies by providing an element of predictability backed by technological adroitness, provides faster, cheaper and more efficient cross-border payments and promotes financial inclusion.

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1 As defined under Income Tax Act, 1961

2 Guiding and Establishing National Innovation for U.S. Stablecoins Act - GENIUS Act

3 Link for the keynote address: https://website.rbi.org.in/web/rbi/-/speeches-interview/stablecoins-do-they-have-a-role-in-the-financial-system

4 https://www.coinbase.com/en-in/learn/crypto-basics/what-is-a-stablecoin

5 https://www.hsbc.co.in/wealth/insights/learn-to-invest/start-investing/stablecoins-in-a-nutshell/

6 https://zebpay.com/in/blog/what-is-a-stablecoin

RISKS ASSOCIATED WITH STABLECOINS

Before analyzing the risks associated with stablecoins, it is important to recognize that the anticipated benefits are not necessarily significant. The advantages cited can largely be achieved through existing, formal payment channels, rather than relying on stablecoins.

Furthermore, Mr. Rabi Sankar, in his address, noted that, in addition to the typical risks associated with cryptocurrencies—such as being unregulated and potentially used for facilitating illicit transactions, stablecoins also carry risks such as **(a)** Reduction in demand for local currency; **(b)** Potential to undermine RBIs ability to control money supply and interest rate; **(c)** Challenges in managing capital flow; **(d)** Impact on banks' role as primary intermediaries between savers and investors; and **(e)** Loss of Seigniorage[7].

He also highlighted that cryptocurrencies have no intrinsic value and that they are not backed by a promise to pay, as they have no issuer. Since they do not meet the basic attributes of money, they are not money. In fact, since they do not have any underlying cash flow, they are not financial assets as well, or, for that matter, any asset at all.

He noted that widespread adoption of stablecoins would undermine central banks' ability to control money supply and interest rates. '*If both an official currency and a crypto asset are used for pricing goods and services, domestic prices could become highly unstable due to the inherent volatility of the crypto asset.*' (IMF-FSB 2023). If residents increasingly hold or transact stablecoins, changes in domestic policy rates may have limited influence on economic decisions, weakening the effectiveness of monetary policy.

As evident from the above, the risks associated with stablecoins far outweigh their potential perceived benefits to the economy. Notably, each of the risks outlined has the potential to destabilize the financial system, which represents a serious concern.

It was observed that the baseline framework established by the Financial Stability Board to regulate global stablecoins has not effectively mitigated the major risks associated with them. Furthermore, the introduction of stablecoins in India can only be considered within the context of the domestic financial ecosystem, with appropriate safeguards to protect the payments landscape. The RBI Deputy Governor emphasised the importance of faith in the national currency, safeguard monetary sovereignty apart from promoting CBDC[8]. He did not see any need to bypass the existing regulatory system and emphasized that, given the serious risks posed by stablecoins, their introduction in India currently lacks a purpose which isn't already served by the national currency.

[7] Seigniorage is the profit a government earns from issuing currency, calculated as the difference between the face value of money (notes, coins) and the cost to produce it.
[8] Central Bank Digital Currency.

Conclusion

Mr. Shankar's views reflect the cautionary stance adopted by the RBI from time to time wherein it has highlighted the risks associated with cryptocurrencies and stablecoins. The approach appears to be not against digitisation but rather usage of technology to promote the fiat currency, in the form of CBDC.

His views, to a large extent, reflects RBI's perspective on this subject and perhaps put to rest any further interpretational dichotomy from a regulatory point of view in India.

While outlining the disadvantages of cryptocurrencies, Mr. Rabi Sankar acknowledged the innovative potential of technologies such as blockchain and tokenization, particularly their utility in cross-border transactions. However, the introduction of stablecoins has been avoided because they do not address any significant gaps in the financial ecosystem.

That said, the economic and technological landscape is constantly evolving, including advancements in blockchain technology and its various use cases. The regulatory system has been reshaping progressively so as to be relevant and abreast with the changing times. Though the country is embracing new age laws, presently it would be difficult to comment on any compelling need to regularise stablecoins, or other cryptocurrency. If that ever happens, one can expect it in a different avatar with adequate guardrails.

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