Fidelity DIGITAL ASSETS®

Stablecoins Explained

Part One: Breaking Down the Basics

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Introduction

This piece is the first of a three-part series, "Stablecoins Explained," which aims to provide readers with a fundamental understanding of the increasingly popular digital asset category, stablecoins. This primer will focus primarily on **fiat-backed stablecoins**, the market's most popular stablecoin type.

Key takeaways from this report include:

- What stablecoins are and how they function at a fundamental level
- Use cases for stablecoins and market challenges users seek to address
- Collateralization mechanisms
- Potential opportunities and advantages
- Notable risks and additional considerations

What Is a Stablecoin?

Stablecoins are a type of digital asset whose value can be pegged to another currency, commodity, or financial instrument—most often the U.S. dollar.[1] This peg is maintained through reserves of dollars, other digital assets, or a mix of both.

Stablecoins are frequently used as a hedge against digital asset market volatility while still offering the speed, privacy, and security of blockchain technology. Although fiat-backed stablecoins are the most common and widely used option, other variations such as algorithmic, crypto-collateralized, and commodity-collateralized stablecoins also exist.

	Stablecoins	Traditional Cryptocurrencies
Volatility	Low or near zero	Can be extremely high
Monetary Policy	Minting and burning based on demand	Determined by the blockchain protocol
Collateralization	Backed by assets in reserves or algorithmically	Not backed by any physical reserves
Degree of centralization	Most are controlled by a central issuer	Most aim to be decentralized

Source: Fidelity Digital Assets® Research

Use Cases for Stablecoins

By utilizing blockchain technology to bring dollars on-chain, stablecoins seek to capitalize on faster settlement, lower fees, enhanced privacy, greater censorship resistance to authoritarian or corrupt governments, and more robust security for users compared to traditional payment rails. This can lower the frictions and inefficiencies associated with those traditional payment rails, creating a more accessible, streamlined, and improved medium for users to transact digitally.

Several of the most common use cases for stablecoins include:

Relative Store of Value

One of the most common uses is as a near-term store of value. Compared to their historically volatile counterparts whose price can fluctuate drastically in either direction, stablecoins can offer a more reliable short-term store of value relative to other digital assets. This is because stablecoins seek to maintain the value of the underlying asset they are pegged to.

For example, the value of fiat-collateralized stablecoins is pegged 1:1 to the U.S. dollar or other types of fiat currency. This is why they are often leveraged by those in geographic regions subject to currency devaluation, government corruption, or a lack of adequate banking infrastructure. Stablecoins may provide residents of affected regions with the ability to store wealth in U.S. dollars without accessing a bank account or receiving permission from any authority to preserve their wealth in a digital wallet.

Medium of Exchange

Stablecoins can also be utilized as a medium of exchange. This means they can be used for global payments, transactions, and remittances without being subject to the significant price fluctuations native to other types of digital assets. This can make stablecoins more suitable for everyday purchases or cross-border payments.

DeFi Usage

More experienced digital asset users may utilize stablecoins to facilitate activity on an array of decentralized finance (DeFi) applications. Stablecoins play a crucial role in different DeFi niches such as liquidity provision, lending and borrowing markets, decentralized trading, swapping, and yield farming. Put simply, they provide a stable asset for collateralizing loans, borrowing funds, and earning yield or interest within the DeFi ecosystem.

Volatility Hedge

Traditional digital assets such as bitcoin and ether have historically been subject to high degrees of volatility, rendering them largely impractical for everyday use as a medium of exchange in their current state. However, stablecoins aim to bridge the gap between the volatility of traditional digital assets and the stability of fiat currencies.

Stablecoins are inherently designed to have a constant value relative to the asset they are pegged to. This offers a means for users to hedge against less predictable price swings seen in the broader digital asset market.

How Stablecoins Work

Fiat-Collateralized

As previously mentioned, fiat-collateralized stablecoins are the most common type of stablecoin and are backed by fiat currencies such as U.S. dollars or euros. This means that for every unit of stablecoin in circulation, the issuer holds an equivalent amount of the underlying asset in reserve. For example, Tether (USDT) and USD Coin (USDC) are two of the largest fiat-collateralized stablecoins, and each token issued is backed by $1 held in reserve by their respective issuers, Tether and Circle.

The advantages of fiat-collateralized stablecoins include their relative ease to understand and implement compared to other stablecoin types. Conversely, disadvantages include users' reliance on the issuer's trustworthiness and transparency to maintain the reserve backing, requiring regular audits and attestations to ensure claimed reserves are held in full.

While fiat-collateralized stablecoins can be backed by any fiat currency, it is important to note that 99% are dollar-denominated. Overall, stablecoins have seen significant adoption over recent years, with their total market cap (including all collateralization types) surpassing $308 billion as of December 19, 2025.

