Financial Stability Board
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July 15, 2020

Re: Paxos Trust Company, LLC Comment on Consultative Document Addressing the regulatory, supervisory and oversight challenges raised by global stablecoin arrangements

To Whom It May Concern:

Thank you for the opportunity for Paxos Trust Company, LLC ("Paxos") to comment on the Financial Stability Board ("FSB") Consultative Document Addressing the regulatory, supervisory and oversight challenges raised by global stablecoin arrangements (the "Report"), and to respond to the key questions that it sets forth.

It was a pleasure to have the opportunity to consult with the FSB in February 2020 during its consideration of the Report, and again in June 2020 following the Report's issuance. We are grateful for the FSB's consideration of input from regulated stablecoin issuers such as Paxos.

I. Background

Paxos Trust Company, LLC is a limited purpose trust company chartered by the New York Department of Financial Services (the "NYDFS") in 2015. Among other business activities, Paxos develops and offers asset-backed digital assets that conform to the FSB's definition of stablecoin—a crypto-asset that aims to maintain a stable value relative to a specified asset—including the dollar-backed stablecoins Paxos Standard ("PAX") and Binance Dollar ("BUSD"), and maintains systems and operations needed to support these products. PAX and BUSD employ an "asset-linked" stabilization mechanism, as described in the Report, meaning that each token is fully backed by one dollar held in reserve. The NYDFS approved and continues to regulate those stablecoins, consistent with nine out of the ten FSB High-Level recommendations to address the regulatory, supervisory and oversight challenges raised by GSC arrangements.

As a regulated financial institution, we agree with the FSB that appropriate, principles-based regulation—including effective cross-border regulatory coordination—is instrumental to the ultimate success of stablecoins. Such regulation must necessarily include regulation not only of stablecoin issuers, but of the stablecoins themselves, as well as of the asset reserves that back the stablecoins.

II. Effective Regulatory Oversight and Consistency Across Jurisdictions Is of Paramount Importance.

A. Regulation Is of Paramount Importance.

As a trust company and regulated financial institution, regulation is of paramount importance to Paxos. We see it as necessary for protecting the assets of customers and partners. Our compliance program has allowed us to work with other highly-regulated institutions and risk-averse brands. The Report appropriately focuses on the importance of regulatory oversight of stablecoin arrangements, including global stablecoin arrangements ("GSCs"), and regulatory consistency across jurisdictions. The Report also accurately identifies and characterizes the material risks to financial stability posed by GSCs.

To mitigate these and other risks relating to the adoption and use of GSCs, the Report properly exhorts G20 members to implement appropriately-tailored regulations, and to coordinate their regulatory oversight across jurisdictions. The Report appropriately promotes a principles-based regulatory framework, in order to provide consistency of minimum standards for stablecoin issuers, while allowing for flexibility to address the particular characteristics of a given stablecoin arrangement, regardless of how it may be tailored to a specific use case. One of those key principles is regulatory oversight of the stablecoin arrangement as well as of the stablecoin issuer.

B. Regulation of the stablecoins themselves—in addition to the regulation of the stablecoin issuer—fosters innovation while protecting consumers.

As Paxos has publicly stated in the past, we largely agree with the Report's recommendations regarding the regulation of stablecoins. The NYDFS regulates Paxos at the company level, and also regulates Paxos's suite of products and services, including issuance of stablecoins. The NYDFS has approved and continues to regulate each of the Paxos-issued stablecoins. The NYDFS's regulatory approval process included an in-depth vetting of Paxos's internal token-specific operational and compliance workflows, and its consumer protection measures. The NYDFS's oversight of Paxos stablecoins already substantially satisfies nine out of the ten FSB High-Level recommendations to address the regulatory, supervisory and oversight challenges raised by GSC arrangements. (The tenth, concerning regulatory cooperation and consistency across borders, is a worthy goal for regulators to work toward.)

