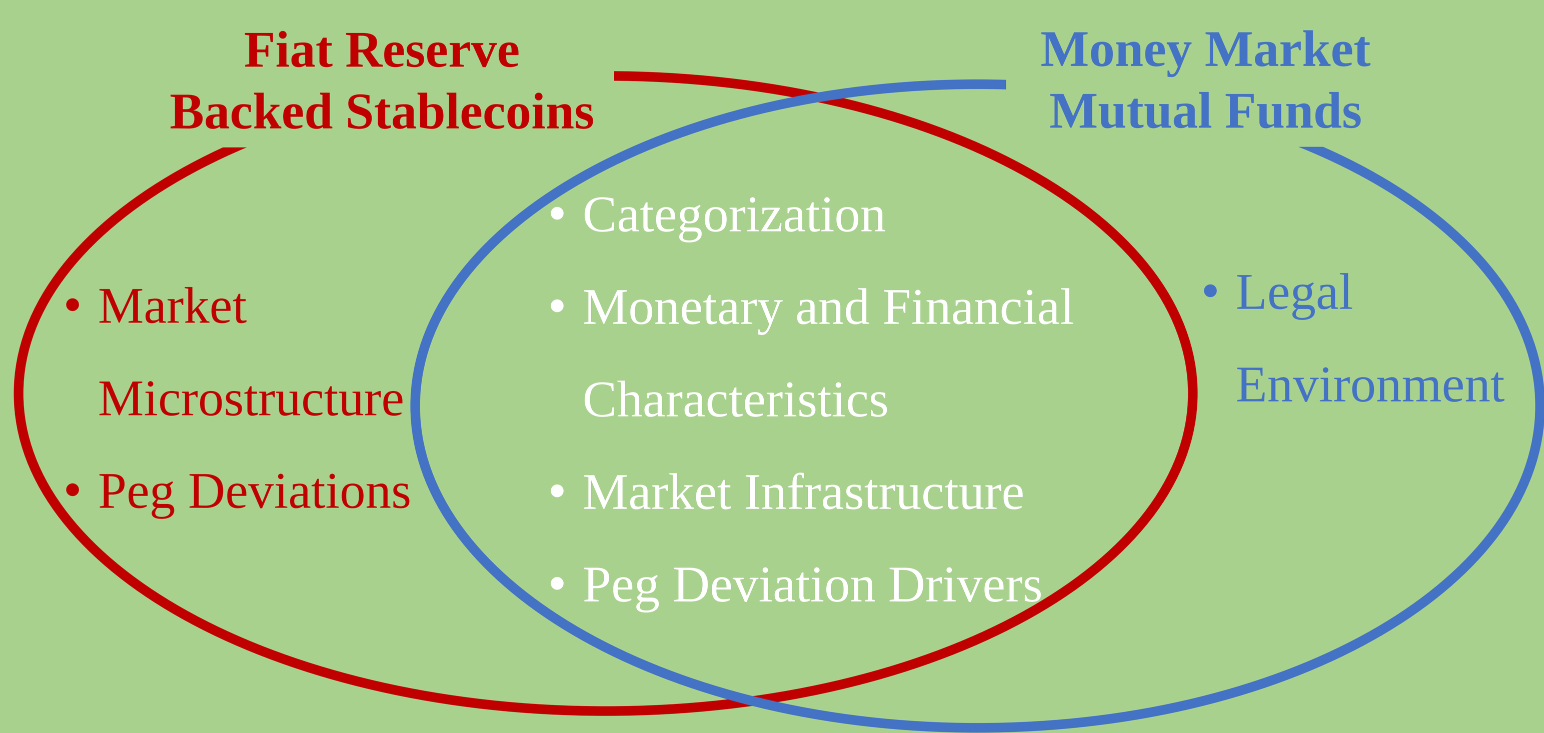
Are Stablecoins the Money Market Mutual Funds of the Future?

Nico Oefele, Dirk G. Baur, Lee A. Smales

University of Western Australia

Graphical Abstract



Objectives

Qualitative comparison of five features:

1. Categorization
2. Market infrastructure
3. Market microstructure
4. Monetary and financial characteristics
5. Legal environment

Empirical comparison of two features:

