

Digital Policy Hub – Working Paper

Digital Dollarization: Stablecoins and Canada's Monetary Sovereignty

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Key Points

- Canada's current regulatory framework classifies stablecoins as securities, which is fundamentally misaligned with their function as payment instruments. This approach stifles domestic innovation and leaves Canada's monetary sovereignty vulnerable to the rapid global growth of foreign digital currencies.
- By mid 2025, US dollar-backed stablecoins have reached \$270 billion¹ in market capitalization with transaction volumes around \$27 trillion, exceeding the annual transaction value processed by major card payment networks, and fundamentally reshaping global digital infrastructure.
- This trend is unfolding within a geopolitical context where the United States is utilizing stablecoins to bolster dollar dominance, and the European Union is pursuing a digital euro to achieve strategic autonomy.
- This phenomenon presents a unique challenge for Canada. A nation deeply integrated economically with the United States, Canada risks becoming a passive recipient of foreign digital currency policies. This situation is not a deliberate policy choice by Canada to adopt the US dollar, but rather an outcome driven by market forces and the absence of a viable domestic digital alternative.
- Canada must urgently implement a new proactive strategy, establishing a regulatory framework for payment stablecoins, fostering Canada's own sovereign digital dollar to compete with foreign alternatives and advancing the development of a Digital Canadian strategy as a critical sovereign backstop.

Introduction

When a small business in Toronto accepts a payment in USDC — a US dollar stablecoin issued by Circle — it participates in a quiet but significant monetary shift. This seemingly efficient transaction bypasses Canadian payment systems, reducing the Bank of Canada's visibility into financial flows and weakening its monetary policy transmission mechanisms. This fundamental change in how money operates is occurring without broad public debate or deliberate policy choice.

This working paper argues that Canada's current regulatory approach, which classifies stablecoins as securities rather than payment instruments, inadvertently enables "digital dollarization by default." This misalignment threatens Canadian monetary sovereignty. While other nations are actively shaping their digital currency futures, Canada's reactive stance risks marginalizing the Canadian dollar and ceding control over its domestic monetary system. Without decisive action, Canada faces a future where its monetary conditions are increasingly influenced by foreign regulators and market forces, applied without Canadian representation.

¹ All amounts are in US dollars.

Global Stablecoin Growth and Market Dynamics

Stablecoins are digital assets designed to maintain a stable value relative to a fiat currency, primarily the US dollar (Arner, Auer and Frost 2020). By mid-2025, the total stablecoin market capitalization had reached approximately \$270 billion, dominated by US dollar-backed tokens such as Tether (USDT) and Circle.² This scale generates powerful network effects, redirecting economic activity onto US dollar-based digital rails and heightening risks to Canada's monetary sovereignty.

In 2024, stablecoin transaction volumes reached \$27.6 trillion, exceeding the joint transaction volumes of Visa and Mastercard by nearly eight percent (Partz 2025). This growth is supported by adoption from major firms such as Stripe, which enables USDC payments in more than 70 countries, and Shopify, which now accepts USDC from its merchants (Weinstein 2025). The efficiency of underlying networks such as Solana, which process transfers in seconds for a fraction of a cent, facilitates this expanding use case (Higginson and Spanz 2025).

Beyond their role in payments, stablecoin issuers have become significant players in sovereign debt markets. As of mid-2025, Tether and Circle collectively hold more than \$127 billion in US treasuries, making them larger holders than some sovereign nations (Reguerra 2025). This elevates them from private money issuers to entities with systemic financial implications. Projections suggest that the market could grow up to nearly \$4 trillion by 2030 (Ghose et al. 2025), further solidifying its role in the global financial system (Stafford and Ardissino 2025; World Economic Forum 2025).

For Canada, a nation with deep economic ties to the United States, the rise of US dollar-pegged stablecoins presents a distinct challenge. Widespread adoption would limit the Bank of Canada's ability to shield the domestic economy from financial shocks. Moreover, Canada's regulatory approach increases the country's exposure to foreign political and economic dynamics, particularly as the United States moves to formally integrate stablecoins into its financial system.

