CIRCLE

Prudential & other considerations for privately-issued digital currencies

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CIRCLE'S MISSION

To raise global economic prosperity through the frictionless exchange of value

Circle is a global financial technology firm that enables businesses to use digital currencies and public blockchains for payments, commerce, and financial applications worldwide. Circle is the sole issuer of USD Coin (USDC) and Euro Coin (EUROC).

Founded in 2013, Circle's treasury and transaction services, business accounts, and platform APIs provide novel financial services and commerce applications that hold the promise of raising global economic prosperity through the frictionless exchange of value.

“Digital currencies”

What do we mean by digital currencies? We view digital currencies like USDC and EUROC as a form of “tokenized cash”, with specific and separate characteristics from other forms of digital assets.

Those characteristics:

1. High quality full cash-equivalent reserve backing
2. On-demand convertibility for fiat cash and cash equivalents through the issuer

Type	Description	Examples
Tokenized cash	Tokens fully-reserved with cash & cash equivalent instruments (e.g. T-bills and other level 1 HQLA with less than 90 days of maturity)	USD Coin (USDC), Binance USD (BUSD), Paxos Dollar (USDP).
Tokenized deposits	Tokens representing fractional-reserved bank deposits	JPM Coin, Avit
Other fiat-asset backed	Tokens reserved with fiat assets of varying credit qualities and liquidity.	Tether (USDT)
Crypto-(over)collateralized	Reserves are over collateralized with crypto asset and/or tokenized fiat assets that do not self-reference to the stablecoin in supply determination.	Dai, Fei
Algorithmic/self-referencing	Stablecoins that are fully or partially backed by a second more volatile reference coin. The supply of the reference coin is pragmatically determined based on the primary coin.	Terra, Iron, Basis, FRAX

USDC as a dispersed saving instrument

75% of USDC-enabled wallets hold less than $100

Over 95% of wallets (holding balances less than $10k) do not transact frequently, with median days since last transaction greater than 90 days

Table 2: Size distribution of wallets

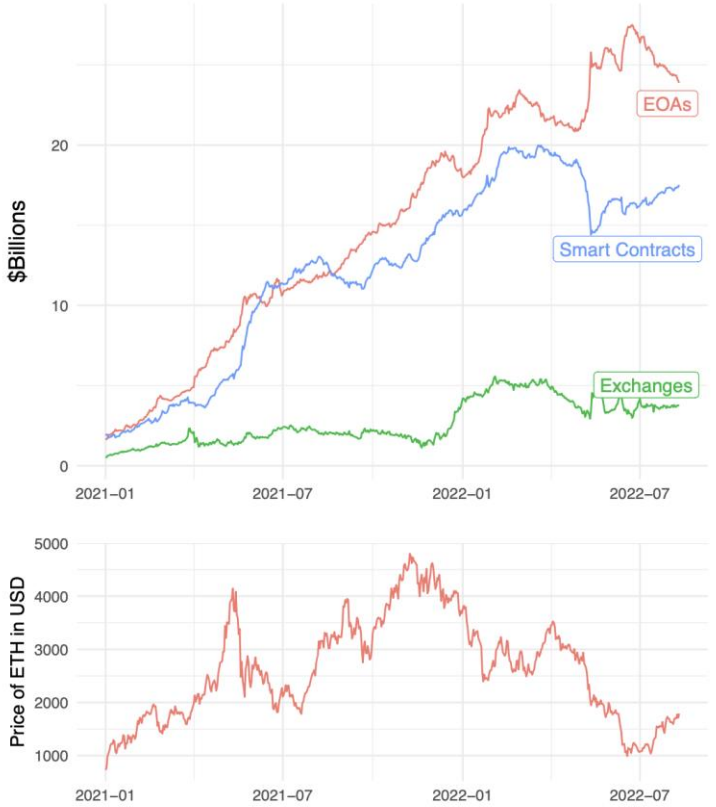
Wallet Size $	Wallets	Total Balance ($mm)	Median days since last txn
<100	1,501,300	22.0	252
100-10k	488,345	524.8	103
10k-100k	63,872	2,086.3	31
100k-1m	19,673	5,557.3	32
1m-10m	3,196	8,290.4	31
10m-100m	276	5,894.6	18
>100m	5	736.7	1

Notes: This tables shows the distribution of wallet sizes excluding smart contracts, exchanges, and VASPs on Ethereum Virtual Machine compatible chains (Ethereum, Polygon, Arbitrum, Optimism, Avalanche).

