

Stablecoin as a Financial Instrument and Stablecoin as a Payment Instrument: Implications for Regulation, Innovation, and Market Stability

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Abstract

Stablecoins have become an integral part of the digital asset ecosystem. Their rapid proliferation has positioned them as foundational tools in the digital finance sector. Yet, both regulatory and academic discourse continue to struggle with their dual nature. A clear distinction exists between the use of stablecoins as payment instruments and their function as financial instruments. As payment instruments, stablecoins primarily serve as mediums of exchange and stores of value, with emphasis on transaction speed, cost efficiency, and settlement. On the other hand, when considered as financial instruments, the value of a stablecoin lies in the economic benefits it offers, its ability to generate returns, and its role in facilitating investment and speculative activities within decentralised finance (DeFi) systems. This paper examines the differences between these roles and highlights their implications for policy and regulatory practice. Failure to recognize this dichotomy risks creating misaligned regulatory frameworks that could either stifle innovation in payments or inadequately address systemic risks in financial markets.

Keywords: Stablecoin, Cryptocurrency, Payment Instrument, Financial Instrument, Decentralized Finance (DeFi), Regulation, Monetary Policy.

1.1 Introduction

The US Securities & Exchange Commission defines a stablecoin as “ a type of crypto asset designed to maintain a stable value relative to a reference asset, such as USD or another fiat currency, or a commodity like gold, or a pool or basket of assets”¹. This definition emphasizes the central purpose of stablecoins, which is to reduce volatility by linking their value to reference assets on a one-for-one basis, making them distinct from other types of crypto-assets. In practice, stablecoins take different forms depending on what supports their value. Some are pegged to fiat currencies (known as fully reserved stablecoins), either directly or through equivalent reserves that may or may not be held by custodians. Others (Asset referenced) are tied to physical assets such

as commodities, securities, or real estate, while some are backed by other crypto-assets. There are also algorithmic stablecoins, which use programmed rules rather than asset reserves to maintain price stability².

Since their emergence in 2014, stablecoins have attained a pivotal stage in their development. Although they were initially adopted within digital asset markets primarily for trading and hedging purposes, their applications have expanded progressively. Increasingly, stablecoins are being deployed to enhance financial access and to provide a measure of stability in economies marked by volatility. The dominant models in circulation are US Dollar-pegged, fiat-backed variants. Their growing importance is not confined to their foundational role within cryptocurrency markets; instead, it also derives from their demonstrated capacity to address persistent inefficiencies in global payment and settlement systems. In this regard, stablecoins have evolved from serving as mere instruments of speculative trading to functioning as tools with wider utility in modern financial intermediation. This transformation has, in turn, drawn the interest of mainstream financial institutions, corporate actors, and regulatory authorities. As of July 2025, no fewer than 11 of the 25 leading global jurisdictions had instituted either comprehensive or partial regulatory frameworks to govern the operation of stablecoins³.

According to the IMF Crypto Asset Monitor, by the second quarter of 2025, the market value of stablecoins had surpassed a record \$230 billion⁴. Projections by EY-Parthenon suggest that by 2030, stablecoins could facilitate between 5 and 10 percent of global payment flows, with a potential value ranging from 2.1 trillion to 4.2 trillion dollars⁵.

Global regulatory bodies continue to struggle with appropriate classification frameworks. For instance, the European Union's Markets in Crypto-Assets (MiCA) regulation treats certain

stablecoins as “e-money tokens,” while U.S. regulators apply the Howey Test to determine whether a stablecoin constitutes a security or collective investment scheme. There are several risks associated with misclassifying complex financial instruments as straightforward payment tools. Stablecoins maintain their value by linking it to real-world assets like the US dollar, using one of three stabilisation methods, off-chain collateral, on-chain collateral, or algorithmic models. Understanding the specific mechanism is key to assessing the risk of a loss of confidence, especially during market stress when a break in the peg could trigger panic and withdrawals ⁶.

The rapid growth of stablecoins has sparked significant debate regarding their dual role within the financial system, as both financial instruments and payment instruments. While both functions are underpinned by their capacity to maintain a relatively stable value, the distinction between them is often blurred in theory and practice.

Following this introduction, Section Two examines the blurring boundaries by exploring stablecoins both as financial instruments and as payment vehicles. Section Three then considers the regulatory implications of this dual character, while Section Four offers the conclusion.

