

Stablecoin Safety Assessment

Coin	USDM
Date	20-11-2023
Overall Grade	B+

Factor Scores:

S. No	Factor	Score	Assessment
1	Stability	0.85	Stable
2	Management	0.82	Low risk
3	Implementation	N/A	Not assessed
4	Decentralization	0.10	Not relevant for fiat-backed stablecoins
5	Governance	0.81	Low risk
6	Externals	N/A	Not assessed

Summary

- USDM is a US dollar-denominated, yield-bearing stablecoin issued by Mountain Protocol. Yield is generated by investing USDM's reserves in short-term US Treasury instruments. The current yield is around 5%.
- USDM is made available to non-US users under the US SEC's Reg S exemption. US persons are prohibited from accessing USDM or Mountain Protocol.
- USDM is a daily rebasing token that rebases the token balance instead of increasing token price to reflect yields accrued.
- Mountain Protocol holds a 'Class M' Digital Assets Business license issued by the Bermuda Monetary Authority (BMA). It is a limited-period, scale-restricted license offered to projects in a 'sandbox' environment that are subject to enhanced supervision and in the process of building effective and scalable compliance programs before being granted a full-fledged Class F license. Bermuda has earned its reputation as a leading offshore financial centre and one of the world's largest reinsurance centres.
- USDM reserves are to be held as US Treasury Bills, with an average maturity of 60 days or less. In the last attestation, US Treasury Bills comprise 94%, with the balance as cash in transit (6%), driven by lags in traditional payment networks. The reserves are held at reputable US-regulated custodians.
- USDM reserves are bankruptcy-remote. They are held in trust by regulated custodians in segregated accounts on behalf of, and for the benefit of, USDM holders.

- We believe USDM is appropriate we believe USDM is a safe stablecoin that is appropriate for non-US retail users, DAOs & non-US institutions who want a regulated stablecoin that also provides access to US Treasury yields.

USDM's rating can be upgraded from B+ to A- upon receiving a Class F license.

Evaluation

1. Stability [Score 0.85]

1.1. Reserves [Score 0.90]

1.1.1. Collateralization % and Type of Collateral [Score 1.00]

As of November 1, 2023, USDM is fully backed by US Treasury Bills (94%) with an average maturity of 60 days or less, with the balance as cash in transit (6%), driven by lags in traditional payment networks. Assets are all held in fully segregated accounts.

As mandated by the Bermuda Monetary Authority, USDM reserves are managed by EQ Capital, a professional investment manager based in Bermuda, in accordance with USDM's [Investment Mandate](#).

Apart from direct investments in US Treasury Bills, USDM may also be backed by US Treasury Notes with near maturity, Money Market Funds investing in short term US Treasuries, Treasury ETFs and Reverse Repo Agreements collateralized by US Treasuries. These have been chosen as US Treasuries are considered the safest USD-denominated assets.

1.1.2. Storage of Assets [Score 0.70]

For off-chain collateral, we rank storage methods as follows (highest to lowest)

- With regulated custodians in reputable jurisdictions
- With regulated custodians not in reputable jurisdictions (e.g, BVI, Bahamas)
- Others / Undisclosed

USDM reserves are currently held at two US-regulated custodians. One is a global systemically-important bank and the other is a Nasdaq-listed Fortune 100 financial institution. Further, each custodian has been pre-vetted by the Bermuda Monetary Authority.

1.1.3. Asset Segregation

[Score 1.00]

USDM reserves are held in trust by a regulated custodian in segregated accounts on behalf of, and for the benefit of USDM holders. We believe that USDM reserves are bankruptcy-remote for the following reasons:

- A 'bankruptcy-remoteness' opinion from an international legal firm has been obtained. Bluechip has reviewed a copy of this.
- Pursuant to Mountain Protocol's Terms & Conditions, the issuer does not retain legal and beneficial title to USDM reserves and holds them in trust for USDM holders
- Mountain Protocol holds USDM reserves in custodial accounts, the terms of which expressly state that those accounts are held 'on behalf of' or 'for the benefit of' USDM holders.
- The Digital Asset Business Act 2018 of Bermuda and the Code of Practice issued thereunder grant legal recognition to the concept of 'client assets', and mandate that such assets be segregated from the licensed undertaking's own funds, and make arrangements to ensure the return of client assets in the event the undertaking is placed into liquidation, becomes insolvent or is a victim of theft.

1.2. Market Feedback

[Score 0.88]

1.2.1. Frequency of Deviation Below Peg

[Score 1.00]

Number of Days where VWAP < Peg by 0.5% or more during the past 180 days = 0

1.2.2. Max Deviation Below Peg

[Score 1.00]

Biggest daily VWAP deviation below peg: 0.30%

1.2.3. Volatility (% per day)

[Score 1.00]

Daily volatility (%) over the past 180-day period: 0.10%

1.2.4. Downside Volatility in a Market Downturn

[Score 0.50]

Average deviation below peg during the 5 worst-performing days for BTC (DoD price change) in a 180-day period: 0.11%

1.2.5. Liquidity Pool Imbalance

[Score N/A]

Not assessed since on-chain liquidity is limited.