Stablecoins are primarily used in digital asset trading on exchanges. This use case is driven by their role as a stable medium of exchange, a fiat alternative in global markets, and a key liquidity tool for both retail and institutional traders. As of December 19, 2025, Tether (USDT) alone has a seven-day moving average over $75 billion in spot trading volume across major exchanges—a figure that may grow higher when considering activity from other exchanges that are not accounted for.[2] Additionally, USDT has facilitated over $42 billion in average daily on-chain transfer volume over the same period.

For instance, in Brazil, stablecoins now account for over 90% of digital asset flows, and the country received $318.8 billion in digital asset value between July 2024 and June 2025—a 109.9% year-over-year increase. Additionally, stablecoin purchases made up over half of all exchange purchases across the Colombian Peso, the Argentine Peso, and the Brazilian Real pairs during this period, according to "The 2025 Geography of Crypto Report" published by Chainalysis in October 2025.

The prevalence of stablecoins in Latin America underscores the region's struggle with inflation, currency instability, and capital restrictions—factors that push households and businesses toward U.S. dollar-linked assets for savings, remittances, and everyday transactions. In practice, stablecoins function as an alternative financial infrastructure, offering both a potential hedge against volatility and a practical payment mechanism where local currencies fail to deliver reliability.

Although the retail-focused use case has historically seen consistent growth, it is important to note that the most dominant applications for stablecoins likely lie in the realm of business-to-business (B2B) cross-border transactions. These international payments could be driving the majority of stablecoin adoption and usage in the region. Latin American adoption provides a noteworthy example of both retail and

commercial use cases. According to Fireblocks' "State of Stablecoins 2025" report, 71% of payment providers, banks, and fintechs in Latin America use stablecoins for cross-border payments. Moreover, every respondent in the region is either live, piloting, or planning a stablecoin payments strategy.

A growing number of companies worldwide are ready to accept stablecoins, with 90% of Fireblocks' survey respondents already taking action: 49% actively use stablecoins for payments, 23% are running pilots, and 18% are planning adoption. Only 10% remain undecided. This signals broad institutional momentum as this data underscores the growing adoption and dominance of USD-denominated stablecoins across various sectors and regions.

Crypto-Collateralized

Crypto-collateralized stablecoins are a less common type of stablecoin and are backed by other digital assets, such as bitcoin or ether. Their value is derived from their collateralization ratio, meaning the issuer holds a higher value of the backing digital asset than the value of the issued stablecoin (e.g., 150% collateralization).

MakerDAO is a decentralized autonomous organization and the issuer of DAI, the fifth largest stablecoin by market capitalization. DAI is a crypto-collateralized stablecoin that is backed by ether and other digital assets, while attempting to maintain a price of $1 per one DAI using smart contracts.

Crypto-collateralized stablecoins may have less reliance on centralized entities compared to fiat-backed options, but they do not come without their own risks. This includes their susceptibility to the volatility of the backing digital asset, potentially leading to de-pegging events if the collateral drops significantly in value over a short period of time.

Algorithmic

Algorithmic stablecoins leverage a more nuanced form of collateralization. These stablecoins use smart contracts and algorithms to maintain their price peg, automatically adjusting the supply of the stablecoin in response to price fluctuations resulting from changes in supply and demand of the token. If the price goes above the peg, the algorithm mints more tokens, which increases supply and drives the price down. If the inverse occurs and the price falls below the peg, the algorithm burns tokens, thereby reducing supply and pushing the price up.

TerraUSD (UST) was a prominent algorithmic stablecoin before losing its peg in May 2022, raising concerns over the reliability and viability of this mechanism. While proposed advantages may include higher degrees of decentralization and potential operational efficiencies relative to other mechanisms, the disadvantages include added complexity and greater reliance on the effectiveness of the underlying algorithm. Additionally, these stablecoins are prone to higher volatility compared to other types due to their reliance on market forces.

When a stablecoin loses its peg or "de-pegs," it means that the value of the stablecoin deviates significantly from the value of the asset it's pegged to. This can occur due to various reasons such as market conditions, liquidity issues, regulatory changes, or design flaws.

If a stablecoin's value collapses, users may lose trust in its stability, impacting its utility for transactions and as a store of value. Holders might rush to exit positions, seeking safety in more established assets or fiat

currencies. This can lead to a more acute market sell-off, causing a domino effect where the value of the stablecoin further declines.

During the Terra de-pegging incident, the algorithmic stablecoin TerraUSD (UST) and its sister token Luna experienced a significant de-pegging event. The value of UST and LUNA collapsed, wiping out almost $45 billion in market capitalization within a week.[3] This was due to a series of events including a sharp drop in UST deposits on the Anchor lending protocol. The collapse of UST and LUNA led to a loss of confidence in the entire Terra protocol, and eventually, the Terra blockchain was temporarily halted.[4]

In most instances, stablecoins can quickly regain their peg through mechanisms like increasing or decreasing the circulating supply. However, the situation with UST was an exception due to the scale of the de-pegging and the systemic issues involved.