Stablecoins as Private Money

Stablecoins emerged to address the price volatility of early cryptocurrencies by combining blockchain technology with reserve assets to maintain a stable value (Arner, Auer and Frost 2020). They vary widely in design, risk and currency backing.

The most prevalent are fiat-collateralized stablecoins, such as USDT and USDC, which are backed one to one by cash and short-term government securities. Other types include crypto-collateralized tokens, which are over-collateralized with other digital assets, and algorithmic models that attempt to maintain price stability through programmed supply adjustments. Algorithmic stablecoins have proven highly susceptible to catastrophic failure, as exemplified by the collapse of TerraUSD in May 2022, which resulted in the

² See <https://coinmarketcap.com/view/stablecoin/>.

loss of more than \$45 billion in value (Badev and Watsky 2023). This variety in design has direct implications for both stability and regulatory risk (see Table 1).

A critical insight for Canadian policy is that more than 90 percent of the stablecoin market consists of fiat-collateralized tokens that function as digital foreign currency, not as speculative investments. However, Canada's securities-based regulation treats all variants identically. This regulatory misalignment helps explain why no major Canadian dollar-backed stablecoin exists, while US dollar variants proliferate in Canadian commerce.

This dominance of US dollar-backed stablecoins carries additional risks beyond sovereignty concerns. While stablecoins aim to provide the benefits of digital assets without extreme volatility, some still experience price deviations from the US dollar peg, as demonstrated by the trading history of USDT and USDC (see Figure 1).

The rise of private digital currencies is reminiscent of the free banking era in the United States (1837-1863), when privately issued banknotes created commercial friction and inefficiency. The problem was resolved by the National Bank Act, which established a uniform national currency (Gorton and Zhang 2022). The current phenomenon also reflects shifting dynamics of trust away from public institutions (Edelman 2023). However, as the Bank for International Settlements (2025) argues, stablecoins fail crucial tests of a sound monetary system: they can undermine the singleness of money, lack elasticity in their supply and present integrity risks.

Monetary Sovereignty in the Digital Era

Monetary sovereignty is not merely the ability to issue currency. It is the state's capacity to use monetary governance tools to achieve economic policy objectives (Murau and van 't Klooster 2023). In today's hybrid monetary system, this includes regulating both public and private forms of money. The widespread adoption of foreign digital currencies, such as US dollar-denominated stablecoins, impairs the central bank's control over the money supply and interest rates, fundamentally constraining Canada's ability to govern its economy.

When Canadian businesses settle transactions in USDC, they engage in "offshore money creation," the use of a foreign unit of account outside its home jurisdiction's control. The European Central Bank has warned that this dynamic could undermine monetary control and replicate patterns observed in dollarized economies (Storbeck 2025; Schaaf 2025). For Canada, this creates an irreversible momentum toward monetary subordination.

The loss of sovereignty extends beyond interest rate control. During financial crises, central banks act as emergency backstops by injecting liquidity into the financial system. If Canadian dollars are substituted by foreign stablecoins, these protections, including deposit insurance and market stabilization mechanisms, risk becoming ineffective. Canadian financial stability could hinge on private foreign entities such as Circle or Tether, which have no obligations to Canadian citizens.

