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Before we begin: Morgan Lewis and Global Technology

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Check back to our Technology May-rathon page frequently for updates and events covering the following timely topics:

<table>
<thead>
<tr>
<th>21st Century Workplace</th>
<th>Cybersecurity, Privacy and Big Data</th>
<th>Medtech, Digital Health and Science</th>
</tr>
</thead>
<tbody>
<tr>
<td>Artificial Intelligence and Automation</td>
<td>Fintech</td>
<td>Mobile Tech</td>
</tr>
<tr>
<td>COVID-19</td>
<td>Global Commerce</td>
<td>Regulating Tech</td>
</tr>
</tbody>
</table>

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Topics

- Nick Moore: Introduction: Stable coins
- Christine Lombardo & Sarah Riddell: US regulatory treatment of stablecoins
- Steven Lightstone: UK regulatory treatment of stablecoins
- Sarah-Jane Morin: US tax treatment of stablecoins
- Neil McKnight: UK tax treatment of stablecoins
Introduction: Stable Coins

- Cryptoassets vs stablecoins – an introduction
- The shortcomings of existing payment systems
- Risks and challenges of stablecoins
- In particular, how do stablecoins fit in to existing regulatory frameworks?
- Public policy issues
SECTION 02
US & UK REGULATORY TREATMENT OF STABLECOINS
Concerns related to stablecoin:

- Financial stability
- Monetary policy control
- Consumer protection
- Data protection
- Financial integrity

Types of stablecoin:

- USD Coin
- PAXOS
- Facebook Libra
US Regulatory Treatment of Stablecoins continued

**AML**
- SEC, CFTC, FinCEN issued a joint statement in 2019 reminding persons engaged in digital asset activities that they are still obligated to comply with AML and countering the financing of terrorism obligations under the Bank Secrecy Act

**Money Services Business**
- FinCEN
- State considerations

**SEC & CFTC Implications**
- In October 2019, the SEC issued no-action relief to Paxos Trust Company, permitting Paxos Trust Company to operate a securities settlement system without registering as a clearing agency

**Trust Company**
- NY Department of Financial Services

**State Attorney Generals**
- Investigation and enforcement authority
US Legislative Efforts: DOA?

IN THE HOUSE OF REPRESENTATIVES

Mr. Davidson of Ohio (for himself, Mr. Sorto, Mr. Gortieres, Mr. Byro, Ms. Gabbard, and Mr. Perriello) introduced the following bill, which was referred to the Committee on Financial Services, and in addition to the Committee on Ways and Means. On a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned.

A BILL

To amend the Securities Act of 1933 and the Securities Exchange Act of 1934 to exclude digital tokens from the definition of a security, to direct the Securities and Exchange Commission to enact certain regulatory changes regarding digital assets secured through public key cryptography, to adjust taxation of virtual currencies held in individual retirement accounts, to create a tax exemption for exchanges of one virtual currency for another, to create a de minimus exemption from taxation for gains realized from the sale or exchange of virtual currency for other than cash, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled.

SECTION 1. SHORT TITLE.

This Act may be cited as the “Token Taxonomy Act of 2019”.

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In March 2020, the International Organization of Securities Commissions ("IOSCO") published a public report (the "IOSCO Report") detailing "potential issues that may arise from stablecoins with global reach and adoption."

To better analyze these issues, the IOSCO Report sets forth a "Hypothetical Case Study" with the following parameters (among others):

- A private company (the "Company") issues a stablecoin (the "Coin") that is intended to act as a means of exchange on the Company's designed platform and is also accessible by third parties.
- The Coin will be backed by assets that are held in accounts at a number of global financial institutions (the "Reserve Fund").
- The Reserve Fund will be managed by the Company with the goal of value preservation and liquidity, and will be composed of (i) low volatility currencies, (ii) bank deposits and (iii) sovereign debt instruments.
- Market makers and liquidity providers (the "Authorized Participants") would maintain the trading price of the Coin at a value close to the value of the Reserve Fund through arbitrage.
- The Coin will be transferred through crypto-asset trading platforms and peer-to-peer transactions.
IOSCO Hypothetical Case Study

The CPMI-IOSCO Analysis identifies the PFMI:s that are likely applicable to centralized stablecoin arrangements, partially distributed stablecoin arrangements and highly distributed stablecoin arrangements:

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<thead>
<tr>
<th>Principles</th>
<th>Centralized</th>
<th>Partially Distributed</th>
<th>Highly Distributed</th>
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<td>7. Liquidity Risks</td>
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<td>17. Operational Risk</td>
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* Indicates that CPMI-IOSCO anticipates that this Principle will be challenging to observe.

** Indicates that CPMI-IOSCO anticipates that this Principle will only be applicable in certain circumstances and, if applicable, will be challenging to observe.
UK Regulatory Treatment of Stablecoins

FCA taxonomy:
- Security tokens (regulated)
- E-money (regulated)
- Unregulated tokens

Dealing in unregulated tokens (except cryptoasset derivatives) does not require FCA authorisation

FCA does not treat stablecoins as separate category of cryptoasset

AML legislation applies to cryptoasset business

FCA encourages consistency in regulation via Global Financial Innovation Network

Treasury will consult on whether further regulation is needed in cryptoasset market

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SECTION 03
US & UK TAX TREATMENT OF STABLECOINS
US Tax Treatment of Stablecoins

No specific guidance on stablecoins from the IRS or U.S. Treasury.