It is important to note that the ability to uphold their peg is fundamental to the success and adoption of stablecoins. Therefore, risk management strategies and careful monitoring of market movements are crucial when engaging in trades involving stablecoins.

Commodity-Backed

Lastly—and perhaps most uncommon—are commodity-backed stablecoins. While less commercially popular, this type of coin does provide a way to tokenize commodities and bring ownership rights of them on-chain.

The most popular iteration of commodity-backed stablecoins by market cap is Pax Gold (PAXG), which is issued and held under the custody of Paxos Trust Company. It is not a traditional fiat-backed stablecoin like Tether (USDT) or USD Coin (USDC) but is instead an asset-backed token where each token represents one fine troy ounce of gold. The gold is stored in LBMA vaults in London, and owners of PAXG effectively own the underlying physical gold. It is a cost-effective way to gain exposure to investment-grade gold while benefiting from blockchain technology. Unlike typical stablecoins, PAXG derives its value from the actual asset (gold) rather than being pegged to a fiat currency.

Collateral Reserves, Backing, Attestations, and Regulation

Government-issued fiat currencies attempt to remain stable (have low volatility compared to other goods and other currencies) through the actions of controlling authorities like central banks. Stablecoins take advantage of the relative stability provided by central banks and the government to create reserves in government-backed fiat currencies such as the U.S. dollar. To monetize stablecoin reserves, some of the funds backing stablecoins are allocated to fixed-income securities such as short-term corporate debt and government-backed debt obligations that ensure the funds remain redeemable and adequately backed.

Transparency and regular audits are crucial for stablecoins to maintain user confidence, regardless of the peg stability mechanism. Stablecoin reserves are maintained by central entities that should regularly audit their capital reserves and work with regulators to ensure that the entities holding stablecoin reserves remain compliant. To buy stablecoins directly from the issuers, users must go through Know Your Customer (KYC) and Anti-Money Laundering (AML) checks like those on digital asset exchanges. Once in

circulation, anyone can send and receive stablecoins, although the central entity issuing them may have the power to freeze funds associated with certain addresses.

Numerous jurisdictions have designated regulatory authorities for issuers of stablecoins, mandating them to secure a license, register, or fulfill other requirements prior to and during the existence of the stablecoins. The purpose of these regulatory structures is to safeguard investors and users, guaranteeing that issuers of stablecoins adhere to the law. The regulatory landscape surrounding stablecoins is still evolving and as regulations develop, they might impact the functionality and adoption of different types of stablecoins.

Advantages and Opportunities

One of the most significant proposed advantages of stablecoins is their ability to inherit the stability of fiat currencies while still offering the speed, privacy, transparency, and security of blockchain technology, leading to potentially drastic efficiency improvements. Stablecoins' use as a payment mechanism could potentially lead to faster and more cost-effective transactions compared to those using traditional fiat currencies in the existing financial system.

Traditional banking transfers can take anywhere from three to five business days to fully process and settle, with longer settlement times and higher fees associated with larger payments or international transfers. The utilization of blockchain technology allows stablecoins to be settled significantly faster, with much lower fees, on a 24/7 basis, and from anywhere in the world. These efficiencies enable faster, more affordable cross-border payments and seamless conversion to fiat currencies on exchanges where available.

Stablecoins also provide users greater utility of their assets. On blockchain-based applications, stablecoin holders may have much more flexibility to facilitate activities, such as taking out loans backed by their stablecoins or taking out insurance to protect their digital assets on other applications. This utility enables them to more easily access a network of applications that offer higher yields than conventional savings accounts, further incentivizing users to hold stablecoins over their traditional fiat currency counterparts.

Lastly, it is important to consider liquidity when discussing stablecoin advantages. As of Q3 2025, Tether (USDT) accounts for over 82.5% of global stablecoin trading volume and is involved in 66% of stablecoin trades on centralized exchanges. More than 60% of spot digital asset trades include USDT pairs, and in DeFi, USDT appears in over 43% of stablecoin liquidity pools. This translates to a broad acceptance of stablecoins on trading platforms and underpins their appeal as being highly liquid.

Risks and Trade-Offs

While stablecoins have many proposed benefits, they do not come without their share of trade-offs. One such trade-off is counterparty risk to the issuer of the stablecoin. In other words, stablecoin issuers may not have the reserves they claim to have or may refuse to redeem tokens for their reserves.