We recommend that the FSB include in its guidance an articulation of the value of clear, consistent, and appropriately-tailored regulation of the stablecoins themselves—in addition to the regulation of the stablecoin issuer—to foster innovation while protecting consumers. This is an important distinction. By regulating the stablecoins themselves, regulators have the flexibility to impose appropriate capital requirements, verify reserves, ensure compliance with anti-money laundering regulation, and exercise greater oversight into the operations and accountability of the stablecoin issuer.

We agree with the Report's underscoring of the way in which the consortium model for stablecoins undercuts accountability by individual issuers and avoids regulation. Regulation of the stablecoins themselves could mitigate some of the risk that the consortium model for stablecoins presents.

C. Successful Mitigation of Risk Associated with Stablecoins Is Contingent Upon Establishing Regulatory Consistency Across Jurisdictions and Resolving Regulatory Uncertainty.

Paxos supports the FSB's recommendation that regulators pursue regulatory cooperation and consistency across borders. Paxos actively encourages the FSB to look to the precedent set by the constructive collaboration of the NYDFS with Paxos and other digital asset providers regulated by the NYDFS as the FSB proceeds.

1. Regulatory Consistency Fosters Efficiency

We recommend that the FSB include in its recommendations that relevant authorities across jurisdictions ensure consistency with respect to the principles, criteria and, where possible, measurable thresholds at which point a stablecoin approaches systemic considerations and, as a result, may be subject to additional regulatory requirements as a GSC. We add that the FSB should include in its recommendations elements used to define "home supervisors" or "lead overseers" and shape their role in regulating stablecoins. Those recommendations should include a means to ensure that the home supervisor or lead overseer maintains consistent regulation within its jurisdiction, and coordinates with its counterparts in other jurisdictions. That consistency will help drive clarity, innovation, and adoption of stablecoins, and will help avoid regulatory arbitrage.

Paxos fully supports regulatory consistency across borders, as well as the concept of a home supervisor or lead overseer that can foster efficiency for both stablecoin providers and regulators. The concept of a home supervisor or lead overseer is important and helpful to both stablecoin issuers and the regulators themselves. Stablecoin issuers cannot effectively answer to scores of different regulatory authorities at all times. Similarly, regulators cannot effectively understand operations of stablecoin issuers or the governing arrangements of stablecoins themselves if they are charged with oversight of so many institutions and products, including those that originate beyond the regulator's geographic jurisdiction. Instead, various aspects of a stablecoin's governance arrangement, including reserves, governance, resolution plans, etc. can all be overseen by a lead or home regulatory authority, with transparency to other regulators as needed.

2. Identifying an Appropriate Adoption Threshold Is Key to Mitigating Potential Risks

As defined, a GSC is effectively a stablecoin that has achieved broader adoption. Therefore, any stablecoin can become a GSC. Identifying the appropriate adoption threshold to invoke distinct, consistent global regulatory and supervisory requirements for stablecoins (including GSCs) is key to mitigating potential risks, maximizing the opportunities that GSCs present, and encouraging innovation with respect to stablecoins that are not yet GSCs. For the sake of regulatory consistency and planning for stablecoin providers, it would be helpful for the FSB to be more prescriptive on when a stablecoin crosses that threshold to becoming a GSC.

Among the elements listed in Annex 5 of the Report that could be used to determine whether a stablecoin qualifies as a GSC, of particular relevance to consider for the appropriate adoption threshold are: (a) achieving a minimum value of stablecoins in circulation equivalent to a defined percentage of the gross domestic product or money supply of a certain minimum number of the G20 countries; (b) exceeding a minimum number of users in a certain minimum number of G20 countries; and (c) the stablecoins are backed by assets denominated in a minimum number of G20 currencies. Authorities should evaluate the additional risk presented by a GSC's specific design and infrastructure, including the nature and means of custody of the reserve assets that back the GSC. We agree with the FSB that no existing, operational stablecoins pose financial stability or other systemic risks.