Open questions:
- Distinguish between stablecoin and other cryptocurrencies?
- Gains/losses generated by underlying basket of assets: Taxable? Reportable? By whom?

IRS Notice 2014-21: convertible virtual currency is treated as property.
Requires basis tracking and FMV determinations.
UK Tax Treatment of Stablecoins

- Cryptocurrencies are not treated as cash, but rather are treated as assets more akin to shares.
- Transactions in cryptocurrencies must be valued to calculate UK tax liabilities.
- The accounting treatment of stablecoins – whether as intangibles or financial assets – may give rise to tax consequences.
- Stablecoins pegged to GBP may remove some of the issues caused by value fluctuations.

HM Revenue & Customs has published guidance on the UK tax treatment of cryptocurrencies (in the form of exchange tokens) but this does not specifically cover stablecoins.
Overview
The growth of stablecoins presents a challenge for global regulators, but also an opportunity to facilitate development of revolutionary access to the modern financial system. A successful way forward will require international collaboration and especially the alignment of the different regulatory spheres into which components of a stablecoin ecosystem will fall.

Global regulation
The cross-border nature of stablecoin gives rise to the need for consistent regulation in relevant jurisdictions. IOSCO’s report demonstrates the patchwork of regulation needed to comprehensively regulate stablecoin.

US regulation
The SEC, CFTC, and FinCEN are on the forefront of crypto asset and stablecoin regulatory issues. Based on legislative efforts, we will see FinCEN take the lead on stablecoin issues with the SEC and CFTC responsible for more traditional oversight (such as clearing agency registration).

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UK regulation
Stablecoins fall within existing regime, but Treasury to consult on whether further regulation needed.

US tax
Convertible virtual currency is generally addressed under U.S. tax guidance but stablecoins specifically are not.

UK tax
Cryptoassets are for UK tax purposes treated more like assets such as shares rather than cash.
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We have formed a multidisciplinary Coronavirus/COVID-19 Task Force to help guide clients through the broad scope of legal issues brought on by this public health challenge.

To help keep you on top of developments as they unfold, we also have launched a resource page on our website at

www.morganlewis.com/topics/coronavirus-covid-19

If you would like to receive a daily digest of all new updates to the page, please visit the resource page to subscribe using the purple “Stay Up to Date” button.
Biography

Nick Moore’s practice focuses on complex cross-border M&A, investments, joint ventures, strategic advice and corporate restructurings, with a particular focus on the fintech and TMT sectors.

His clients in the fintech sector include banks, investment banks and insurers, notably advising TSB on its separation from Lloyds, Williams & Glyn on its proposed separation from RBS and some of the largest ever transactions in the UK insurance market including the merger of Allied Zurich and Zurich Allies to create Zurich Financial Services and the acquisition by Swiss Re of GE's UK business.
Christine Lombardo advises investment managers and broker-dealers on financial regulatory matters.

She concentrates her practice on securities regulation for a broad range of financial firms including retail asset managers, private fund managers, family offices, broker-dealers, other professional traders, and high-net-worth individuals.

Christine also counsels legal, compliance, and business personnel on the structure, operation, and distribution of advisory programs, including digital advisory offerings, and investment products, including hedge funds, private equity funds, venture capital funds, real estate funds, and other alternative investment products.
Biography

Leveraging her experience as a lawyer at the US Commodity Futures Trading Commission (CFTC), Sarah V. Riddell advises domestic and foreign exchanges, derivatives clearing organizations, swap execution facilities, and other financial institutions on a broad range of regulatory matters, including CFTC registration and compliance.

Sarah also assists hedge fund clients with CFTC and National Futures Association (NFA) registration, compliance, and examination questions.
Steven Lightstone advises on financial services, securities, and derivatives regulatory issues.

His clients include asset managers across a wide range of asset classes and their funds, fintech firms, banks, broker-dealers, payment institutions, institutional investors, insurers, lenders, and market associations.

Steven is a founding member of the firm’s fintech group and regularly contributes to the firm’s fintech blog.
Biography

Sarah-Jane Morin represents public and private companies, private equity funds, venture capital funds, real estate funds, portfolio companies, and alternative investment vehicles in the tax aspects of complex business transactions and fund formations, including domestic and cross-border investment strategies, sponsor investment strategies, limited partner investment strategies, mergers, acquisitions, integrations, buyouts, recapitalizations, debt and equity restructurings, and ongoing operations and tax compliance issues.

She also advises on international tax issues, including the tax aspects of offshore vehicles (CFC/PFIC/GILTI regimes), anti-deferral rules (Subpart F), withholding, cost sharing, and transfer pricing.
Biography

Neil McKnight advises on the full range of corporate, finance, and real estate tax matters, including corporate mergers and acquisitions (both buy and sell side), reorganisations, and real estate acquisitions, disposals and investment transactions.

Neil has a particular interest in indirect tax and VAT matters relating to cross-border transactions, particularly in the fintech and technology sectors.
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