



Stablecoins

A Primer for the Accounting Professional

August 2019

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1. INTRODUCTION

On behalf of the Wall Street Blockchain Alliance, we are pleased to present this primer on the topic of “Stablecoins”, and their relevance to the Accounting profession. This work is the result of the collaborative efforts of many of our global members, in particular the firms and individuals whom are part of our WSBA Accounting Working Group, as well as the WSBA team, our Board of Directors and Advisors. We are grateful for all of their thought leadership and hard work. In addition, this primer would not have been possible were it not for the ongoing partnership between the WSBA and our colleagues at the [Association of International Certified Professional Accountants \(AICPA\)](#) and [CPA.com](#). The partnership between our three organizations has been fruitful from the start, to the benefit of our collective members as well as the wider accounting profession, and we look forward to our ongoing collaboration.

The rise of Stablecoins marks the latest evolution in the fast-paced world of cryptoassets and blockchain. Since the original launch of bitcoin in 2009, the challenges of volatility and speculation have marred the viability of these digital assets in the eyes of many market professionals for some time. As we will read, one of the goals of stablecoins is to minimize this volatility, allowing stablecoins to be a more integral part of financial transactions, global trade and much more. At least that is the theory.

The role of the accountant and auditor is becoming ever more important in this aforementioned digital asset world. In fact, as the knowledge and expertise of accountants and auditors grows in this space, we are finding that the accounting professional is becoming an integral part of the evolution of blockchain and cryptoassets. This primer, and indeed all of the efforts across our multiple working groups and global member base, are meant to guide and promote that evolution.

We welcome your thoughts and feedback, and hope that you find this document informative as well as useful. In that spirit, it is our hope that this is the first in a series of thought leadership papers that continue to aid the advancement of the digital asset ecosystem, the accounting profession and in fact global markets around the world.

Sincerely,
Ron Quaranta, Chairman of the Board
Wall Street Blockchain Alliance – August 2019

2. WHAT ARE “STABLECOINS”?

In their simplest definition, Stablecoins are cryptoassets or cryptocurrencies that were created to address one of the greatest challenges in the crypto world; namely *volatility*. By being “pegged” or tied to some underlying asset or group of assets, the goal is the minimization of price volatility. Several options and considerations that, while not exhaustive, represent items that appear pertinent for accounting and finance professionals include, but are not limited to, the following:

1. A stablecoin that is pegged or fixed to another currency issued by a country with less volatility than the issuing country's currency. Many of the most well-known stablecoins, including, Trust Token (Trust USD), Circle (USDC), Gemini (GUSD), and Paxos (Paxos Standard) have pegged the stablecoin 1:1 to the United States Dollar (USD). In the context of financial considerations, from a legal perspective there are two sub-options for stablecoins pegged directly to another currency (or another commodity):
 - a. Adjustable pegs are allowed to fluctuate between the par value (1:1, for example) and an acceptable range of predetermined rates. Legally, how these acceptable ranges are determined, maintained, and communicated to the issuer of the stablecoin, holders of stablecoins, and regulators is both important and still emerging in terms of definitive guidance.
 - b. Commodity backed stablecoins are another popular option. Venezuela is launching the [Petro](#), an oil-backed cryptocurrency pegged to the price per barrel of oil produced in that country. In addition, Facebook has announced the [Libra](#) token, which is pegged to a basket of bank deposits and short-term government securities. Not only may there be volatility associated with commodity prices, legal considerations also must include the skill and technical ability of the issuing body and commodities brokers involved to maintain the commodity-based peg.
2. Collateralized stablecoins. Upon initial review, a stablecoin that is pegged (or supported) by a third-party asset such as the USD or gold and stablecoins that are collateralized by other assets may appear to be the same to investors, customers, or

clients. A superficial similarity however, seemingly correct, is inaccurate, and a point of differentiation with both financial and legalistic implications.