Primary use of USDC as store of value, means of payment, and unit of account for DeFi innovations

- Less than 10% of USDC balances are held on exchanges
- Vast majority are held in Externally Owned Accounts (private wallets)
- DeFi, as represented by USDC locked in smart contracts, constitute large use case and balance holdings
- Overall circulation of balances are uncorrelated with Ethereum price, but rebalancing between EOAs and smart contracts are notable during recent market crash

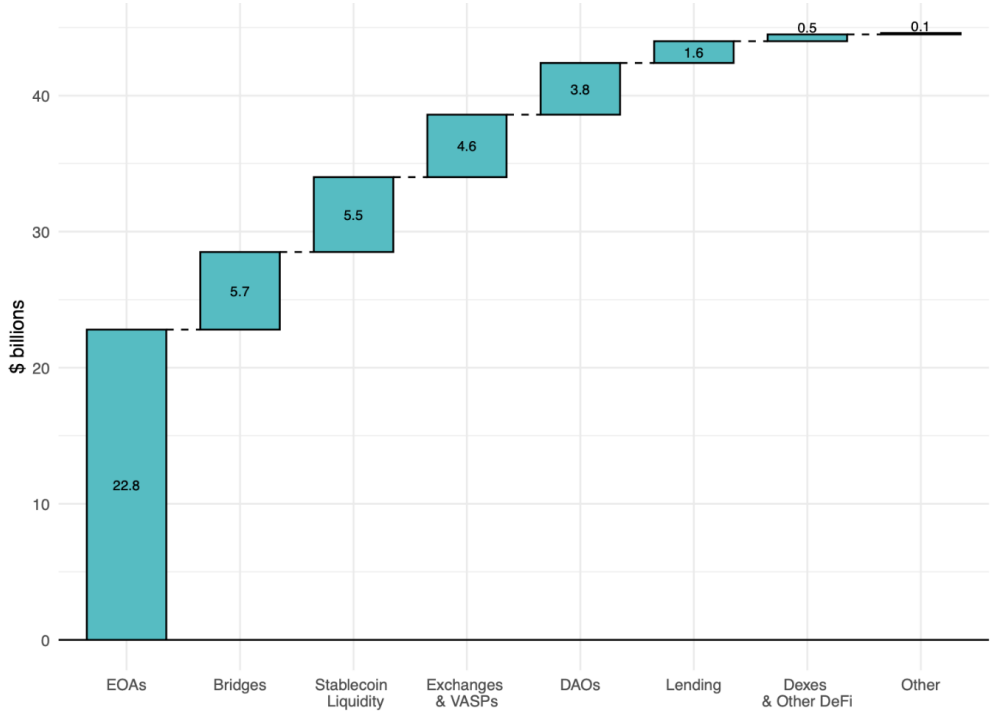
Figure 3: USDC balance by wallet type and Ethereum price



Majority of USDC holdings are non-speculative and non-yield generating (held in EOAs, DAOs, etc)

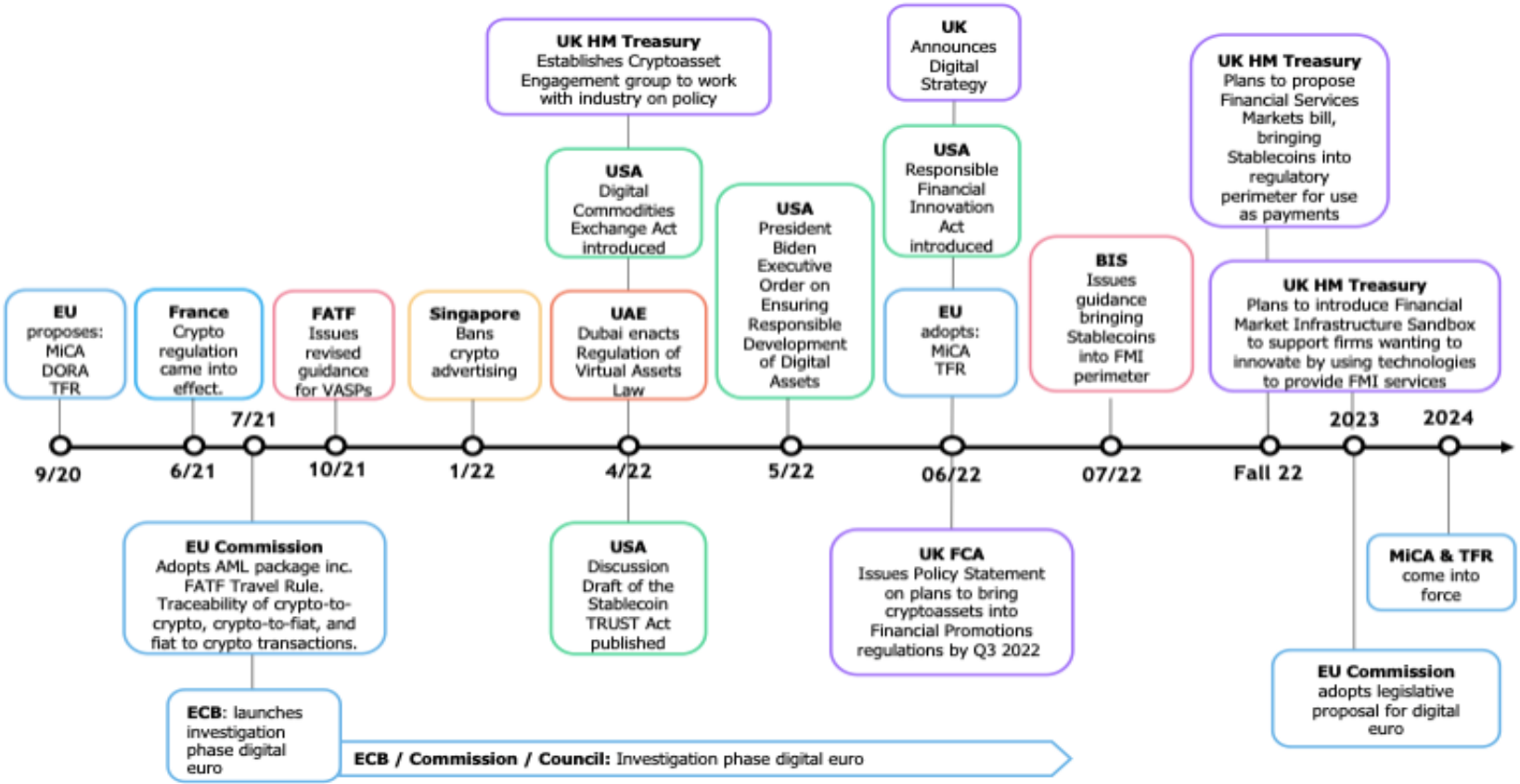
Bridges and stablecoin liquidity complexes could be sources of outflow vulnerability