Table 1: Taxonomy of Stablecoins

Type	Mechanism	Examples	Advantages	Disadvantages
Fiat-collateralized	Pegged to traditional currencies such as the US dollar or euro, backed by cash and/or cash-equivalent reserves held by issuer. Tokens represent claims on reserve assets denominated in the sovereign currency to which the stablecoins' value is pegged.	USDT (Tether), USDC (Circle), BUSD (Binance USD), which together account for more than 90% of the \$227 billion stablecoin market.	<p>Stability: Dollar-pegged stablecoins have exhibited safe asset qualities, with prices temporarily rising above peg during extreme market distress.</p> <p>Efficiency: Near-instantaneous 24/7/365 transactions.</p>	<p>Trust risk: Investor redemption risk from issuer if holders lose confidence in reserve soundness.</p> <p>Transparency issues: While USDC has regular public attestations, USDT has faced scrutiny due to lack of fully public reserve audit.</p> <p>Regulatory exposure: Subject to monetary policy and inflation of underlying fiat currency.</p>
Crypto-collateralized	Backed by volatile cryptocurrencies with over-collateralization to absorb price swings. Smart contracts automatically liquidate if collateral falls below threshold.	Dai (MakerDAO), FRAX, USD0, USDe (Ethena)*	<p>Decentralization: Maintained by smart contract systems operating exclusively on public blockchains.</p> <p>Transparency: On-chain verification of collateral.</p> <p>Innovation: Integration with decentralized finance platforms allows lending, borrowing and liquidity provision.</p>	<p>Volatility risk: Exposed to underlying cryptocurrency price fluctuations.</p> <p>Complexity: Over-collateralization requirements and liquidation mechanisms.</p> <p>Scalability: Limited by underlying blockchain capacity.</p>
Algorithmic (non-collateralized)	Use automated smart contracts to defend peg by buying and selling stablecoin against governance tokens, with supply adjustments based on demand. Algorithms increase or decrease the supply of stablecoins in response to demand.	TerraUSD (failed – \$45 billion value eliminated in May 2022), Fei (experienced temporary de-pegging), IRON (failed)**	<p>Capital efficiency: No collateral requirements.</p> <p>Scalability: Can theoretically scale without reserve constraints.</p> <p>Innovation: Pure algorithmic price stability mechanism.</p>	<p>High failure risk: TerraUSD collapse eliminated more than \$45 billion in value within a week.</p> <p>Complexity: Design flaws can lead to de-pegging as exemplified by temporary collapse of Fei.</p> <p>Market confidence: Dependent on sustained belief in algorithmic mechanisms.</p>
Asset-backed (non-fiat)	Pegged to commodities such as gold or other real-world assets. Some utilize tokenized money market funds or government treasuries as backing.	EURC (Euro), GYEN (Japanese yen), XCHF (Swiss franc), USDY (backed by short-term US treasuries)***	<p>Diversification: Exposure to different asset classes.</p> <p>Hedge properties: Protection against specific currency risks.</p> <p>Real asset backing: Direct exposure to government securities or commodities.</p>	<p>Liquidity constraints: May be less liquid than fiat-backed alternatives.</p> <p>Complexity: More complex pricing and redemption mechanisms.</p> <p>Market risk: Subject to volatility of underlying assets.</p>

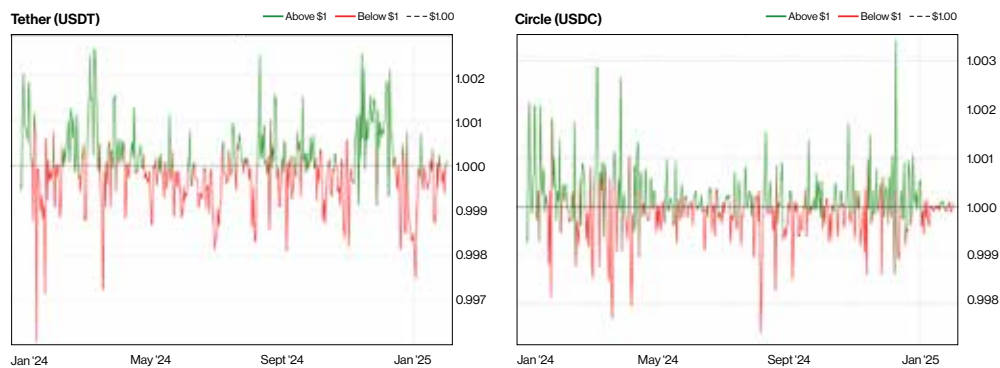
*Dai is a US dollar-pegged stablecoin created by locking cryptocurrency as collateral in the MakerDAO protocol; it has operated since 2017 and is one of the largest decentralized stablecoins. FRAX is a US dollar-pegged stablecoin issued by Frax Finance. USD0 is a US dollar-pegged stablecoin issued by the Usual protocol, backed by tokenized US Treasury bills. USDe is a US dollar-pegged asset issued by Ethena that maintains its peg using crypto collateral combined with hedging strategies in the derivatives market.

