



Introduction to Stablecoins

What is a Stablecoin?

Stablecoins are a type of cryptocurrency whose value is pegged to a more traditional asset, such as the U.S. dollar or the Euro, and whose value is considered stable with respect to that asset. This means stablecoins are less volatile than conventional cryptocurrency, yet they remain widely accessible, affordable and easily transmittable, making them a valuable tool for businesses.

Background

Since its inception, cryptocurrency has always been substantially more volatile than other more traditional assets, such as the U.S. dollar or the Euro. This volatility has presented risk for companies accustomed to dealing in these more traditional assets and made it challenging for them to enter the crypto space. Stablecoins were developed to address this challenge and make cryptocurrency more accessible to the risk-averse business world. The first stablecoin hit the market in 2014, a full year before the launch of [Ethereum](#). Within a few short years, however, Ethereum had matured to be the platform of choice for stablecoins. In fact, according to [a report from ConsenSys](#), by January, 2021 almost **three-quarters** of all stablecoins were being issued on the Ethereum blockchain.

Stablecoins are pegged to more traditional assets and are considered stable with respect to those assets. As a result, their values fluctuate less than traditional cryptocurrency, a big plus for businesses. Stablecoins offer two key guarantees: the party issuing them is on the hook to mint and buy back coins at the price they were issued (or very close to it), and the issuing party has the assets needed to support this commitment, thus ensuring that any and all coins can be bought back whenever needed. This security net makes stablecoins an attractive crypto option for the business world.

Stablecoins can be backed by a few different sources, including fiat currency (traditional currency backed by the government that issued it), precious metals, algorithmic functions and even other cryptocurrencies. Each backing source carries different risk levels, with those linked to fiat currencies generally considered on the more stable side, as they're directly tied to a country's centralized financial system. On the riskier side of the stablecoin spectrum are those backed by other cryptocurrencies.

QUICK TAKEAWAYS



Stablecoins are a class of cryptocurrency whose value is pegged to a more traditional asset, such as the U.S. dollar, and whose value is considered stable with respect to that pegged asset. As a result, stablecoins are less volatile than traditional crypto options.

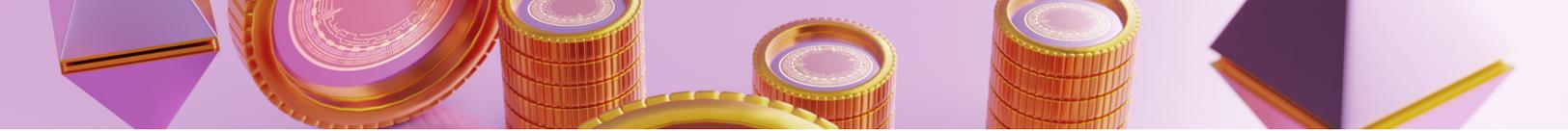


Stablecoins can be backed by a few different assets, including fiat currency, precious metals, other cryptocurrencies and even algorithmic functions. The type of backing has a direct influence on the risk factor of the stablecoin.



Stablecoins offer an attractive crypto option for businesses as they are more stable than traditional cryptocurrencies. However, they are not risk free and regulation in the space is still in its infancy.





In many of these cases, the backing is purposely padded to account for volatility, meaning the crypto is worth significantly more than the stablecoin, thus providing a cushion in case of price drops.

Precious metals, such as gold, are another common backing option, and some stablecoins even use computer algorithms to help keep prices steady. These algorithms work by adjusting token supply to balance out price changes. However, this approach is deemed riskier than others and many in the space don't consider these coins to be true stablecoins as they're not anchored to existing assets.

Stablecoins are often utilized in [Decentralized Finance \(DeFi\)](#), a growing category of financial applications that run on Ethereum and aim to democratize finance by cutting out banks, credit unions and other fee-carrying middlemen. However, they offer significant advantages to any business looking to utilize digital currency. Their overall stability is the top selling point for businesses. If stablecoins can maintain the peg with the given asset, they can be considered equivalent to the stable asset while being more convenient to transact with. With minimal volatility yet high accessibility, stablecoins provide a way to reap the benefits of decentralized finance and digital currency, but with less risk.

That said, it's incorrect to assume that stablecoins carry no risk. They can still crash, and some have gone so far as to call their name a misnomer. Indeed, the "stable" in stablecoin refers only to stability with respect to the pegged asset - it doesn't imply any stability of the pegged asset itself. For example, if the U.S. dollar were to crash, any stablecoin pegged to it would crash as well.

There is also currently no concrete way to verify that parties issuing stablecoins truly have the assets available to back them up, and some providers have even been dinged for their lack of transparency on this issue. Additionally, despite increased scrutiny as of late, the space still lacks organized frameworks and regulation, which poses a potential hurdle for many businesses. Finally, because they were created to be stable, stablecoins don't provide the same investment opportunity as other cryptocurrencies, as values aren't likely to skyrocket.

In sum, while stablecoins offer some key benefits for businesses looking to operate in digital finance, they are not risk free and regulation efforts in the space are still in their early stages. However, it's clear that there is a significant opportunity for stablecoins to disrupt the future of banking and our global financial services system as we know it, and forward-looking businesses should keep a close eye on the space.

HOW DO I FIND OUT MORE?



Read: [The Ethereum Foundation's stablecoin overview](#)



Peruse: [CoinDek's article, What is a Stablecoin?](#)

[View file on web page](#)



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To learn more about joining the EEA, reach out to james.harsh@entethalliance.org or visit <https://entethalliance.org/become-a-member/>.

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