Figure 4: USDC balance by wallet category



Policy & Regulatory Landscape

Global Regulatory Landscape Snapshot



What are policymakers & regulators saying?

Financial Stability Board: "Most existing stablecoin issuers promise (implicitly or explicitly) to maintain a stable value, typically relative to a single fiat currency. However, many of these existing stablecoins are issued by unregistered and unlicensed entities and do not have credible mechanisms to support their promise of price stability." - *Review of the FSB High-level Recommendations of the Regulation, Supervision and Oversight of "Global Stablecoin" Arrangements: Consultative report*

CPMI-IOSCO: "PFMI define an FMI as 'a multilateral system among participating institutions, including the operator of the system, used for the purposes of clearing, settling, or recording payments, securities, derivatives, or other financial transactions'...In considering the functions of FMIs against those performed by SAs, the CPMI and IOSCO have determined that the transfer function is an FMI function. Accordingly, an SA that performs a transfer function should be considered an FMI for the purpose of applying the PFMI." *Application of the Principles for Financial Market Infrastructures to stablecoin arrangements*

U.S. Treasury: "A wholesale CBDC could support interbank settlement among commercial banks if they were to issue tokenized deposits, or provide a risk-free settlement asset for tokenized securities transactions. A wholesale CBDC might also be used as a backing asset for stablecoins, which could make it easier to transfer value among stablecoins, in addition to supporting greater interoperability and choice." - *Nellie Liang, Undersecretary for Domestic Finance*

Bank of England: "You should be able to exchange for fiat money at par on demand and ensure that the payment mechanism (the payment pipes) have the same end-to-end risk management that we ask of other payment systems. It would have to be regulated, yes. Are any of the stablecoins that are currently out there fit for that purpose wholesale or retail? I very much doubt it." - *Sir Jon Cunliffe, Deputy Governor*

U.S. Federal Reserve: ""Any entity issuing money denominated in the U.S. dollar and drawing on the trust of the Federal Reserve needs to be subject to federal prudential regulation and supervision...Stablecoins have the potential to scale quickly because of network effects. An unregulated, unsupervised, deposit-like asset could create tremendous disruptions, not just for financial institutions but for people who might rely on the coin if it were to get wide adoption." - *Fed Vice Chair for Supervision Michael Barr*

Circle's response

- Stablecoin arrangement participants play different roles, and stablecoin arrangements themselves are entirely unique from closed-loop, proprietary systems, thus demanding novel regulatory frameworks.
- Participants should be well-capitalized, and the participants responsible for the issuance of stablecoins should employ a reserve-backed model, with robust governance, risk management, and liquidity standards.
- Regulatory regimes that treat these arrangements should be fit for purpose, not a "cut-and-paste" model of existing market integrity or financial market infrastructure rules, given the differences in operational models, underlying technology, use-cases, and development on top of novel infrastructure.
- Regulatory clarity for these novel financial products and services can provide greater incentive for traditional financial institutions to incorporate digital assets onto their balance sheet.

What are we advocating for?

Regulators around the world are taking different approaches to how to regulate the issuance, transmission, and custody of digital currencies. Circle has been consistent in how we think digital currencies should be regulated:

1. Digital currencies should be fully reserved with high quality liquid assets (cash and short duration government obligations).

1. Digital currencies should be prudentially regulated and supervised by federal/national regulators at the central bank level or equivalent.

1. Digital currency issuers should have direct access to accounts at the central bank.

Thank you