** TerraUSD was an algorithmic stablecoin that collapsed in May 2022, erasing approximately \$45 billion in value within one week. Its failure triggered a broader crypto market downturn and led to criminal charges against its founder. Fei was an algorithmic stablecoin launched in 2021 that suffered de-pegging issues shortly after launch and has since been wound down. IRON was a partially collateralized algorithmic stablecoin that collapsed in June 2021 after large investors withdrew funds that reduced its token value to near zero.

*** EURC is a euro-pegged stablecoin issued by Circle (the company behind USDC), fully backed by euro reserves and compliant with EU regulations. GYEN is the first regulated Japanese yen-pegged stablecoin, issued by GMO Trust and approved by New York regulators. XCHF was a Swiss franc-pegged stablecoin issued by Bitcoin Suisse, backed by physical Swiss francs (it was discontinued in 2024). USDY is a yield-bearing US dollar token issued by Ondo Finance and backed by short-term US Treasury bills, allowing holders to earn interest on their holdings.

Source: Author's elaboration, based on news, LinkedIn profiles, Pitchbook and Crunchbase.

Figure 1: Price Stability and Trading Volume of USDT and USDC (2024–2025)



Source: Author's elaboration with data from <https://coinmarketcap.com/currencies/tether/>; <https://coinmarketcap.com/currencies/usd-coin/>.

The charts illustrate price deviations from the \$1.00 peg for the two largest US dollar stablecoins.

Canada's Regulatory Framework for Stablecoins

The Canadian Securities Administrators (CSA) largely treat trading in crypto assets, including “value-referenced crypto assets” (their term for fiat-backed stablecoins), as securities/derivatives activity conducted via “crypto contracts.” Platforms can only offer certain fiat-backed stablecoins under strict terms (for example, high-quality liquid reserves and disclosure). That is not the same as recognizing a Canadian dollar stablecoin as a regulated means of payment. The result is uncertainty for legitimate payment use. The CSA issued Staff Notice 21-333 in October 2023, setting out terms and conditions for the operation of crypto asset trading platforms and stablecoin issuers (CSA 2023).³ Despite twice delaying implementation due to industry concerns, the regime remains in place (CSA 2024). While intended to protect investors, this approach has been criticized for failing to differentiate between payment-focused stablecoins and speculative assets (Canadian Web3 Council 2025).

Meanwhile, prudential supervisors are moving, but only on part of the picture. Beyond securities regulation, the Office of the Superintendent of Financial Institutions (OSFI) has issued capital and liquidity guidance for banks' and insurers' exposures to crypto assets (OSFI 2025). However, it does not establish a retail payments framework for stablecoins themselves. And the Bank of Canada's new Retail Payment Activities Act began supervising payment service providers in September 8, 2025, following an initial registration window that opened on November 1, 2024, but it is limited to operational

³ For stablecoin issuers, the undertaking requirements mandate the value-referenced crypto assets (VRCAs) must reference Canadian or US dollars on a one-for-one basis and have; written policies and procedures for prudent management of reserve assets; recovery and orderly wind-up plans in case of crisis or failure; and identification, management and public disclosure of conflicts of interest. Submission to Canadian jurisdiction and appointment of a Canadian agent for service; along with extensive ongoing disclosure obligations, are also required (CSA 2023).

