

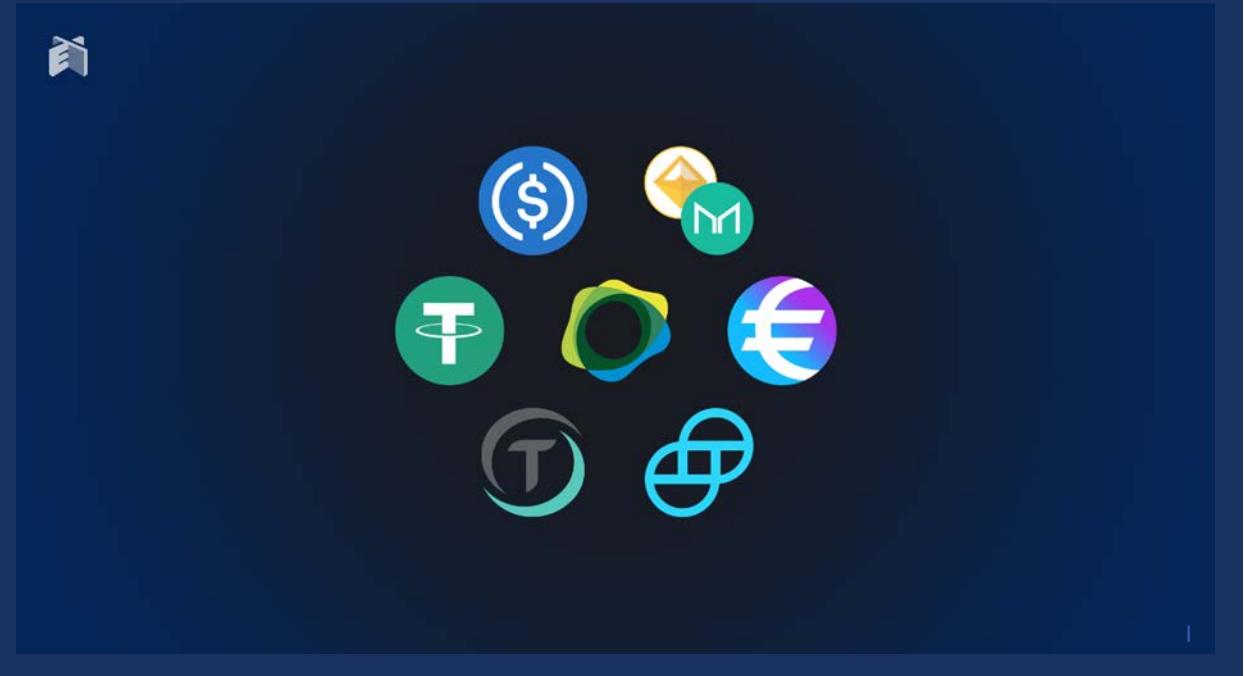
SUMMARY OVERVIEW OF STABLECOINS AND THE LAW REGARDING STABLECOINS

CFTC, TECHNOLOGY ADVISORY COMMITTEE
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WHAT ARE STABLECOINS:

- Stablecoins are digital assets that employ one of several techniques to seek to reduce their price volatility against other assets. Often, stablecoins have a nominal face value that refers to an asset such as a fiat currency, a physical commodity, real estate or a security (the “underlying”). The underlying might also be a basket of assets.
- Stablecoins collateralized by underlying assets sometimes have the underlying assets held by third-party custodians.
- Stablecoins may or may not be redeemable for the underlying assets. They are often intended to be traded on cryptocurrency exchanges.
- Other stablecoins use algorithms as a means to seek price stability, such as by increasing supply when a token’s value rises above, or decreasing it when value falls below, a pre-programmed ‘peg’ (such as 1:1 with USD).
- Stablecoins are designed to be used for payment and other purposes in connection with crypto and other digital assets, often to replace fiat currency as the means of payment.

WHAT ARE STABLECOINS:

- A stablecoin may have a face amount denominated in a fiat currency and may be collateralized by that currency or a combination of that currency and other collateral (e.g., cash equivalents, such as certificates of deposits, short-term treasury bills or money market mutual fund shares) equal in value to the face amount of outstanding coins.
- Alternatively, a stablecoin may have a face amount denominated in a specified measure of a tangible commodity (e.g., one troy ounce of gold) and be collateralized by that commodity or a combination of that commodity and other collateral in an amount equal to the face amount of outstanding coins.

