

## Stablecoin Stability Assessment

# Paxos USD (USDP)

Nov. 26, 2024

### Summary

S&P Global Ratings assesses Paxos USD (USDP)'s ability to maintain a stable price vis-à-vis the U.S. dollar at 2 (strong). This stablecoin was launched in 2018 by Paxos Trust Co., initially as Paxos Standard, before being renamed Paxos USD in August 2021.

**Our asset assessment of 2 (strong) reflects USDP's low-risk and liquid reserves.** These can be held as either (i) cash deposits at various banking institutions (ii) U.S. treasury bills held by Paxos Trust Co., or (iii) reverse repurchase agreements (repos), backed by treasury bills or money market funds, held by Paxos Trust Co. Paxos Trust Co.'s issuance of U.S. dollar-backed stablecoins has been under the supervision of the New York State Department of Financial Services (NYDFS) since 2018. We note that cash deposits can be held at various rated as well as unrated U.S. financial institutions, however, they benefit from insurance from the Federal Deposit Insurance Corp. (FDIC) and are subject to the supervision and restrictions of the NYDFS.

**We have not made any adjustment, considering the NYDFS regulation of USDP, as well as USDP's governance and direct redeemability with Paxos.** These factors, in our view, offset the lack of secondary market liquidity.

**The stablecoin stability assessment could improve if we had further clarity whether the cash portion of the reserves were deposited with highly rated institutions.** On the other hand, the stablecoin stability assessment could worsen if we observe the use of riskier assets.

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[This report was not produced at the request of the stablecoin issuer or sponsor but with their input.]

### Asset assessment

1   Very strong
<b>2   Strong</b>
3   Adequate
4   Constrained
5   Weak

### Adjustment

Neutral (0)
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### Stablecoin stability assessment



Assessed on a scale of 1-5, where 1 is very strong and 5 is weak.

# Asset assessment: 2 | Strong

1   Very strong	2   Strong	3   Adequate	4   Constrained	5   Weak
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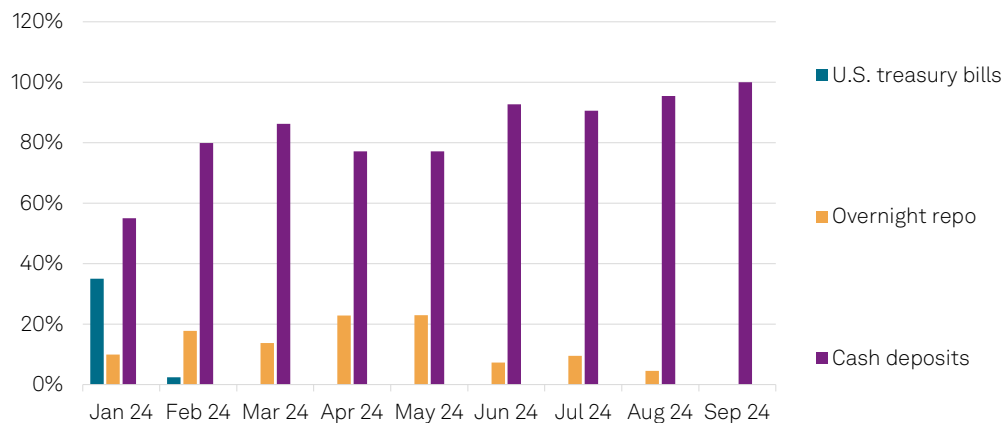
**USDP was created in 2018 and is a fully fiat-collateralized stablecoin.** It is issued by Paxos Trust Co. which is headquartered in New York. Being under the supervision of the NYDFS, Paxos Trust Co. is required to comply with certain guidance as a stablecoin issuer. In line with such guidance, for each USDP token it issues, Paxos Trust Co. receives corresponding U.S. dollars from customers, which it holds as collateral (or reserves) in the form of (i) cash deposits at various banking institutions insured by the FDIC, (ii) cash equivalents such as money market funds or overnight reverse repos backed by the U.S. Treasury, and (iii) U.S. treasury bills with tenors of three months or less.

**Over the past 12 months, USDP has increasingly shifted its reserves to cash deposits insured by the FDIC at eligible U.S. institutions.** According to the latest report published by Paxos Trust Co., as of Sept. 30, 2024, all USDP reserves are held in cash deposits at various U.S. institutions and benefit from insurance from the FDIC. These deposits are subject to NYDFS-approved restrictions and supervision. Over 2024, we have seen a continuous decline in circulation of USDP, to \$107.1 million as of Sept. 30, 2024, from a peak of \$1.04 billion in April 2023. One of the reasons for this decrease over 2024 is the community vote from decentralized blockchain protocol MakerDAO to remove USDP from the peg stability module of the DAI stablecoin.

**As of September 2024, all the reserves are held as cash deposits and can be considered highly liquid, but we note that they may be held at a variety of rated as well as unrated banks.** While cash deposits may be held at less creditworthy institutions, they benefit from FIDC insurance. Nevertheless, in case of default of the institution, it may take several months to receive payment from the FDIC. We also note that these funds are spread across many U.S. institutions, which significantly reduces the risk of reliance on one institution. Further, they are subject to the restrictions and supervision of the NYDFS. Overall, we assess USDP's assets at 2 (strong).