and end-user funds safeguarding risks in retail payment activities and was not designed to govern the issuance and redeemability of a Canadian dollar stablecoin. More recently, the Department of Finance has been developing a new legislative framework for licensing and reserve standards (Faridi 2025). However, this fragmented and reactive approach has granted foreign stablecoins a substantial head start, exacerbating the risks of digital dollarization. In this regulatory vacuum, US dollar-denominated stablecoins are scaling under clearer frameworks elsewhere, generating cascading risks throughout the Canadian economy. These risks manifest differently across various actors: for the Government of Canada and the Bank of Canada, diminished monetary sovereignty and reduced policy traction; for financial institutions, increased compliance complexity and de facto exposure to US regulations; for businesses, heightened foreign exchange pass-through to prices and costs; and for consumers, reduced predictability in everyday payments, remittances and savings, thereby elevating the potential for broader economic shocks.

Divergence from International Approaches

Canada's regulatory framework fails to make the fundamental distinction that defines global best practice: recognizing payment stablecoins as distinct from speculative crypto assets. While Canada applies securities regulation to all stablecoins indiscriminately, major economies have developed nuanced frameworks that enable innovation while managing specific risks (see Table 2).

The European Union's Markets in Crypto-Assets (MiCA) regulation distinguishes between e-money tokens and asset-referenced tokens, each with tailored requirements. The United Kingdom designates payment stablecoins as "digital settlement assets," bringing them under payments regulation rather than securities law. Singapore's framework for single-currency stablecoins focuses on value stability and reserve credibility, recognizing their potential as legitimate payment instruments. Switzerland's Financial Market Supervisory Authority (FINMA) applies a functional analysis to existing regulations, treating stablecoins as either deposits, collective investment schemes or securities depending on their specific structure and function, demonstrating that even traditional frameworks can accommodate nuance that Canada lacks.

The US Regulatory Counterpoint: The GENIUS Act

The United States has moved to establish comprehensive stablecoin regulation through the Guiding and Establishing National Innovation for US Stablecoins Act (GENIUS Act) in July 2025, which treats payment stablecoins as distinct financial instruments rather than securities. The GENIUS Act mandates that issuers maintain full, one-to-one backing with liquid assets such as US dollars, insured deposits, short-term US treasuries, or Federal Reserve balances held in segregated accounts, monthly public audits and classification as financial institutions subject to anti-money laundering (AML) rules. The regulatory structure divides oversight between federal and state authorities, large issuers (more than \$10 billion) answer to federal regulators, while smaller players face state supervision. Most significantly for Canada, the GENIUS Act extends US jurisdiction to any foreign stablecoin serving US customers, effectively forcing global compliance with US standards. This extraterritorial reach means Canadian businesses using stablecoins may inadvertently subject themselves to US financial regulation.

Table 2: Global Stablecoin Regulatory Framework Comparison

Jurisdiction	Regulatory Classification of Stablecoins	Regulatory Body/Legislation	Main Objectives
Canada	Securities and/or derivatives	CSA Staff Notices 21-332, 21-333 (VRCAs)	Investor protection, risk mitigation
European Union	E-money tokens and asset-referenced tokens	MiCA	Financial stability, consumer protection, strategic autonomy
United States	Digital payment stablecoins	House Financial Services Committee, Treasury (GENIUS Act, STABLE Act)	Dollar dominance, financial stability, AML
United Kingdom	Digital settlement assets	Financial Services and Markets Act 2023 FCA/ Bank of England Regulation	Financial stability, consumer protection, innovation
Switzerland	Deposits/collective investment schemes	FINMA Guidance 06/2024	06/2024AML/ CFT compliance, financial stability, innovation support
Singapore	Single-currency stablecoins	Payment Services Act 2019, MAS Regulatory Framework	Value stability, financial innovation, consumer protection

Source: Author's compilation from various regulatory authorities.