WHAT ARE STABLECOINS:

- A person seeking to purchase a stablecoin from the issuer will typically send funds (fiat or virtual) equal to the face amount of a fiat currency stablecoin or the then-current fiat currency value of the unit(s) of the physical commodity stablecoin (e.g., the dollar cost of one troy ounce of gold).
- The trustee or administrator of the stablecoin will set aside the funds received (or additional adequate collateral) to back the stablecoin and instruct the issuer to mint and distribute the appropriate number of stablecoins.
- Smart contracts may play a role in this process, serving to automate the minting and distribution function.

SUMMARY OF EXAMPLES (based on public sources):

Stablecoin Name	How Collateralized	Permissioned vs Permissionless Blockchain	Privacy / Confidentiality of Transactions
Tether	Fiat + other	Permissionless	Less Private
TrueUSD	Fiat + potentially other	Permissioned	More Private
Turnkey Jet	Fiat	Permissioned	More Private
Libra	Basket of fiat and other	Permissioned	More Private
Paxos Gold	Allocated gold	Permissioned	More Private
Basis	N/A	Permissionless	Less Private
Maker/Dai	Cryptoassets	Permissionless	Less Private
JPM Coin	Fiat	Permissioned	Most Private
USC	Fiat	Permissioned	Most Private

EXAMPLES OF STABLECOINS (based on public sources):

- **Tether.** Tether is a US dollar stablecoin organized by a company associated with Bitfinex exchange. Until February 2019, Tether appeared to be collateralized 100% by US dollars. In April 2019, the NY Attorney General alleged that a substantial portion of Tether's fiat collateral was transferred (without adequate legal documentation and without notice to purchasers) to another entity to support loan repayment obligations of Bitfinex; this legal action has now been stayed. Tether is redeemable for US dollars.
- **TrueUSD.** TrueUSD and other TrueFiat stablecoins (collectively, "TrueFiat") are stablecoins issued by TrustToken. They are intended to be collateralized 100% by the reference fiat currency, although cash equivalent assets may be used as collateral. TrueFiat are redeemable for the reference currency.

EXAMPLES OF STABLECOINS (based on public sources):

- **Turnkey Jet, Inc.** Turnkey Jet sought and obtained Securities and Exchange Commission no-action relief to issue a stablecoin that could be used exclusively to purchase its charter jet services. The stablecoin (with a nominal face value of \$1) would rest on a private blockchain and not trade on a cryptocurrency exchange. The TKJ token would be redeemable for the issuer's charter jet services. SEC staff said the TKJ token would not be a security under securities laws, but did not refer to the TKJ token as a stablecoin. TKJ tokens will be backed by US dollars in escrow.
- **Libra.** Libra is a proposed stablecoin that would be issued by the Libra Association, an initiative spearheaded by Facebook. Libra is not yet fully defined, so its features and functions remain to be determined, although the white paper suggests that it is intended to function as currency in any platforms that adopts it, and its value is proposed to reflect a blend of several fiat currencies; it is proposed to be backed by bank deposits and short-term government securities but its redemption features are uncertain.

EXAMPLES OF STABLECOINS (based on public sources):

- **Paxos Gold.** Paxos Gold (PAXG) is a digital asset offered by Paxos Trust Company LLC, a New York Department of Financial Services licensed limited purpose trust company, where one token is backed by one fine troy ounce of a 400 ounce London Good Delivery gold bar and stored in Brink's gold vaults. Every token is associated with the serial number of a specific gold bar (e.g., allocated gold). A Paxos Gold digital token can be redeemed for a choice of fiat currency or physical gold or, for institutional customers, for unallocated gold.

EXAMPLES OF STABLECOINS (based on public sources):

- **Basis.** Basis was a proposed stablecoin that would have relied on two other tokens for stability. Its goal was to track the US dollar through an "algorithmic central bank." The Basis token would have been the stablecoin and stability would have been achieved by increasing the supply of "bond tokens" or "equity tokens" depending on whether the volatility was above the dollar or below the dollar. The mechanism was designed to mimic a central bank's quantitative easing and interest rate raising process. The Basis project was abandoned by its team due to regulatory uncertainty over the status of the bond and equity tokens as securities.
- **Maker/Dao.** Maker/Dao is a US dollar stablecoin that utilizes an Ethereum smart contract to lock up cryptoasset collateral as a means to create Dai stablecoins. Anyone can utilize the smart contract to deposit collateral and create Dai. There is also a Maker token, the holders of which can vote to engage in emergency actions necessary to ensure appropriate functioning of the platform and receive stability fees. Because collateral is pooled, it is possible that significant price swings in the collateral will impact the amount of collateral that is returned by the smart contract upon redemption of Dai.

