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Virtual Event Series

Should Treasuries Be Tokenized?

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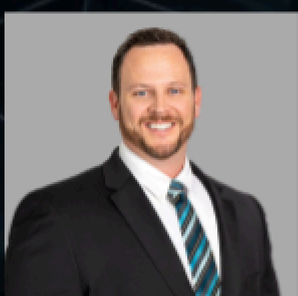
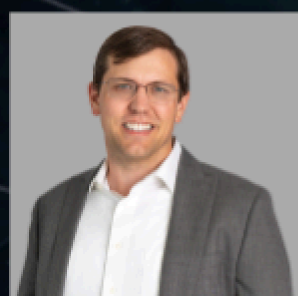


Ryan McRobert
Partner
Fenwick & West



Ryan Mitteness
Partner
Fenwick & West

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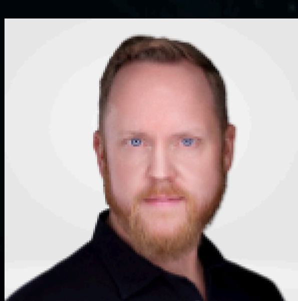

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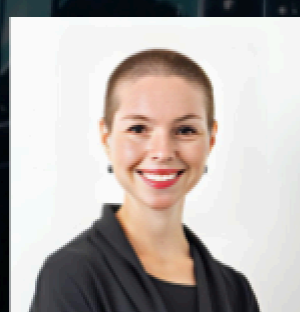

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DiffuseTap: Should Treasuries Be Tokenized?

Last time on DiffuseTap, Ryan McRobert and Ryan Mitteness, Partners at Fenwick & West, talked to us about the growing market for tokenized US treasuries, which investors are interested in these products now, and the regulatory hurdles in bringing them to prominence.

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DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas)... straight from your armchair like a boss.

Meet the Speakers

Ryan McRobert provides strategic counsel to entrepreneurs and growing companies in the technology sector, with a focus on Web3.0. Ryan has assisted in the development of many decentralized structures and models that are now used industrywide.

LinkedIn: @ryan-mcrobert

Ryan Mitteness advises clients in life sciences and technology space on capital markets, SEC compliance and other general corporate matters. He has represented issuers, investors and financial institutions in all manners of transactions, from IPOs, reverse mergers, and ATM offerings, to PIPE offerings, and other financings.

LinkedIn: @ryan-mitteness

About Diffuse

We are an alternative fund platform offering differentiated investment products. From digital assets, to VC funds, and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information visit www.diffusefunds.com.

KENNY ESTES: On to the Ryans. Let's start with Ryan McRobert. Do you want to give a little bit of your background and what you're up to over at Fenwick? And then, we can pass it over to Mr. Mitteness.

RYAN MCROBERT: Absolutely. Great to see everyone, great attendance today. Thanks for being here. My name is Ryan McRobert. My partner Ryan Mitteness and I are both with Fenwick and West, in the Fenwick Seattle office. Fenwick is a large law firm based in Silicon Valley, and I'm a partner in its startup and blockchain group. I've been with Fenwick my whole career, and a very large part of my practice now is working with crypto and blockchain companies.

Everything from formation to fundraising, to token generation events, to working with the offshore long term governance association, the DAOs, or the foundations, whatever you want to call it. We have about 30 people in our blockchain group. It’s the largest blockchain group, to my knowledge, in any law firm in the world and it's something that we take a lot of pride in.

We work with hundreds of different companies and have done hundreds of token launches over the course of the lifespan of the group. I'm very happy to be here. Thank you to Diffuse for giving us a chance to talk today.

Real world asset tokenization is obviously a very hot topic. Hopefully we could shed a little bit of light on what it looks like from a regulatory perspective. The other Ryan, Ryan Mitteness, I'll turn it over to you, if you would like to do an intro.

RYAN MITTENESS: Yes, thank you. And thanks, everyone, for having us. I'm excited to be here. This is my first time doing a DiffuseTap function. As McRobert noted, I'm a partner here in the Seattle office at Fenwick, where. I'm in the capital markets group.

My practice has historically been focused on public companies, IPOs, companies going through the SEC registration process, etc. I advise clients and issuers on all sorts of SEC compliance matters and any type of securities offerings, both public SEC compliance and private exempt offerings. And then, also helping clients deal with SEC registration requirements and interactions with the SEC on a go-forward basis.

I've started recently working more with the blockchain group and thinking more about what SEC registration pathways could look like and how to further integrate our capital markets practice with our blockchain group. I think we're coming up with some exciting developments there. Maybe it will not happen today, but I think there is a bright future for the SEC pathway on these matters. I look forward to talking more about tokenized treasuries and other real world assets.

