



ARC RESERVE CURRENCY

WHO BENEFITS IF ARC IS A SUCCESS?

The ARC Reserve Currency is established and operated (until fully decentralised) by a ring-fenced (“SPV”) with ‘leakage’ minimised including no opportunity for beneficiaries (e.g. shareholders) of the SPV to benefit from financial gain arising from dividends or value appreciation of the SPV (it is effectively a *not-for-profit* in this regard). Naturally, this leads to two questions:

1. “Is it sustainable?” and;
2. “Who benefits if ARC is a success?”

The first of these questions is addressed easily: the SPV is able to charge up to 0.5% of the NAV of the SPV each year to cover expenses, such as audit, director fees etc. An objective for the SPV is to reduce these costs, as the NAV of SPV increases in value. This should provide sufficient funding for ARC to be sustainable.

The second of these “Who benefits if ARC is a success?” is discussed in this note, exploring direct and indirect payments to the ecosystem and its participants.

Note: *this is one of a series of papers that describe the nature and purpose of the ARC Reserve Currency. Please see www.arccy.org for further details, including the rationale for ARC.*

ARC is a work in progress. Please contact us at hello@arccy.org for comment and suggestions.

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1 Introduction

Many blockchain technologies and cryptocurrencies are likely to be enhanced with a successful stablecoin. In some ways, the entire ecosystem could benefit. In this note we focus on specific participants that may be able to economically and financially benefit directly from the ARC Reserve Currency (“ARC”).

We consider there to be three material areas of economic and financial gain if ARC is a success:

1. Holders of ARC
2. Direct payments from the SPV¹:
 - Salaries to executives and directors of the SPV
 - Payments to suppliers
 - Taxes to government(s)
3. Economic gain for Participants:
 - Exchanges
 - Wallet providers
 - Liquidity and price monitoring
 - Underlying lending partners and arrangers of debt finance
 - Underlying borrowers

2 Holders of ARC

The obvious beneficiaries will be the holders of ARC, achieving financial stability in real terms by holding ARC. The gain for holders will be in relative terms, as compared to other currencies, e.g. national currencies and digital currencies, which may depreciate in real terms and lose their buying power over time; or be more volatile (and less attractive than ARC on a relative investment basis).

ARC coin can only be purchased at a price equal to the NAV of the SPV per coin. No-one, including the founders and advisers to ARC, is able to purchase coins at a discount from the SPV (the issuer of ARC coin). We consider that selling coins at a discount would undermine an asset-backed stablecoin, as it would dilute the value for all other holders of that coin. Therefore, ARC holders would not benefit from discounted purchases of ARC from the SPV. However, as we will see later, participants may benefit by providing liquidity and price-monitoring activities on the exchanges.

3 Direct Payments from the SPV

3.1 Salaries to executives and directors

The highest paid director (and executive) details will be disclosed on the SPV website – www.arccy.org

- NED: as a non-executive director, based on the NAV of SPV, a fair monthly fee will be in the range USD 2-5k per month. There will be 2-3 NEDs at the outset.

¹ Please note: dividends, and the sale and purchase of shares in the SPV will be forbidden in the constitutional documents.

- Executives: any appointment and pay for full-time senior executives, will be linked in some way to the NAV of the SPV, and there should be an independent remuneration committee to set the salary of the executives. A committee will be established in due course.

Immediately following the Initial Coin Offering (“ICO”), Stephen Findlay and Garrick Hileman will be appointed as NEDs for the SPV, and will be paid in accordance with the structure outlined above. There will also be a Corporate Director, who will be appointed by the SPV from a Trust services company based in the chosen jurisdiction for the SPV.

At the outset, there will not be any other executives paid directly by the SPV. If either of the founders (or another person) becomes an Executive, then the basis of their appointment, their role and their remuneration will be shared publicly on www.arccy.org. Any other appointments will be disclosed if their proposed remuneration is higher than the existing highest paid executive(s).

3.2 Payments to Suppliers

Material payments made to third-party suppliers, particularly any related parties, will be disclosed on the SPV website – www.arccy.org. This will be updated on (at least) an quarterly basis. The disclosure will include:

- total payments to the highest three suppliers (as a minimum); and
- an analysis of all expenditure, categorised by the nature of the service / good(s).

3.2.1 Set up costs

BondMason² has funded the third-party launch costs of the SPV and provided significant IP to the project. These set-up costs will be reimbursed from the ICO proceeds (and are included in the 1% of proceeds set aside for such costs); and disclosed publicly on the www.arccy.org website. These costs are likely to be less than USD 100,000 in total.