3. Just because a stablecoin, such as those mentioned above, are pegged or supported by a commodity or asset, does *not* mean that the holder of said stablecoin has access to, or a claim to, that underlying asset. Legally speaking, simply because an investor has ownership of a particular stablecoin does not mean there is recourse in the event of instability or other issues on the part of the issuing institution. This may come as a surprise to investors in stablecoins pegged to underlying “hard” or real-world assets.
4. A *collateralized* stablecoin is different in one very simple but very important way from pegged stablecoins. In the event of financial instability, political instability, or other events that call into doubt the viability of the issuing institution, the holder of the stablecoin actually has a claim to the underlying physical asset, and are able to exchange it directly for its value in gold, USD, or in the case of Petro – oil. The actual legal means by which stablecoin ownership is proven, and the redemption process for the stablecoin will vary from coin to coin and is an issue that is important to understand and monitor.
5. What level of redeemability actually exists? Taken one step further from the comparison of pegged stablecoins versus collateralized stablecoins, a further issue that arises is whether or not these different pegged or collateralized stablecoins are truly redeemable for the underlying asset in question.
 - a. For example, the stablecoin Tether, one of the largest and most well-known stablecoins, is backed (pegged) for USD on a 1:1 basis but is not directly redeemable for USD on that same basis. The extra steps and processes necessary to redeem the stablecoin issued by Tether adds friction (cost and time) to the redemption process.
6. Due to the price volatility of some cryptocurrencies, and even some of the stablecoins designed and issued, the stablecoin itself may be over collateralized. Especially true for stablecoins backed by other stablecoins, such as BitUSD, the level of collateral may be in excess of 200% to prevent a breakdown in functionality if the cryptocurrency falls by – for example 50% or 75%. One major legal issue that may arise is what occurs if the underlying cryptocurrency suffers a failure or legal

incident. In other words, if a stablecoin is underpinned by a cryptocurrency, and that cryptocurrency fails, what happens to the holders of that stablecoin?

7. From a strictly bankruptcy law perspective, and something that does not appear to be different for stablecoins versus other assets, it cannot be assumed that a holder or investor automatically has a legal right or claim to that underlying asset. Again, for investors putting capital to work in this emerging area, this may come as an unforeseen consequence of these decisions. A good example has been liquidation of a “collateralized debt position” (CDP) on the programmatic lending platform MakerDAO, due to sudden drops in ether price which devalued the collateral held within the platform.

3. WHAT ARE STABLECOINS MEANT TO ACCOMPLISH? GOALS AND CRITICISMS.

Stablecoins were built and designed with a relatively simple and straightforward goal in mind: to address one of the biggest headwinds facing broader adoption of cryptocurrency. Price volatility and the perceived lack of stability associated with traditional decentralized and distributed cryptocurrencies like Bitcoin continues to be a source of hesitation for merchants and consumers alike seeking to adopt cryptocurrencies as viable currency options. To address this perceived lack of stability, as outlined above, several options have entered the marketplace with regards to exactly how these coins and tokens will be stabilized: fiat currency, commodities, or other cryptocurrencies. Regardless of the specific mechanism and methodology utilized to stabilize the coin or token in question, the overarching goal and primary criticisms remain relatively consistent.

- a. **Goal** - the goal of any stablecoin is to encourage the broader adoption and utilization of stablecoins as viable alternatives to fiat currencies. An additional or tangential goal may be to highlight the benefits of a particular payment system associated with the stablecoin, but the underlying message is the same. Some may see these coins and tokens as a midway or bridge point between traditional fiat and truly decentralized cryptocurrencies, but the increased institutional interest in this space seems to point toward the longevity of the sector at this point.
- b. **Criticisms** - Two primary criticisms tend to come from opposing factions of the cryptocurrency ecosystem at large. On the one hand, proponents and supporters of truly decentralized cryptocurrencies feel that linking cryptocurrencies to fiat currencies runs against the underlying concept of cryptocurrency. Conversely,

individuals and institutions that continue to hesitate to adopt cryptocurrency do not, based on market volume, seem to perceive stablecoins as a quantitatively significantly better improvement versus traditional fiat currencies.

4. WHAT ARE SOME TYPES OF STABLECOINS?

At this point, the list of stablecoin projects is only expected to grow. Stablecoins that emerged over the past year are beginning to address the volatility through decentralized and centralized platforms. New technologies are rapidly emerging that will likely create new opportunities and risks for investors, the financial services industry, and blockchain companies seeking to raise capital. The ecosystem has already identified several stablecoin types, including:

- a. *Fiat stablecoin* - pegged against or collateralized by currency (fiat) such as the US dollar or Euro generally in a fixed ratio (1 stablecoin = 1 US\$).
- b. *Crypto stablecoin* - pegged against or collateralized by other virtual currencies. Examples of crypto stablecoin are [Bitshares](#), [BitUSD](#), [MakerDAO](#) (DAI, Sweetbridge, Haven), [nUSD](#), and Augmint.
- c. *Commodity stablecoin* - pegged against or collateralized by a commodity. The commodity can be a metal (gold, silver, platinum, and copper), energy (crude oil, heating oil, natural gas, and gasoline), livestock (pork bellies, live cattle and feeder cattle), or agricultural (corn, soybeans, wheat, rice, cocoa, coffee, cotton and sugar).
- d. *Algorithmic stablecoin* - a trustless stable cryptocurrency which closely correlates with the US dollar. This is achieved through algorithmically adjusting coin supply based on ecosystem demand. [Basis](#), [Fragments](#), [Carbon](#), [Kowala](#) are good examples of algorithmic stablecoins. Future algorithmic stablecoins may be similar to an index fund (mutual fund or exchange-traded fund) designed to follow certain preset rules so that the fund can track a specified basket of underlying investments.
- e. *Hybrid stablecoin* - generally pegged or collateralized by fiat first and then a basket of assets later using an off-chain tokenized collateral. Examples of hybrid stablecoins are Reserve, [Saga](#), and [Aurora](#), Boreal.
- f. *Derivative-backed stablecoin* - a financial instrument that exists both on-chain and off-chain and can be used to protect investors and other members of the ecosystem