KENNY: I'm surprised that as our lawyers, you did not advise us to disclaim that you're our lawyers. I feel like there's some conflict of interest we should have put out into the ether there. Mr. McRoberts, maybe we'll start with you. What is the state of play for treasuries? Because that is the title for this talk. “Treasuries on chain”, specifically.

MCROBERT: I'm actually going to hand this over to Mr. Mitteness. But by the way, Kenny, thanks for the disclaimer. I wasn't planning on dropping that in there. But you're also not the only client on this call, so I'll just leave it at that. Sorry Ryan, please go ahead.

MITTENESS: Yeah. Talking about the tokenized treasury market as a whole right now, in a way, it is exploding from just a year ago, as far as the on-chain portion of it. Currently, it looks like we're at about $1.2 billion right now in US treasuries that are tokenized.

By far, the two biggest players right now are Franklin Templeton, which has a US registered mutual fund that anybody can invest in through their specific proprietary on-chain program. And then, just this March, Blackrock launched its private fund, which is already now the largest single source of tokenized treasuries. That fund is valued at more than $380 million as of right now.

Those are the biggest players right now. It's almost an exploding space. And if you think about the US treasury tokenized market, it’s about $1.2 billion. In comparison, the total market of stable coins, which in some sense, tokenized US treasuries is trying to take a piece of, is about $150 billion right now. There is a large room for growth there to further capture that.

KENNY: Okay. McRobert, did you want to add anything to that?

MCROBERT: I think Mitteness said it well. There is a lot of potential for future growth. I think there is an idealized future theory of Blockchain, with instantaneous settlement and reduced intermediary costs for folks who are looking to invest in treasuries. At the end of the day, there are various DeFi protocols that exist for the purposes of getting a return on your stable coins to an extent. But treasuries could offer a slightly better risk profile for being able to get those returns.

KENNY: Alright, let's unpack that. Slightly better returns for treasuries on chain. Why? My understanding is that treasuries is the most liquid market in the world, right? So by definition, is it going to be less efficient on-chain? And if you're not getting stable coin type yield, and you're taking on-chain risk and protocol risk, why are people doing this?

MCROBERT: I look at it from a slightly different perspective, which is, who are the people that would be really interested in accessing treasuries on-chain? I think there are a lot of them. The first that comes to mind is DAO entities, or potentially treasuries for DAOs that hold a tremendous amount of stable coin holdings or other assets.

They originally received tokens as part of a token generation event and allocation for the foundation for the ecosystem. Maybe they engaged in treasury diversification. They own a lot of stablecoins that are just sitting there. That's the first that comes to mind for who would want to access this.

They're not going to have a large bank account with a large amount of fiat to allow them to purchase treasuries otherwise, but they would want something that provides that level of security that treasuries do without having to use a third party DeFi protocol in order to capture that return. I think that is potentially the largest source of demand right now.

And over time, depending on how one sees the future, could we have large institutional entities that are not 100% crypto who are interested in also having treasuries held on-chain, because that's part of their business model? I don't know. But right now, I view the demand as those who hold a lot of stable coins. And a lot of times, it's the DAOs that have diversified their treasury to hold a lot of stable coins for various purposes who want to access this.

KENNY: Okay. So, these are crypto-native companies. Mitteness, anything you want to add?

MITTENESS: Yeah. These are crypto-native companies that may have a large chunk of assets and stable coins that are receiving 0% interest. And if you could move it to an on-chain treasury, that is already closer to 5%. Obviously, that's worth it without the risk.

And then, on the other side are people who are getting their feet wet in crypto and looking at a conservative way to move in there. That is the institutional investor side looking at it. Tokenized treasuries obviously seem like a safe starting point.

KENNY: Okay. That makes sense, especially as we expand out so let's knock on wood. We have a question in the chat there. What is the biggest impediment for growth in the on-chain treasury market?

MITTENESS: I think right now it's the registration pathway, and how they are going to be offered. Looking at funds other than Franklin Templeton, almost all the funds you want to invest in right now are strictly private placement only to accredited investors and large qualified purchasers under the Investment Company Act.

These funds have taken the approach of "we're going to offer these to large institutions, but we're not going to deal with the SEC registration pathway to have them broadly available to retail markets." Which, given some of the current statements from the SEC, is probably a fair way to go.

Franklin Templeton formed their blockchain-backed fund back in '21 and has seen a little bit more support. That has been growing, and it's finding its way now to the broadly available market through the SEC registration pathway

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KENNY: Okay, which is tricky. Do we think crypto is going to become a separate regulatory body, like what we're seeing in places like UAE, Hong Kong, and China? Personally, where do you think we're going to end up here?

