ALTERITAS

Stablecoins will be regulated sooner or later. Shall we be afraid of regulation or embrace it?

There has been a lot of buzz about stablecoins especially since the collapse of TerraUSD (an algorithmic stablecoin) and its sister coin LUNA in May of this year.

Stablecoins are cryptocurrencies which are usually pegged to a reference asset such as a fiat currency e.g., the US Dollar. If a stablecoin is pegged to the US Dollar the ultimate goal of such a coin is to remain stable versus the pegged asset. This provides investors a way to exchange cryptocurrencies on exchanges without first having to convert the money to fiat currency.

A stablecoin such as USDC (2nd largest by market cap according to coinmarketcap) is pegged to the US Dollar with USD cash reserves and short-term US government securities. Other stablecoins use money market paper, reserves of cryptocurrencies and other instruments to guarantee the peg. Up until now it is not regulated what assets are eligible to back a stablecoin and which parties are allowed to issue stable coins in the first place. This adds to uncertainties within the investor community and rightly so.

To unleash the full potential of stablecoins we need smart regulation which allows investors to take advance of this new asset class. By using stablecoins instead of fiat currencies investors are paying only a fraction of the transaction fees, enjoy immediate settlement, and have access to the market 24/7. This is certainly much better than what we have now in the traditional banking payment service industry. **Current estimates suggest that there are about $200bn deposited in stablecoins compared to $19 trillion in bank deposits.** The market is still in its infancy but is has the potential to modernize our slow and inefficient payment system and increase competition.

For this new market to grow we need a **resolution framework** which gives good oversight where innovation can take place, where **regular audits** are performed that ensure stablecoins have the reserves they say they have, setting **standards for operational resilience**, and **avoiding concentration of power** as well as **conflicts of interests**.

A separation of payment services and other banking related serviced may even open the door to FDIC insurance for stablecoins. Just imagine.

As of time of writing the US congress is discussing a new stablecoin trust act which is only 2 pages long providing a legal framework and regulatory clarity. Please see following link: The Stablecoin TRUST Act

While it seems an impossibility for democrats and republicans to sit down together and work out something meaningful, it appears like a miracle that **the new stablecoin trust act enjoys bipartisan support**. This in itself is huge.

While mid-term elections are just around the corner (Nov. 8th, 2022) there is a high likelihood we will get a divided Congress, with Republicans winning the majority of the House and Democrats retaining control in the Senate. This is a so-called gridlock in Washington, a situation where it is utterly difficult to pass new laws. Historically, this situation has proven a tailwind for equity markets and risky assets in general.

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It is counterintuitive but this situation would be an ideal breeding ground for the adoption of the new stablecoin trust act. By all means we don't want to get political, however, it is a fact that republicans are more pro crypto than the democrats. U.S. Republican Senator P. McHenry who is leading the negotiations with the House of Financial Services Committee and the Treasury Department is hopeful that all involved parties will settle on final legislation in the coming months.

We at SerMont believe the stablecoin trust act gets bipartisan support because it would render no other fiat currency but the **US Dollar the global default payment currency** and create significant demand for US Dollars and short-term US treasuries. **If the bill gets passed by congress it would be a first powerful US crypto oversight measure.**

Already in April of this year it was no other than Blackrock, Fidelity and a few other investors who raised $400mln for Circle, a crypto focused technology firm, which is the issuer of the USDC stablecoin. This funding round gave Circle a valuation of $9bn. This is roughly double the valuation the company had in summer of 2021. The company said in a statement it will use the funds to promote the company's strategic growth as demand for dollar digital currency and related financial services continues to scale globally.

So here we are, while most mainstream media are moaning about the crypto winter and the collapse of stablecoins the world's largest SEC regulated asset managers stepping up their investment and forming strategic partnerships with Circle. These companies are already preparing for what may come after the crypto winter. Yes, the collapse of Terra USD was a disaster which cost about $60bn and created a lot of headaches. However, we should keep in mind this is an evolving industry where mistakes happen that will hopefully lead to better outcomes in the future. There must be room for mistakes in a nascent industry even if they are painful.

If Republicans end up winning the House of Representatives in the mid-term elections in November stablecoins may get a formal recognition by spring 2023. Why is this so important? A prerequisite for deep, liquid and less volatile markets for any asset class is the adoption by a large investor community. **Without regulation institutional wealth managers** such as pension funds and state wealth funds etc. **are not allowed to participate in the asset class since they are non-compliant** with their compliance department. Hence, a regulation for stablecoins would be a vast win for the industry.

For all of the above we are embracing stablecoin regulation since it will bring regulatory clarity and open the door to a large new investor community. At the same time are aware that regulation can lead to more volatility in the short term. What impact will such regulation have on e.g., USDT the largest stablecoin by market capitalization? The collateral backing USDT is a mixed bag mimicking a money market fund. If something were to go wrong with USDT it would have far reaching consequences for the entire crypto industry.

Nonetheless, regulation for stablecoins is unavoidable and it will come. The question is not if but rather when the stablecoin bill will be passed on Capitol Hill.

A little example from practice. The **commercial register in Liechtenstein accepts stablecoins** as a contribution in kind which speeds up the process of establishing new companies and foundations tremendously. Our trust company **SerCor** has been **accepting stablecoins for contributions in kind for upcoming incorporations for over a year now.**

Once a decision on the future of the payment system is made lawmakers can then turn their attention to the question **which token or protocol is a security an which qualifies as a commodity**. Currently, there is a **turf war going on between the Chair Mr. Gensler of the SEC who deems most digital assets as securities and the CFTC which is pushing for legislative changes that would give it more authority and oversight over the asset class.**

It may be time well spend to have a quick look at the Digital Commodities Consumer Protection Act of 2022 which is only 4 pages long and a bipartisan effort.

To cut a long story short the bill provides the CFTC authority to regulate digital commodities. The legislation specifically excludes securities from its definition of digital commodities.

The bill aims to settle the ongoing turf war between the SEC and the CFTC over primary regulatory jurisdiction for crypto assets. The bill creates a new digital commodity asset class and would empower the CFTC to regulate the market for these assets. It would require all digital commodity platforms, brokers, dealers, custodians, and trading venues to register with the CFTC via new registration categories.

But let's take one step at a time. If congress were to pass the stablecoin bill in a first important move towards sensible regulation, we at SerMont believe that this would propel entire crypto market 10% - 20% higher overnight simply for the positive signaling effect this new important law would have.
If in a second step the digital commodities bill will be passed by congress, we would truly achieve institutional adoption in the crypto space which opens the gate to a significant pool of assets.

We strongly believe consumers need to be protected, investors need regulatory clarity, and at the same time innovation and digital transformation must be encouraged to increase mainstream adoption.

We are proud to be part of this digital transformation via our Alteritas SONICCX Blockchain Fund. The mandate of the fund is to support blockchain infrastructure, the backbone of ditigal transformation. For further information please check out our homepage www.sermont.com.

Thank you for your attention and the trust you have placed in us.

Kind Regards,

Volker Zaworka

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