1.3. Stability Mechanism

[Score 0.75]

1.3.1. Core Mechanism

[Score 1.00]

USDM relies on market participants to arbitrage differences between the market price of USDM and

the net asset value of USDM). We believe this is the most effective price stability mechanism.

When USDM trades away from its peg, any user who has a KYC'd account with Mountain Protocol can mint or redeem USDM for USDC (currently) or U.S Dollars (soon) and make an instant profit. This risk-less profit opportunity attracts more participants and eventually pushes the market price of USDM towards its peg.

1.3.2. Primary Liquidity Access

[Score 0.50]

Only institutions who possess a KYC'd account with Mountain Protocol can mint or redeem USDM for USDC (currently) or U.S Dollars (soon).

2. Management

[Score 0.82]

2.1. Restrictions

[Score 0.82]

2.1.1. Known Core Teams

[Score 1.00]

Mountain Protocol was founded in October '22 by Martín Carrica (CEO) and Matías Caricato (CTO). Some notable investors backing the team are Coinbase Ventures, Castle Island Ventures and founders of OpenZeppelin, Reflexer Labs and Nansen.

Additionally, Mountain Protocol has introduced a third-party oversight mechanism for critical operational and financial functions with meaningful financial impact. Steakhouse Financial has been engaged to take on the oversight role.

2.1.2. Jurisdiction Score

[Score 0.62]

Our jurisdiction scores are derived from the World Justice Project's Rule of Law (RoL) Index – which ranks countries. Where unavailable, we use proxy scores from the World Bank's Rule of Law governance indicator.

Mountain Protocol is headquartered in Bermuda. Bermuda is a leading offshore financial center and one of the world's largest reinsurance centers.

2.2. Track Record

2.2.1. Team's Background

[Score N/A]

Not scored

3. Decentralization

[Score 0.10]

3.1. Regulatory Oversight

[Score 0.00]

Regulatory oversight increases the risk of censoring endpoints of the stablecoin's network (such as the issuer, banks and custodians) as well as users. A score of 0 indicates a high degree of government censorship risk.

Mountain Protocol is regulated by the Bermuda Monetary Authority as a Digital Assets Business (DAB). In addition, Mountain Protocol also complies with guidelines and sanctions from international authorities such as US Treasury Department, OFAC, FinCen etc.

Note: Censorship resistance is not a key objective common to all stablecoins. Consequently, a low score may not be a relevant source of concern to most stablecoin users. Furthermore, regulatory oversight can also be beneficial to some users as it entails more robust consumer protection mechanisms and increased transparency.

3.2. Custodian Risk

[Score 0.50]

When evaluating custodian risk (i.e, credit risk of entities holding assets), we consider the distribution of assets between entities that hold the assets, such as the issuer, their banks and custodians.

USDM reserves are currently held at two US-based, regulated custodians. One is a global systemically-important bank and the other is a Nasdaq-listed Fortune 100 financial institution. Further, each custodian has been pre-vetted by the Bermuda Monetary Authority.

3.3. Type of Collateral

[Score 0.00]

When evaluating decentralization, we consider the extent to which the stablecoin's value is tied to a central authority or external fiat currency. Monetary policies / decisions taken by such authorities / central banks can have an impact on the purchasing power of the collateral.

USDM is fully backed by USD-denominated assets such as US Treasuries and US Dollars.

(Fiat currencies earn a score of 0 and decentralized cryptocurrencies earn a score of 1)

Note: Independence from a nation's monetary policies is not a key objective common to all stablecoins. Consequently, a low score may not be a relevant source of concern to most stablecoin users.

3.4. Decision Making & Voting Power

[Score 0.00]

Fiat-backed stablecoins such as USDM are run by private corporations. As such, the absence of decentralized decision making and voting power is a feature, not a bug.

3.5. User Blacklisting

[Score 0.00]

Mountain Protocol can blacklist specific user wallets.

Note: Censorship through blacklisting helps prevent legitimate users from transacting with criminals. This is particularly relevant to institutional users who are obligated to report their transactions and activities.

4. Governance

[Score 0.80]

4.1. Holder Protection

[Score 0.50]

Mountain Protocol holds a 'Class M' Digital Assets Business license issued by the Bermuda Monetary Authority (BMA). It is a limited-period, scale-restricted license offered to projects in a 'sandbox' environment. This license subjects Mountain Protocol to enhanced supervision and requires the company to build out an effective and scalable compliance program. Upon meeting the BMA's requirement, Mountain Protocol may be granted a full-fledged Class F license.