(miners, etc.) from price fluctuations, interest rate risk (inflation) and transfer risk through futures, forwards, swaps or options. These derivative instruments can become complex multi-layer and multi-purpose.

- g.** *Sovereign stablecoin* - a coin backed by and approved by a central bank or a regulatory authority. The purpose and the reason for the issuance can vary. Countries like Cuba, Russia, China, [Iran](#), North Korea, and Venezuela can use a sovereign stablecoin to fight inflation, trade wars, economic embargos or sanctions.

5. WHAT SHOULD ACCOUNTING AND TAX PROFESSIONALS KNOW ABOUT STABLECOINS?

It is impossible to fully summarize everything that a professional should know about such a fast moving and emerging space, especially with new entrants to the market on a continuous basis, but we will provide a list of key considerations that should be factored into an analysis of these coins. While not intended as an all-inclusive listing, but rather a starting point for further analysis and conversation, the points to consider include but are not limited to, the following:

- a.** What is the underlying asset that stabilizes the coin in question?
- b.** Who is the issuing organization or the consortium of organizations pooling resources to support the coin?
- c.** Are documentation and internal controls properly in place to verify and externally report that any underlying assets reported by management do indeed exist?
- d.** Tests and independent verification of the stabilization mechanism itself must be able to be conducted, i.e. does the purported stabilization actually function as documented?
- e.** Rights and obligations of coin holders must be able to be verified, both in order to determine reporting taxonomy, but also from a governance and redeemability perspective.
- f.** Is the issuance of a coin a taxable event?
- g.** How should the stablecoin be classified for accounting purposes to the issuer, holder and custodian of the stablecoin?

- h. How sound and safe is the [smart contract](#) that has been created to mint, distribute, and burn stablecoins?
- i. What is the business continuity and disaster recovery plan of the issuer or custodian?
- j. Is the underlying asset hosted by a [qualified custodian](#) or trustee?
- k. What is the process by which the stablecoin can be redeemed, exchanged, or otherwise converted from stablecoin status to some other form of financial asset? *(Note: Though many USD pegged stablecoins trade at a non 1.00 value due to various factors such as supply and demand, redemption always occurs at exactly 1.00 dollars thus having the market price and redemption price differ.)*
- l. What is the documented goal and purpose of this stablecoin? Is it simply to create an additional financial asset, or is it affiliated with an underlying use case, blockchain network, etc.?
- m. Are there audited financial statements and other organizational information readily available for review and examination prior to coin issuance? *(Particularly relevant would be any SOC 1 or SOC 2 audits of the organization as well as defined controls around private keys and development practices around the smart contract implementing the stablecoin).*
- n. What are the reporting and compliance conversations that have been had between the issuing organization and applicable regulators?
- o. Have the organizations that have adopted the usage, or plan to do so, of a particular stablecoin agree to a common form of classification and reporting, whether under IFRS or GAAP?
- p. Though outside the scope of this primer, the reader should be aware that certain stablecoins may also have functions associated with [decentralized finance](#) - “DeFi” and so may need to be evaluated for factors such as interest income or other items.

6. CURRENT CHALLENGES FOR THE ACCOUNTING PROFESSION.

Current challenges for the accounting profession as connected to stablecoins echo many of



the challenges facing the profession connected to cryptocurrency at large. Specifically, the recording, tracking, and disclosure of relevant information remains an ongoing challenge for practitioners. Additionally, the lack of guidance and reporting frameworks issued by either the FASB or IASB continues to amplify the ambiguity surrounding the taxonomy, reporting, and disclosure requirements. Building on the points outlined under *What Accounting Professionals Should Know* it appears clear that the primary challenges and headwinds facing stablecoins run parallel to those facing traditional decentralized cryptocurrency. First, a lack of guidance and reporting advice has resulted in a variety of methodologies in the marketplace, muddying the waters as to the true state and valuation of said stablecoins. Second, until such time that stabilization mechanisms become more transparent and available for review, questions will continue to arise regarding the validity and veracity of purported stabilization. Stablecoins appear to be emerging as a fast-growing segment of the cryptocurrency marketplace, but there remain numerous accounting and reporting issues that need to be resolved in order to facilitate further market adoption.

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