3.2.2 Continuing costs

There are 4 main areas of service provision to the SPV:

- Technology and IP
- Asset allocators and reporting
- Foreign exchanges and banking services (national currency transfer and storage)
- Corporate administration services: e.g. regulatory advice, audit, tax, company secretarial, etc.

3.2.2.1 Technology and IP

The SPV will, from time to time, procure services from other technology providers, including consultants, security experts etc. The SPV will also incur nominal technology costs, such as hosting, etc.

BondMason will provide IP, technology, reporting and asset allocation services to the SPV. It will continue to provide IP and other resources as the SPV grows, enabling the asset allocation strategy and reporting (as we will see in further detail the next section).

² BondMason Group Ltd, UK company number 08411234

3.2.2.2 *Asset allocators and reporting*

The SPV will procure asset allocation and reporting services from suppliers that are able to deploy capital, and manage reporting back to the SPV on its positions. This may be one of the biggest areas of direct expenditure for the SPV.

At the outset, BondMason will provide these services, facilitating deployment, allocation and reporting during the minimum viable product (“MVP”) stage of ARC³. BondMason charges its clients 1.0%-1.5% p.a. for access to direct lending opportunities and reporting. The fee payable by the SPV to BondMason will be in this range initially⁴, and perhaps towards the higher end – e.g. 1.5% p.a., assuming that the SPV has relatively modest amounts of NAV (e.g. less than \$250M) and recognising that BondMason is providing a deeper set of services than typically provided to its other clients.

However, it is worth noting that the fee payable to BondMason during these early periods may be covered by surplus returns achieved by the SPV relative to its Target Return⁵. Therefore, these fees should not impact the growth in value of the NAV of the SPV, or the effectiveness of ARC. It may also be possible that the deployment through BondMason gives rise to a surplus return over the Target Return for the NAV, assisting with the rate of adoption for ARC early on.

As the NAV of the SPV increases, and its asset allocations will be increasingly weighted toward more widely available and liquid pools of assets (e.g. corporate bonds and gilts), the fee to the allocators of capital will reduce. For example, third-party asset allocators (BondMason or otherwise) should receive a maximum of 25bps (perhaps less) for enabling investment into, and reporting on, readily accessible and listed investments such as gilts. These fee expectations are in line with market standards⁶, and should also provide ARC holders with comfort that the project is sustainable.

Asset allocators will be selected to distribute capital into certain regions or assets types, and will be invited to apply to the SPV via www.arccy.org to tender their services to assist with deployment of the SPVs capital.

We anticipate that the total revenues to third party suppliers, for allocating assets and providing reporting and transparency services, from the SPV will tend toward be 10-25bps of the total NAV, when the NAV is above \$1.5bn:

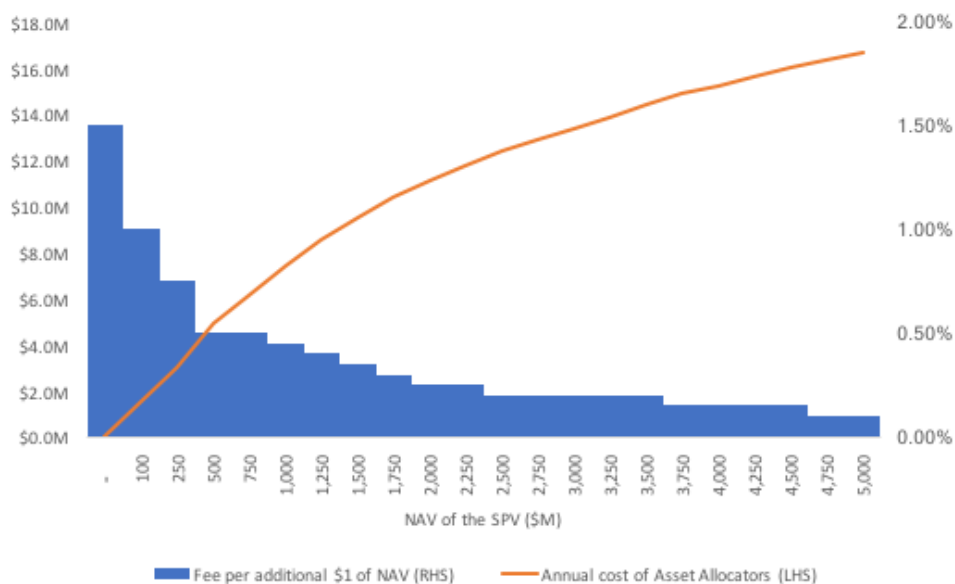
³ Please see ‘Research Road Map’ paper available on www.arccy.org

⁴ BondMason charges clients 1.0%-1.5% p.a. based on the value of their holdings, for access to direct lending returns.