6. Peg deviations
7. Peg deviation drivers

NICO OEFELE

↑

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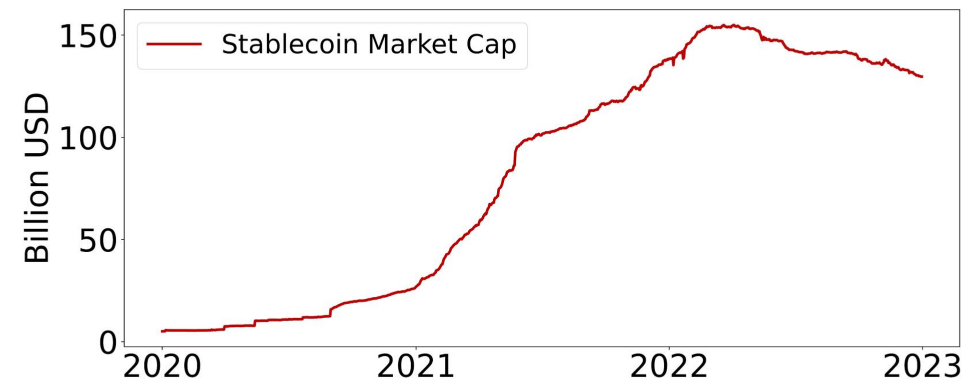
ARE THEY?

Motivation

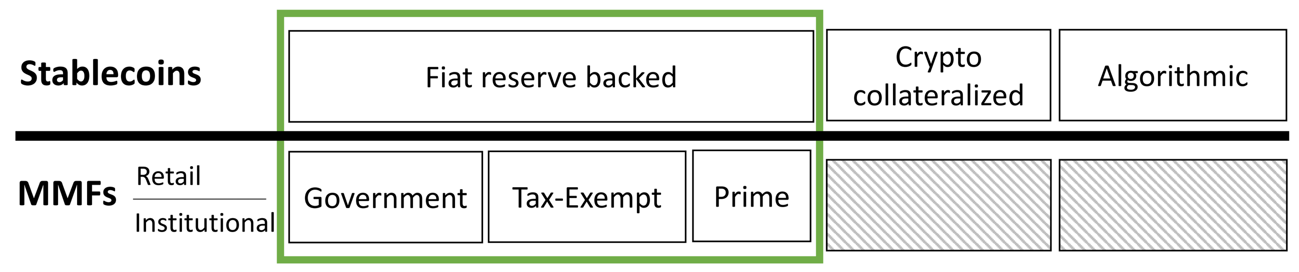
"I have no intention to ban them [stablecoins], but, stablecoins are like money market funds, they're like bank deposits, but they're, to some extent, outside the regulatory perimeter and it's appropriate that they be regulated […] same activity, same regulation."

Jerome Powell (2021)

Testimony before the House Financial Services Committee

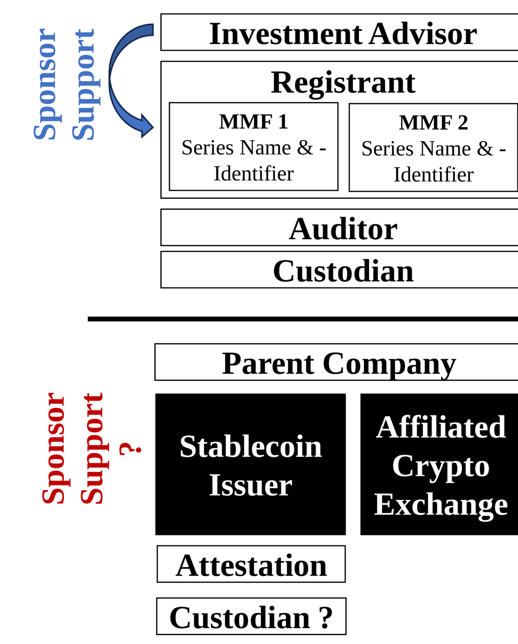


Categorization



- Stablecoins can be categorized using MMF frameworks.
- Only fiat reserve backed (FRB) stablecoins are linked to the money market but do not distinguish between retail and institutional investors.

Market infrastructure



MMFs: Issued by registrants and backed by investment advisors (sponsors).

The separation of funds and management is a defining characteristic of mutual funds.

FRB stablecoins: Exhibit significant heterogeneity, based on the issuer's location.

Affiliated exchanges enable indirect sponsor support (see microstructure).