**Exposure to currency or interest rate risks appears limited at present given the majority of USDP reserves are held as cash deposits.** Further, as part of the NYDFS' guidance, since the USDP reserves are held as cash deposits, money market funds, or U.S. treasury bills, exposure to interest rate risk is limited, given the short-dated nature of these instruments.

## USDP reserves breakdown over 2024



Source: S&P Global Ratings.

# Adjustment: Neutral

Neutral

Negative

## Overall adjustment

Considering the NYDFS' regulatory framework and governance (in particular, the segregation of USDP's assets from the sponsor Paxos Trust Co.), we do not adjust our asset assessment. Secondary market liquidity may appear scarce and current market capitalization is relatively modest compared to the overall stablecoin market. However, USDP can be redeemed directly and within one business day with Paxos Trust Co. for U.S. dollars.

## Governance: Clear guidelines for asset management with appropriate transparency

- Being under the supervision of the NYDFS, the assets of the stablecoin are disclosed publicly and in line with regulation, focusing only on the U.S. treasury bills, overnight reverse repos backed by U.S. treasury bills, money market funds, and cash deposits at various financial institutions insured by the FDIC.
- Transparency is maintained through monthly reporting of reserve holdings and third-party attestations. Paxos Trust Co. publishes a monthly reserve report outlining the composition of the reserves five business days after the end of each month.
- In addition, Paxos Trust Co. has engaged an independent registered public accounting firm to regularly examine and attest to the underlying U.S. dollar balance.

## Regulatory framework: USDP must follow NYDFS guidelines

Because Paxos Trust Co. is under the supervision of the NYDFS for its issuance of U.S. dollar-backed stablecoins, a set of rules apply as part of the NYDFS' stablecoin guidance:

- There must be a proper segregation of the assets backing USDP from the assets of USDP's sponsor Paxos Trust Co. The assets backing USDP must be insulated from a bankruptcy of Paxos Trust Co. Under New York banking law, in the event of Paxos Trust Co.'s insolvency, USDP's assets cannot be used to settle Paxos Trust Co.'s debts, thus providing a layer of protection to the holders of USDP.
- There is a minimum requirement for the quality of the assets (as mentioned above in the asset assessment section).
- Monthly attestations of USDP reserves must be published by an independent certified public accountant licensed in the U.S. In the case of USDP, this is WithumSmith+Brown, PC.
- An annual report must be provided by an independent certified public accountant licensed in the U.S., verifying management's assertions concerning the effectiveness of the internal controls, structure, and procedures for compliance with the requirements of the monthly attestation. This is required by law and confirmed by the auditor.

## Liquidity and redeemability: Direct primary redeemability but weak secondary market liquidity

- USDP can be directly redeemed for the same value in U.S. dollars with Paxos Trust Co. if the user has an account with know-your-customer verification. According to the stablecoin's terms and conditions, redemption will occur in up to one business day. This is within the guidance set by the NYDFS where the redemption should not take more than two business days after receiving the redemption order.
- Although Paxos Trust Co. may require a minimum amount of USDP for redemption, that amount is currently minimal and equal to the minimum wire fee charged by the holder's bank for the transaction.
- Although existing for several years, USDP is less prominent than other stablecoins such as USDC, USDT, or DAI. USDP can be traded on the secondary market of some centralized exchanges, including Binance and Coinbase, but with relatively low liquidity. Furthermore, while USDP was one of the eligible stablecoins under DAI's Peg Stability Module, a community vote from MakerDAO decided to reduce this exposure to zero.

- Like other stablecoins, the availability of parties that can support payments 24 hours a day, seven days a week, remains limited. Therefore, redemption of USDP is constrained by the U.S. banking system's operating hours.

### **Technology and third-party dependencies: Audited smart contracts and no third-party dependencies**

- USDP is deployed on the Ethereum blockchain as an ERC-20 token, which is the technical standard for interchangeable tokens using the Ethereum blockchain.
- The smart contract was last audited in June 2019 by Trail of Bits, which did not mention any high-risk features in its audit report.
- The smart contract uses open-source code and we are not aware of any bug bounty program (an incentive for developers to identify and report vulnerabilities). The contract does not rely on an oracle to connect to data and information from external systems. Since all of USDP's reserves are held and managed off the blockchain, there is less reliance on blockchain technology. Therefore, a major disruption of the blockchain network is likely to have a limited impact on the stability of the coin.

### **Track record: Limited price volatility and relatively marginal weight within the stablecoin market**

- USDP showed some price volatility in March 2023 following the Silicon Valley Bank (SVB) failure. We believe this can be attributed to general market sentiment on stablecoins at that time, rather than to any reasons specific to USDP. The volatility lasted for only a short period. We have seen limited price volatility in 2024.
- USDP's market capitalization peaked at \$1.49 billion in May 2021 before declining, although it stayed above \$1.0 billion in April and May 2023. As of Nov. 14, 2024, USDP's market capitalization was at \$109.7 million on Etherscan. Although USDP is one of the first stablecoins issued, it currently represents a limited proportion of the overall stablecoin market, with less than 0.06% of the total market capitalization.

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