A notable example of this type of risk came to light during Circle's USDC de-pegging incident resulting from the Silicon Valley Bank collapse. In March 2023, Silicon Valley Bank faced closure by regulators, with Circle having up to $3.3 billion of its USDC reserves at the bank. When news of the bank's

shutdown hit the market, concerns arose surrounding Circle's ability to meet its redemption requests for USDC. Fearing potential trouble accessing their funds, USDC holders rushed to sell their coins, driving the price down and breaking what was supposed to be the stable peg of 1:1 to about $0.88, a significant deviation.[5]

Tied to the counterparty risk associated with stablecoin issuers is the potential lack of transparency among their collateral reserves. As a result, stablecoin holders may not be able to verify the true collateral holdings of the issuer if they are a centralized entity. The frequency and type of reserve attestations vary among issuers. However, the lack of consistent transparency regarding existing reserves or collateral creates a reliance on a greater level of trust assumptions from users as they may not know whether the issuer holds sufficient assets. This centralization risk lends itself to further concerns surrounding censorship, as centralized issuers have the power to freeze or censor addresses at will or at the command of a higher authority.

Another challenge associated with the centralized structure of stablecoin issuers is the risk associated with third-party auditing and attestations. Centralized third-party auditors could make errors in their attestation reports or incorrectly report the value of the collateral in reserve, leading to additional reserve risk.

A knock-on effect of both counterparty risk and lack of full transparency into reserve holdings is the risk associated with stablecoins de-pegging in price from that of their underlying asset. This occurs when the market price of the stablecoin deviates significantly from its intended peg to the reference asset. For fiat-collateralized stablecoins, this can be caused by two potential scenarios. The first is a loss of trust in the issuer's ability or willingness to maintain the reserves. Alternatively, it could stem from the issuer possessing insufficient reserves to cover all outstanding coins in circulation.

Lastly is regulatory uncertainty, which can create challenges for businesses and users, potentially limiting innovation and hindering mainstream adoption. While recent developments point towards more tailored regulatory frameworks being codified into law, changes in regulations could impact their viability or usage in both the near and long term, potentially impacting their holders.

At this time, stablecoins are not insured by the Federal Deposit Insurance Corporation (FDIC) or protected by the Securities Investor Protection Corporation (SIPC). However, while they lack FDIC or SIPC coverage, stablecoins are arguably different instruments that warrant bespoke regulatory frameworks tailored to their unique characteristics.

Stablecoins, like any other digital asset, come with their share of risks and trade-offs. Ongoing regulatory and legislative developments are examples of this, however, guidance issued by regulators has helped shape existing frameworks. For instance, USDC is regulated by the NYDFS, one of the first U.S. regulators to issue guidance on stablecoin requirements and reserves. Similar regulatory developments abroad, such as the Markets in Crypto-Assets (MiCA) regulation enacted in the EU, have shared insights into the direction the U.S. has started to take.

In July 2025, the GENIUS Act passed Congress with bi-partisan support 308-122 in the House and 68-30 in the Senate. The GENIUS Act is the first piece of major federal legislation on digital assets to pass in the U.S. and was signed into law on July 18 by President Trump.

The law will take effect on the earlier of two dates: January 18, 2027, or 120 days after federal regulators issue all final regulations. Its implementation depends on a multi-step rulemaking process. First, agencies

will propose rules, each followed by a public comment period. After final rules are published, the Act's requirements—including strict reserve standards, disclosure obligations, and compliance measures—will become enforceable.

Key aspects of the bill include:

- The establishment of clear regulations for stablecoin issuers
- Federal and state-level supervision and oversight stipulations
- Reserve requirements
- Public disclosures of redemption policies and reserve attestations
- A regulatory classification specifying that permitted payment stablecoins are not considered securities under established securities laws

Stablecoins have their own unique potential benefits and considerations. Despite some of the risks stablecoins carry, their potential to transform the flow of dollars in a more frictionless, transparent, and cost-effective manner has proven to be a noble use case thus far. With the growing global demand for access to dollars driving the rise of stablecoin adoption and an increasing number of use cases, we believe the future of stablecoins is promising. We expect this global adoption trend to continue into the foreseeable future.

Conclusion

Stablecoins represent significant innovation in the digital asset landscape, offering a bridge between traditional finance systems and digital assets. By maintaining a stable value through various pegging mechanisms, stablecoins offer several potential use cases. Today, stablecoins are being used as a near-term store of value, a medium for day-to-day transactions, an aspiring hedge against volatility, and a currency for DeFi-based transactions. Looking ahead, it will be important for investors to consider the relevance of each use case against their own financial goals and needs alongside the coin's associated risks and potential advantages.

Interested in discussing the different use cases for stablecoins with our team?

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[5] CoinGecko, USDT vs. USDC: Which Stablecoin Should You Use?, March 2023.