Notes: STABLE is the Stablecoin Transparency and Accountability for a Better Ledger Economy Act; FCA is Financial Conduct Authority; FINMA is the Swiss Financial Market Supervisory Authority; MAS is the Monetary Authority of Singapore.

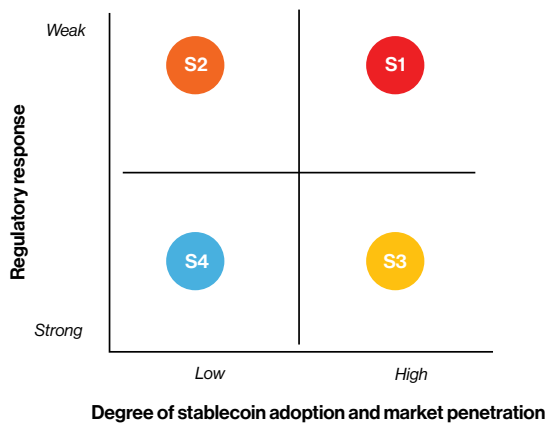
The Geopolitics of Stablecoins

The rise of stablecoins is deeply intertwined with global geopolitics. The US approach aims to reinforce the US dollar's global status by mandating that reserves be held in US treasuries, effectively creating a massive, globally distributed demand for US government debt (Davies and Farrell 2025). In contrast, the European Union is prioritizing tighter control and accelerating its digital euro project to secure "strategic autonomy" and counteract the influence of US dollar-backed stablecoins (Lagarde 2022; Kaminska 2025). By failing to define its own path, Canada risks becoming a passive recipient of these geopolitical forces. The expansion of US dollar-based stablecoins could result in "digital dollarization by default," driven by market efficiency and cross-border payment needs. This passive erosion of sovereignty is significantly harder to reverse once it gains momentum.

Scenario Analysis: Pathways for Canada's Digital Monetary Future

To understand Canada's potential trajectories, this analysis employs scenario planning, a strategic tool for navigating uncertainty (Schoemaker 1995). The analysis maps two critical dimensions (see Figure 2):

Figure 2: Canadian Stablecoin Policy Scenarios



Source: Author's elaboration.

- **Dimension 1: Degree of stablecoin adoption and market penetration:**
 - **High adoption:** Stablecoins achieve widespread usage for payments and cross-border transactions, significantly competing with or complementing traditional financial instruments.
 - **Low adoption:** Stablecoins remain primarily within niche use cases.
- **Dimension 2: Regulatory Response**
- **Strong and coordinated:** Comprehensive regulatory frameworks are effectively implemented through robust federal-provincial coordination, clear jurisdictional mandates and alignment with international standards.
- **Weak and fragmented:** Characterized by unclear jurisdiction between federal and provincial authorities, delayed implementation of robust rules, limited international coordination and persistent regulatory gaps.

All scenarios operate under the premise of US dollar-pegged stablecoin dominance, reflecting current global market dynamics and the absence of domestic alternatives.

Scenario 1: Digital Dollarization by Default (High Adoption and Weak Response)

This scenario describes a future where US-denominated stablecoins are widely used for transactions such as payments and cross-border transactions, effectively bypassing domestic payment rails. The regulatory environment remains unclear, with delayed rules and persistent fragmented approaches. This trajectory would lead to accelerated digital dollarization, significantly eroding the Canadian dollar's relevance and weakening the Bank of Canada's monetary policy effectiveness. This environment would also result in reduced domestic innovation and inadequate consumer protection, as regulatory uncertainty stifles local development and exposes Canadians to direct financial losses.

Scenario 2: Stagnation and Vulnerability (Low Adoption and Weak Response)

Under this scenario, stablecoins remain primarily within niche use cases, while the regulatory environment remains fragmented. While this scenario might offer a temporary deferral of the most widespread risks associated with digital dollarization, it fails to address the underlying vulnerabilities. Canada would miss significant opportunities to capitalize on the efficiencies offered by stablecoins. Domestic innovation would remain stifled, as Canadian firms continue to operate under regulatory uncertainty. Limited adoption also means Canada falls behind international competitors in digital finance development while remaining exposed to uncontrolled foreign financial infrastructure.