EXAMPLES OF STABLECOINS (based on public sources):

- **JPM Coin.** JPM Coin is a stablecoin token designed to facilitate instantaneous payments between institutional clients. A JPM Coin has value equivalent to one US dollar, and is backed by dollars held by the bank in designated accounts. Coins are issued when clients deposit money into a designated account. They may be transacted between other qualified clients, and be redeemed from the bank for USD. These steps may occur instantaneously, as to reduce settlement time. Early applications of JPM Coin have included international payments, debt issuance, and treasury services (corporate subsidiary transfers).
- **Utility Settlement Coin.** The Utility Settlement Coin (USC) is a stablecoin being developed by a group of 14 banks, led by UBS and including Credit Suisse, for the settlement of international trades. The project is being developed by a company called Fnality, funded by these banks. USC would represent cash held by these banks, and would come in several versions, each representing a different currency. Fnality hopes to launch the product in 2020. The project serves a similar role as JPM Coin. However, it appears more aimed toward transfers between the banks themselves, rather than institutional clients.

KEY CONSIDERATIONS WHEN REVIEWING A STABLECOIN

- The features and functions of the coin are critical to the utilization and valuation of the coins as well as the legal analysis and regulatory categorization.
- Questions about the underlying asset(s) or item(s) (if any)?
 - Is the coin fully backed by and redeemable for the underlying? Is it a digital representation of the underlying?
 - How are the underlying custodied?
 - If physical assets, how are they tracked?
 - Can there be substitutions of underlying?
- Are any financial services being provided and, if so, by whom (there may be multiple providers)?
- Technology neutral regulation is an important principle.
- What disclosures are or should be required of the creator and other parties?
- On September 6, 2019, the Board of Governors and Federal Advisory Council discussed stablecoins among other topics. There was concern expressed that an alternative payments system, like Libra, “has the potential to disintermediate some customer activity from banks.” However there was also acknowledgement that, when stablecoins are tied to a specific fiat currency “they have utility as tools for improving transaction speeds and recordkeeping.”

WHAT IS THE LEGAL TREATMENT OF STABLECOINS:

- The determination regarding the nature of a stablecoin for regulatory purposes is likely highly facts and circumstances dependent. Key considerations are the nature of the stablecoin and the collateral (if any) backing it as well as redemption rights associated with the stablecoin. The treatment of stablecoins may be very different outside the US.
 - A stablecoin is likely to assume the regulatory outcome of a referenced underlying asset (e.g., a stablecoin based on derivatives is likely to be considered a derivative itself).
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- **In the US:**
 - Any fiat currency stablecoin or commodity-backed stablecoin 100% backed by the referenced fiat currency or commodity and that serves as a currency substitute may be considered a payment instrument under state money transmitter laws particularly if there are full redemption rights. If the stablecoin is redeemable for currency, the issuer of the stablecoin would likely have to register with FinCEN as a money service business and seek licenses from the various state money transmitter regulators as a payment instrument issuer. Exchangers of stablecoins will likely also have to register with FinCen as an MSB and with states as money transmitters.

WHAT IS THE LEGAL TREATMENT OF STABLECOINS:

- A stablecoin backed 100% by its referenced fiat currency or commodity is likely not a security, although its potential status as a security is heavily dependent on the details of its structure and marketing.
- The issuer of a stablecoin backed by precious metals or other commodities may be subject to state law requirements related to commodities dealers (which requirements may be separate from payment instrument regulation under state money transmitter laws).
- A stablecoin backed 100% by fiat currency or a tangible commodity is likely a “commodity” under the Commodity Exchange Act, but the CFTC should have no day-to-day oversight over such a stablecoin; it retains anti-fraud and anti-manipulation authority, however.

WHAT IS THE LEGAL TREATMENT OF STABLECOINS:

- Any fiat currency stablecoin or commodity-backed stablecoin not satisfying the above criteria may also be considered a security, in addition to being considered a payment instrument and/or subject to other possible laws.
 - A stablecoin backed by a basket of assets and/or actively managed to achieve a stable price may implicate securities laws.
- **Outside the US:**
- Stablecoins may be considered derivatives as well as securities, in addition to being subject to e-money regulations (e.g., EU). The key is how the stablecoin is structured and marketed.
 - Switzerland's financial regulator recently issued initial guidance on stablecoin treatment under Swiss law.

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All written materials are Gary's, are based on public information and do not necessarily reflect the views of Katten's clients, or individual partners or employees. Gary's views do not constitute legal advice and are subject to change.

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