2.1 Blurring Boundaries

At the 2025 Summer Davos convened by the World Economic Forum, Bo Li, Deputy Managing Director of the International Monetary Fund, underscored the persistent regulatory ambiguity surrounding stablecoins, particularly with respect to their classification within established monetary aggregates. He posed a foundational question, whether stablecoins should be considered money, and if so, whether they belong within existing categories such as M0 or M1, or warrant the creation of a new classification altogether ⁷. This inquiry highlights a broader conceptual and policy dilemma, of whether stablecoins should be integrated into traditional measures of the money

supply or treated as a distinct financial instrument requiring bespoke regulatory treatment. The resolution of this issue carries significant implications for the design of monetary policy, financial stability oversight, and cross-border regulatory coordination.

The ambiguity surrounding stablecoins lies in their capacity to function simultaneously as currency and asset. In practice, the boundary between these roles is often porous and indistinct. But for policymakers, that distinction underpins how these instruments are governed, how risks are managed, and how consumers are protected.

2.2 Stablecoins as Payment Instruments

As mentioned, Stablecoins occupy a unique position within the digital asset ecosystem due to their design, which ensures price stability by pegging their value to fiat currencies, such as the US dollar. This feature enables them to function like traditional money, making them suitable for fast and low-cost cross-border transactions that are independent of conventional banking systems ⁸.

The primary function of stablecoins within the digital asset ecosystem is to serve as a means of payment, primarily due to their seamless operability across multiple blockchain networks ⁶. As payment instruments, stablecoins perform the core functions of money. They serve as a medium of exchange for remittances, merchant payments, and peer-to-peer transfers. They also act as a store of value, preserving purchasing power between receipt and expenditure. Furthermore, they function as a unit of account, with prices in crypto-native environments often denominated in stablecoins. From a technical standpoint, these tokens are built for high transaction throughput, low fees, and quick settlement. Blockchain platforms, such as Stellar and Solana, are commonly

chosen for their efficiency in processing payments, particularly in contexts where speed and cost are critical.

The relevance of stablecoins in payment systems goes beyond mere convenience. They offer a programmable and transnational alternative to legacy financial networks, which are often characterised by fragmentation, high transaction costs, and limited accessibility. Stablecoins present a viable solution to improve financial services for households and businesses. Their adoption could significantly reduce reliance on traditional intermediaries and enhance financial inclusion, particularly for underserved and unbanked populations ³.

Regulatory frameworks are beginning to respond to this evolution. The Guiding and Establishing National Innovation for U.S. Stablecoins (GENIUS) Act of 2025, enacted on 18 July 2025, represents the first comprehensive legislation in the United States focused on payment stablecoins. The Act aims to protect consumers, maintain financial stability, and promote transparency. It outlines the categories of institutions permitted to issue stablecoins, sets strict requirements for reserve management and redemption, and clarifies the legal classification of these instruments under securities, commodities, and banking regulations. The European Union's Markets in Crypto-Assets (MiCA) Regulation addresses the growing use of stablecoins as payment instruments by introducing a comprehensive legal and supervisory framework.

In summary, stablecoins are no longer peripheral innovations. They are becoming central to the future of payments, combining the liquidity and neutrality of fiat currency with the efficiency and programmability of blockchain technology. Their strategic adoption could reshape the financial landscape.

2.3 Stablecoins as Financial Instruments

Stablecoins have gradually evolved into a distinct category of financial instruments within the digital asset space. Their primary purpose is to mitigate the volatility commonly associated with cryptocurrencies and to preserve value in decentralised markets. Unlike regular cryptocurrencies, stablecoins are usually tied to fiat currencies or commodities, which allows investors to hold digital assets without necessarily converting them into traditional bank deposits ⁹.

While stablecoins are presented as payment instruments, they often function more like financial assets. The recently enacted GENIUS Act attempts to regulate this duality by prohibiting interest payments in exchange for lighter oversight. However, as Klein (2025) observes, crypto firms have already begun to exploit loopholes by rebranding interest as “rewards.” If left unaddressed, this regulatory gap could expose retail users to losses and pose broader financial risks. ¹⁰

Stablecoins also play a key role in both centralised exchanges and other DeFi platforms. They are commonly used in trading pairs, collateralised lending, and borrowing, forming an important part of the infrastructure of Crypto Asset Service Providers. Their use in smart contract-based systems enables them to support capital deployment, credit extension, and yield generation. These functions are comparable to those of traditional financial instruments such as money market funds and repurchase agreements ².

Stablecoins are increasingly being used as active financial instruments. They are involved in speculative strategies, arbitrage, and portfolio hedging, showing a shift from passive value storage to more dynamic financial roles. This shift introduces a range of risks, including credit risk from

issuers and borrowers, liquidity risk during depegging events, weaknesses in smart contract design, and broader systemic risks within the DeFi ecosystem ¹¹.