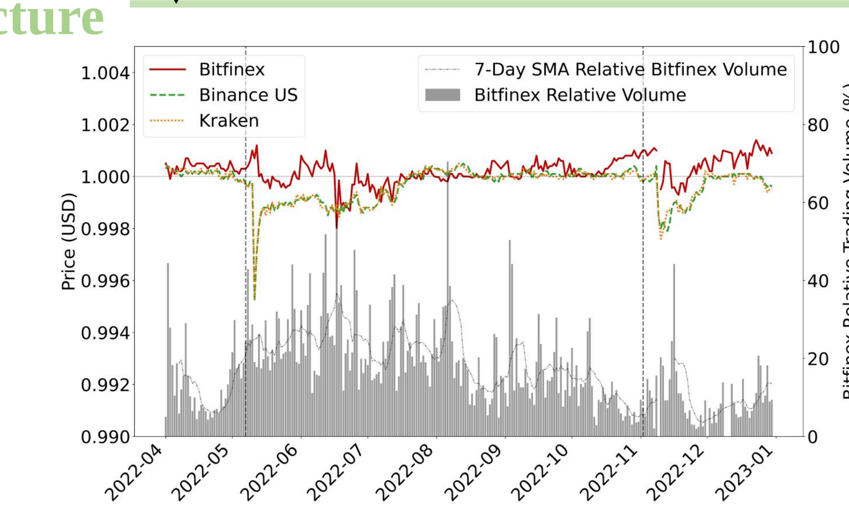
Monetary and financial characteristics

MMFs: Considered broad money under the OECD definition. The contractual obligation to allow daily redemptions and their regulatory treatment as marketable securities qualify them as financial assets.

FRB stablecoins: Meet the IAS 32 definition of financial assets. Are they truly money-like? → *LET'S DISCUSS!*

Market microstructure

Secondary market is distinct for FRB stablecoins. The figure highlights elevated Tether prices on its affiliated exchange, Bitfinex, during crisis periods.



Legal environment

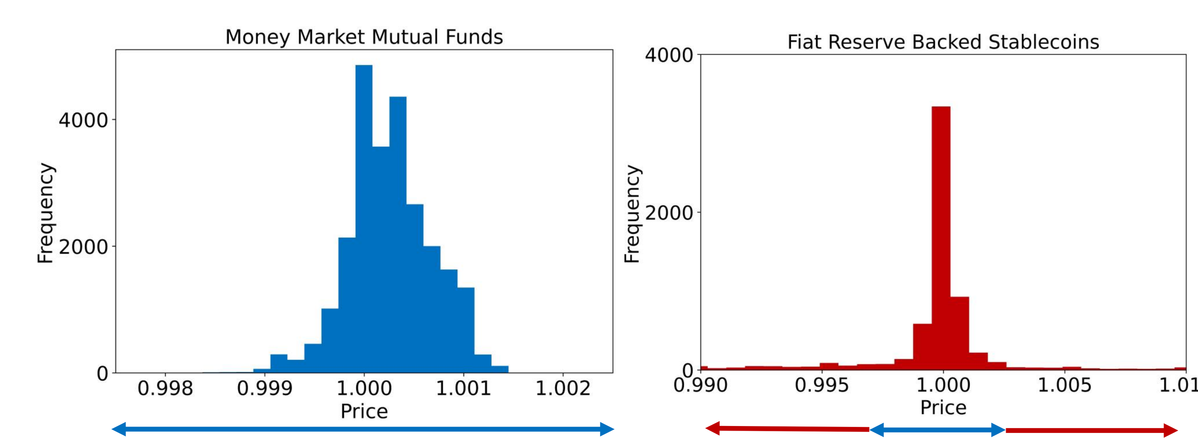
MMFs: Regulated by the SEC under the Investment Company Act of 1940 but are not classified as deposits under the Glass-Steagall Act of 1933.

FRB stablecoins: Remain largely unregulated, with an ambiguous relationship between issuer and holder.

What happens if an FRB stablecoin issuer goes bankrupt? → *LET'S DISCUSS!*

Peg deviations

15% of price observations for FRB stablecoins are not within $0.0025 of par.



Peg deviation drivers

$$\boldsymbol{Peg\ Deviation_t} = \alpha + \beta_1 Macroeconomic_t + \beta_2 CryptoMarket_t + \beta_3 GlobalRisk\&Uncertainty_t + \beta_4 Size_t + \varepsilon_t$$

- Increasing **geopolitical risk** (-0.92***) and **economic policy uncertainty** (-0.39***) negatively affect MMF peg deviations.
- **Size**: Larger MMFs (0.27***) and stablecoins (1.7*) experience less downward peg deviations.
- Increasing **inflation expectations** is associated with decreasing prices of both instruments. Monetary theory explains negative effect on MMF peg deviations (-1.05***). Secondary market pricing mechanism. and opportunity cost of holding a non-yield financial assets explain negative effect on FRB peg deviations (-9.66***).
- Unlike short-term interest rates, FRB stablecoins are sensitive to **inflation expectations** regardless of their size (-24.76***).

Conclusion

FRB stablecoins have the potential to become the MMFs of the future if crypto markets continue to grow as an asset class.

While significant differences continue to persist, FRB stablecoins possess many characteristics resembling MMFs. The decreasing disparities observed for the three largest FRB stablecoins suggest that they become more like MMFs with increasing market capitalization. The potential separation of stablecoin issuers and stablecoins through regulation could help protect investors from losses in the event of bankruptcies.