MITTENESS: I would be very surprised if we had an entirely separate legal regime for digital assets. If we go back, the basis of US securities laws is intended to be very flexible to be adaptable for new technologies, and does not change the underlying purpose and function of the assets.

What we need is regulatory guidance in US regulation on how we actually adapt the existing laws. I mean, US securities laws generally are not prescriptive in a way. They tend to be disclosure-focused. The point is to make it clear to investors what you're investing in. What that means is we just need clear guidance as to how the current laws can be interpreted in a way, and digital assets can fit within that regime.

KENNY: Okay. It's interesting because I know for a fact that historically, disclosure has actually made behavior worse. Because you disclose something, and then you just go do it even if it's massively conflicted, as opposed to just not disclosing it. You are actually much less likely to do that. There are all sorts of interesting reasons why that might not be the best regulatory framework, but that's where we are.

McRobert, along those lines, is the SEC going to own this? At the end of the day, these are still treasuries, right? The cap table management just happens to be done in a slightly different manner. Do you think tokenized stocks and tokenized treasuries are ultimately going to be under the SEC?

MITTENESS: Yeah. I agree. There is no quick movement from the legislative side on this. I mean, the SEC basically said "we're in charge of this", and they have acted by enforcement. It's hard for me to imagine that it doesn't continue to fall one way or another under the SEC, whether there is legislation put in place to actually update the 33 Act or the 34 Act to allow for some different avenues for tokenized securities. It remains to be seen. Hopefully, yes, but I think they will still absolutely fall under the purview of the SEC at the end of the day.

KENNY: Okay. I guess that makes sense. For the treasuries that these funds are holding under the hood, what is the regulatory burden there? How much does it cost to stay compliant with the SEC, in this case? Mitteness, maybe you could take that one.

MITTENESS: Sure. It varies quite a bit on which hat you are going to take. There are private funds out there that are structuring their way to avoid the SEC registration pathway. If you are issuing as a registered fund, or some other registered issuer that is going to be issuing these securities, there are a few different pathways in this full Form S-1 registration, which would be a kind of full IPO process.

There is a pathway called Regulation A, also called the mini IPO, that has caps on the offering size at around $75 million. Each of those pathways can be a little cheaper. The initial upfront is probably going to be, no matter what, especially in this framework, six figures at least. And for a full S-1, you are probably looking north of a million in any type of transaction just for the initial process.

And that is going to include lawyers costs, accounting costs, and time getting through the SEC process. The way it works is, you submit a registration statement, the SEC comes back with comments, you respond and amend it, and the SEC comes back. It's a back and forth process until you clear the SEC comments, and then go effective.

KENNY: I notice that you didn't say the SEC approves, because they never prove anything, right? They just stop asking questions at some point.

MCROBERT: Exactly. Just until they don't object anymore. It's always the initial part, including the initial people to do it and the initial entities to do it, that is going to be the most expensive. But you do get the advantage of first mover there, if you get a fund through and then you want to trade more funds like it. In theory, it should be relatively straightforward to start duping, and you get some cost efficiencies and subsequent issuances.

KENNY: Okay. McRobert, do you want to add on to that cost of compliance topic?

MCROBERT: Yeah. Just brass tacks, it's over a million dollars in costs to do an S-1 offering. There are other things like the Reg A offering, or the mini-IPO. Costs can vary from 250k to a million. It's something in that ballpark. But to what Ryan said, there is an efficiency of scale. Being first mover always costs more.

And if and to the extent there was a series of S-1 offerings that are done, or series of Reg A offerings, there are definitely lower costs over time as that is done by the same entity, and they have been through the process before.

Having said that, it's not efficient and it's expensive. That's the world that we live in right now, if you want to actually comply with the rules in order to launch these offerings. We exist in a world that was contemplated in 1933, and not one that was contemplated in 2024, where we are.

KENNY: Yeah, but that '33 Act came around for some really crappy behavior, and people are still people. There's definitely a germ of something useful in there.

MCROBERT: Yeah. I'm not saying we should scrap the 33 Act. It was created as a result of the Great Depression, and what happened to the stock market leading up to that. There is a real good reason or rationale for it. It just hasn't been adapted to the world that we're living in.

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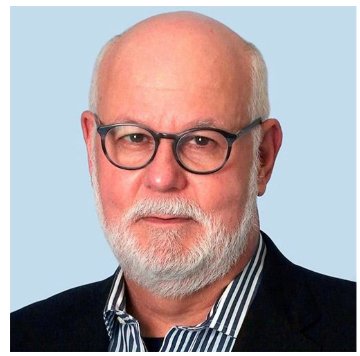

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