The Digital Asset Business Act 2018 mandates the following:

- Section 17 - *"A licensed undertaking holding client assets shall keep its accounts in respect of such assets separate from any accounts kept in respect of any other business."*

- Section 18 -
 1. *"A licensed undertaking holding client assets shall maintain a surety bond or trust account, or indemnity insurance for the benefit of its client in such form and amount as is acceptable to the Authority for the protection of its clients or such other arrangements as the Authority may approve."*
 2. *"To the extent that a licensed undertaking maintains a trust account in accordance with this section, such trust account must be maintained with a qualified custodian appropriate for the type of asset held."*

Further, the BMA's Code of Practice for digital asset businesses reinforces the above by stating that *"Section 18(1) of the Act directs a DAB to ensure that any assets belonging to clients are kept segregated from the DAB's own assets. The DAB may place client assets in a trust with a qualified custodian, have a surety bond or indemnity insurance, or implement other arrangements to ensure the return of client assets in the event the DAB is placed into liquidation, becomes insolvent or is a victim of theft."*

Although the BMA does not have specific-purpose regulations or guidelines for stablecoins, the BMA's approach to licensing Mountain Protocol under the Digital Asset Business Act 2018, seems directionally aligned with the NYDFS' approach.

In summary, we find USDM by Mountain Protocol to be a safe stablecoin. Bluechip will continue to monitor for any risks arising from changes to USDM's product design until Mountain Protocol receives a Class F license.

4.2. Periodic Reserves Attestations

[Score 1.00]

Our rating considers the type & frequency of reserves attestations.

Type [Score 1.00]

Attestations can be broadly classified into 2 categories based on the nature of the auditor's report. – 'Assurance Engagements' and 'Agreed Upon Procedures'.

Assurance Engagements are similar to audits in that the auditor determines the nature and extent of work required to express an independent opinion (provide assurance) on a particular matter. The auditor is free to conduct as deep an examination as they may deem appropriate to arrive at a reasonable conclusion. Assurance Engagements require the auditor to stake their reputation, and therefore carry more weight. Assurance Engagements provide either a 'reasonable level of assurance' (also called examinations) or a 'limited level of assurance' (also called reviews). The former is better and offers the same level of assurance that is provided in a full-fledged financial audit but with a comparatively smaller scope and subject matter.

Agreed Upon Procedures are engagements wherein the auditor is engaged by the issuer to perform specific tasks and report on factual findings. The auditor's scope of work is limited by the issuer and does not involve expressing an opinion. Instead, the auditor provides factual statements in his or her report and the users of such reports are expected to form their own opinions on the matter. In such cases, the auditor does not stake their reputation and provide an assurance of any sort. AUPs, while useful, are inferior to Assurance Engagements.

Frequency [Score 1.00]

Reserves attestations can be monthly, quarterly, half-yearly or annually.

Since review procedures are performed on reserves data as of a particular day (typically, last day of the quarter), they do not consider transactions and events which occur in between reporting dates. Consequently, periodic reserves attestations provide a lower degree of assurance compared to a full scope financial audit.

Mountain Protocol has engaged Nephos Global, a UK-based accounting firm (through a UAE subsidiary), to provide monthly assurance opinions on its reserves. These attestations are performed in line with International Financial Reporting Standards (IFRS).

4.3. Financial Audits

[Score N/A]

Periodic Reserves Attestations alone are inadequate to ascertain the existence and adequacy of reserves, they need to be complemented by full scope annual financial audits.

As a Digital Assets Business license holder, Mountain Protocol is required to

- Have the annual financial statements audited by an approved auditor
- Seek prior consent from the Bermuda Monetary Authority for appointment of the auditor

Mountain Protocol has engaged Harris and Trotter, a UK-based audit firm specializing in digital assets. Some of their prominent clients are Wintermute, 'The Sandbox', Biconomy, Blockchain.com and 1inch.

We have not assigned a score as Mountain Protocol is yet to be audited after the recent launch of USDM.

4.4. Redemption Policy

[Score 1.00]

Our scoring reflects whether stablecoin issuers have reasonable and transparent timelines for processing redemptions.

According to Clause 7(3) of Mountain Protocol's Terms and Conditions (Withdrawal and Liquidity SLA):

"Mountain Protocol keeps liquidity to facilitate 24/7 redemptions. This liquidity is sized to support business as usual redemptions. In case of large redemption flows, users would default to a T+2 business day withdrawal SLA. This SLA does not supersede delays required for Mountain Protocol to comply with regulatory or compliance obligations and also depends on the uptime of our financial partners."

Mountain Protocol has adopted best-in-class redemption terms that are comparable to redemption mandates by NYDFS.