III. The Management of Stablecoin Reserve Assets Is Critical to the Security and Governance of a Stablecoin.

We agree with the FSB that the management of stablecoin reserve assets is critical to the security and governance of the stablecoin. The security of the asset reserves, and regulators' and users' ability to verify those reserves, are the most important elements of stablecoin design and infrastructure. That importance of stablecoin reserves may not be fully acknowledged in the Report, and the FSB should give the subject even more prominence. The importance of reliability of reserves cannot be overstated.

Many stablecoin issuers effectively develop the technology for the stablecoin, but lack necessary understanding of the more traditional financial components. In order to elevate the realm of stablecoins more broadly, stablecoin issuers need to excel at both aspects. Critical to stablecoins' success are the reserves that back asset-linked stablecoins, particularly a mechanism for the public to verify the amount and security of those reserve assets.

If those reserves are not secure, or do not equal or exceed the number of tokens outstanding, the stablecoin is inherently unstable. Transparency of those reserves is equally crucial. Any regulator, user or potential user of the stablecoin should be able to confirm easily that the reserves exist in amounts equal to or in excess of the number of tokens outstanding. Ideally, stablecoin issuers undergo robust and reliable auditing, then make those audit reports publicly available. Finally, stablecoin reserves must not be available for loan, and must be held bankruptcy remote, such as through a legally recognized trust company. Moreover, stablecoin issuers should be prohibited from accessing those reserves for any purpose unrelated to the issuance, redemption, or stabilization of value of the stablecoins; provided, however, that regulators should permit stablecoin issuers to hold the reserves in extraordinarily secure assets, such as government-backed bonds, and to keep any return on those assets as the issuer's fee. The certainty and structure of regulatory oversight can help to ensure bankruptcy remoteness, along with reliable resolution planning.

The Report could better recognize variations in maintenance and oversight of reserves, including whether the reserve assets are held bankruptcy remote, or whether the reserves are held in the safest possible assets, such as, in the case of a currency-backed stablecoin, those backed by the full faith and credit of the country that issues the currency. The Report could also draw a clearer delineation between whether the reserves are maintained in the specific assets backing the stablecoin (e.g., United States Dollars backing United States Dollar-backed stablecoins) versus other assets backing the stablecoin that might lead to fluctuation in the value of the stablecoin.

IV. Regulatory Goals Must Be Met with Sufficient Flexibility to Enable Financial Innovation.

We think that the recommendations in the Report effectively balance the regulatory goals of financial stability and consumer protection with financial innovation. They provide principles for regulators to follow in implementing their regulations, without being overly prescriptive in a way that would stifle innovation, or prohibiting the use of stablecoins altogether. How well regulators have achieved this balance, though, will ultimately be determined by individual regulators' application of the Report's recommendations.

As the Report acknowledges, the financial system of the future will be different from the financial system of the past. Inventive developments may be unprecedented, but that does not make them inherently bad or unstable. The appropriate regulatory framework allows for each development to be considered on its merits, subject again to principles-based rules. As we move toward broader adoption of stablecoins including GSCs, the differences among types of stablecoins and rules on their governance and reserves will become amplified. The Report appropriately recognizes the need for systematic principles to accommodate and address those differences across the regulatory framework.

As consumers of any product or service benefit from fair market competition, so do users of stablecoins benefit from robust competition in the stablecoin arena. We recommend that the Report's recommendations include a framework to establish a balance between regulatory scrutiny and a means to reduce barriers to entering the stablecoin arena. The appropriate balance would meet consumer protection objectives while increasing access, facilitating innovation, and fostering competition amongst stablecoin offerings. A principles-based and tiered approach with consistent minimum standards could be effective to achieve this balance.

The regulatory scheme should also focus on fair-functioning markets, and be constructed to encourage compatibility of many, if not all stablecoins, across platforms. The enhanced market efficiency that such compatibility creates allows for participant arbitrage and enables faster adoption. Regulators should coordinate across jurisdictions to promote and maintain fair competition in the broader global stablecoin marketplace.

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We appreciate and support the Report's constructive tone towards stablecoins. And we appreciate the opportunity to participate in the dialogue surrounding its recommendations. We look forward to continuing the conversation.

Kind regards,

Charles G. Cascarilla
Chief Executive Officer