Scenario 3: Managed Integration (High Adoption and Strong Response)

In this scenario, there is widespread use of stablecoins in Canada, but within a robust, comprehensive and harmonized regulatory framework. Canada successfully manages adoption of foreign stablecoins through comprehensive regulatory frameworks that maximize benefits while mitigating sovereignty risks. The risks of digital dollarization would be significantly mitigated through clear rules, effective oversight and the potential for Canada to strategically foster its own domestic Canadian dollar-pegged stablecoins. Monetary sovereignty would be preserved, allowing the Bank of Canada to effectively monitor and influence the money supply, potentially by integrating stablecoins into the broader financial system with appropriate oversight. Moreover, a clear and supportive regulatory environment would foster innovation, reducing uncertainty for Canadian firms, attracting investment and retaining talent within the domestic digital asset ecosystem.

Scenario 4: Cautious Isolation (Low Adoption and Strong Response)

This scenario shows a situation where stablecoins remain largely niche in Canada, despite the presence of a strong regulatory framework. While this scenario ensures regulatory readiness if stablecoin adoption unexpectedly surges, low adoption means missed economic benefits. The cautious approach

may result in overly restrictive regulations that discourage innovation or insufficient consumer value propositions compared to existing payment system.

Conclusions

The rise of stablecoins poses a significant challenge to Canada's monetary sovereignty. The current regulatory approach inadvertently creates a pathway for "digital dollarization by default," diminishing the Bank of Canada's capacity to conduct effective monetary policy. To navigate this complex environment, Canada must move beyond its reactive stance and adopt a comprehensive, forward-looking strategy. Failure to act decisively risks marginalizing the Canadian dollar in the emerging digital economy and ceding critical control over the future of money.

Policy Recommendations

- **Comprehensive regulatory reform package**
 - Canada needs to move beyond its approach to stablecoins and recognize their fundamental function as payment instruments rather than investment vehicles, aligning Canada's approach with international best practices and removing the primary barrier to domestic innovation.
 - A formal task force should be created, co-led by the Department of Finance and the Bank of Canada, to develop a harmonized federal-provincial framework that provide the necessary legal clarity and reduce prohibitive requirements that currently stifle domestic innovation. This unified approach will eliminate jurisdictional confusion, provide clear legal pathways for Canadian stablecoin development and ensure consistent oversight standards across the country.
- **Strategic development initiatives**
 - Canada should strategically promote domestic stablecoins within a regulatory sandbox, with testing specifically designed to accelerate Canadian dollar-pegged stablecoin development. This controlled testing environment would allow private sector firms to develop and pilot innovative payment solutions under streamlined regulatory requirements while maintaining robust consumer protections. Government backing for qualifying Canadian projects would signal strong policy commitment and attract necessary investment capital.
 - In the short term, Canada must negotiate a bilateral framework with the United States for coordinated stablecoin oversight. This agreement should secure exemptions from extraterritorial provisions of the GENIUS Act for Canadian-regulated entities, establish joint supervision mechanisms for cross-border stablecoin flows and develop shared technical standards that ensure interoperability without compromising sovereignty. By transforming geographic proximity to the United States from a vulnerability into a strategic advantage, Canada can maintain monetary sovereignty while benefiting from North American economic integration.

- **Reconsider the digital Canadian dollar strategy**
 - The Bank of Canada should maintain central bank digital currency development capacity as a strategic contingency measure. While not immediately necessary given the potential for private sector solutions, a digital Canadian dollar may become essential if private stablecoin adoption accelerates beyond levels that can be effectively integrated within Canada's monetary policy framework. This sovereign backstop would ensure that Canada retains ultimate control over its monetary system regardless of private sector developments.

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