In economies where macroeconomic uncertainties persist, Stablecoins offer alternative investment options and tools for managing financial risk. Their relevance is increasing, especially as individuals and institutions seek ways to diversify portfolios and hedge against inflation, currency instability, and limited access to global markets. Understanding the financial nature of stablecoins is important for regulators, investors, and policymakers. Their evolving role calls for appropriate regulatory responses, informed investment decisions, and continuous monitoring to ensure financial stability and protect users.

Stablecoins should not be seen merely as digital versions of fiat currency. Stablecoins are actively used in liquidity pools, lending platforms, and staking arrangements. These activities provide them with the characteristics of short-term, income-generating assets, similar to interest-bearing instruments in conventional finance. They are versatile financial assets whose stability, liquidity, and programmability place them at the crossroads of traditional finance and emerging decentralised systems. Their continued development will shape the future of financial innovation and regulation.

3.1 Regulatory Implications

Regulatory approaches to stablecoins are evolving rapidly as policymakers and financial authorities respond to the growing significance of these assets in global finance. The central objective of these frameworks is to ensure the secure and reliable functioning of tokenised money

by establishing clear standards for reserve management, disclosure practices, compliance with anti-money laundering and know-your-customer provisions, and the licensing of issuers.

From 2023 onwards, several jurisdictions began to implement comprehensive regulatory regimes. The European Union led with the Markets in Crypto-Assets (MiCA) regulation, establishing clear rules for the issuance and operation of stablecoins. Comparable initiatives were introduced in Hong Kong, Japan, and Singapore, reflecting a wider international effort to safeguard financial stability. In the United States, the Senate enacted the Guiding and Establishing National Innovation for US Stablecoins (GENIUS) Act of 2025, which provides explicit requirements for reserves, stability mechanisms, and supervisory oversight.¹²

From a policy standpoint, stablecoins pose challenges in areas such as legal clarity, governance, AML and counter-terrorism financing compliance, cybersecurity, consumer protection, data privacy, and tax enforcement. Addressing these concerns requires coordinated regulatory responses and robust institutional frameworks¹³. The functional boundary between payment and financial instrument is rarely clear-cut. A single stablecoin, such as DAI or USDT, may be used for retail transactions and subsequently deployed in a liquidity pool, reflecting the fungibility inherent in blockchain-based assets. While this versatility is a technological feature, it presents significant challenges for regulatory classification.

Despite their intended design, stablecoins have yet to achieve consistent price stability, raising questions about their reliability. As Bag (2023) notes, ongoing monitoring and proactive policy interventions remain essential to address emerging risks and maintain confidence in their use.¹⁴

A critical shift occurs when the rationale for holding a stablecoin moves from transactional purposes to financial returns. This change alters the risk profile, stablecoins held primarily for payments mainly affect users and payment system infrastructure, whereas those held for financial purposes introduce broader risks to lenders, borrowers, and protocol operators, increasing the potential for systemic contagion.

In this context, the Securities and Exchange Commission must ensure that stablecoins comply with securities laws, particularly when used in investment arrangements. At the same time, monetary authorities remain concerned with the implications for monetary policy and the potential risks to financial stability posed to the traditional banking system.

5. Conclusion

The next chapter of stablecoin development will be shaped by regulation. While market forces and economic incentives have driven adoption, especially for trading, hedging, and financial access, regulatory frameworks are now emerging globally. These rules will influence how stablecoins are issued, what currencies they are backed by, and the compliance tools required. As international bodies and national regulators step in, their decisions will determine the diversity, reach, and resilience of the stablecoin ecosystem moving forward. International standard-setting institutions, such as the International Organisation of Securities Commissions, the Financial Stability Board, and the Financial Action Task Force, have placed Stablecoins on their policy agendas. The passage of the GENIUS Act also constitutes a landmark development in the evolution of the stablecoin

ecosystem, and its significance will extend beyond the United States, as it establishes a regulatory benchmark that other jurisdictions may adopt.

Policymakers must adopt a nuanced, activity-based regulatory approach. A stablecoin used for remittances should not be subject to the same stringent capital and disclosure requirements as one that is integral to a leveraged lending protocol, and vice versa. Recognizing this functional dichotomy is not merely an academic exercise; it is a prerequisite for developing a regulatory framework that safeguards financial stability and protects consumers without stifling the genuine innovation stablecoins bring to both payments and finance.

Regulatory oversight should ensure that stablecoins used in investment schemes comply with securities laws, while monetary authorities must address their impact on monetary policy and the stability of the financial system. The Securities and Exchange Commission Nigeria welcomes all stablecoin businesses that are ready to operate on conditions that protect and empower Nigerian markets.

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