⁵ BondMason clients have achieved an average return in excess of 8.0% p.a. in each of 2015 (part year), 2016 and 2017 to date, from direct lending. In excess of the Target Return anticipated by the SPV.

⁶ Typically, asset management fees are 1-2% p.a. on small funds; and closer to 30bps to 45bps for larger CLOs.

Chart: Estimated cost of asset allocators to the SPV is expected to decline on a percentage basis as the NAV of the SPV increases.



It is worth noting that the long-run objective is for the SPV to deploy capital using a decentralised asset allocation methodology, as the ecosystem develops. This may further reduce any fees payable to third-party allocators, as well as improving the efficiency and transparency of the SPV overall. However, the SPV does not intend to lend directly itself (e.g. be an originator of lending opportunities).

3.2.2.3 Foreign exchange service providers

The SPV will allocate capital across multiple currencies. Third-party foreign exchange service providers will be used to convert from one currency to another, and to (in addition to banks) may hold some of the cash allocations of the SPV in the client funds accounts.

The SPV will procure these services from a single provider at the outset, but this may grow over time. Discussions are continuing with a number of parties.

The foreign exchange service providers are likely to benefit in two ways:

- Spread fees: Making a spread on the translation from one currency to another;
- Account fees: Fees and charges associated with the SPVs accounts and transactions.

The 'spread fees' will be harder to quantify, as these are somewhat hidden from view, and need to be considered in the context of the average buy-sell rates available at the time of a currency conversion. Nonetheless, the SPV will seek to calculate (and estimate) these each year for disclosure purposes.

The 'account fees' are easier to identify and quantify, and will be disclosed in accordance with other third-party supplier payments.

Currency rebalancing is planned to occur each quarter, which may help to reduce some of these costs.

3.2.2.4 Corporate administration services

The SPV will require corporate administration services, in addition to the corporate director noted above, to enable it to operate with good governance. These will include audit services, regulatory reporting, company secretarial services etc.

In the context of the total spend of the SPV, particularly when the SPV has a NAV in excess of \$1bn, it is not expected that these payments will be material. However, on a percentage basis, they may be greater at the outset, as the SPV commences activities.

3.3 Taxes

The SPV is likely to need to pay taxes on any gains each year, and perhaps on other aspects of its activities. These will be at the prevailing rate in the selected jurisdiction. These will be accrued for out of the returns achieved by the SPV on a day-to-day basis, to ensure that the NAV of the SPV doesn't drop on a single day when annual (or quarterly) tax payments are made.

4 Economic gains to participants

4.1 Exchanges

Perhaps the largest beneficiaries from a successful stablecoin will be the exchanges. The exchanges could benefit from larger trading volumes – either from new clients who are increasingly willing to participate in cryptocurrencies given the existence of a stablecoin, or existing clients that are looking trade in and out of a stablecoin depending on their investment decisions, relative to other digital currencies.

Exchanges typically make a 0.17% spread⁷ between the buy and sell (bid-offer) rates across the more notable cryptocurrencies. This spread crystallises on each trade, so an increase in volume arising from the success of ARC is likely to increase the revenues achieved by the exchanges overall.

We predict that the revenues available to the exchange industry will likely be the biggest source of economic gain arising from ARC.

The founders and backers of ARC⁸ do not have any financial or ownership relationship with any of the digital exchanges. Although the SPV will invite exchanges to list ARC, relative to other digital currencies, and to facilitate the trading of ARC between their participants.

4.2 Wallet Providers

Wallet providers may also benefit from increased usage arising from stablecoin, and in a similar way with more new participants. As ARC is an ERC20 compliant token, only ERC20 compliant wallet providers are likely to benefit.

The founders of ARC do not have any financial or ownership relationship with any wallet providers. Although the SPV will invite wallet providers to accept ARC, and promote this in their marketing (e.g. websites).

⁷ Source: analysis of leading currencies on leading exchanges.

⁸ Including BondMason Group Ltd.

4.3 Liquidity and price monitoring

Users will be indirectly remunerated by providing liquidity in ARC.

If an exchange is pricing ARC above NAV per coin – perhaps driven by a lack of supply on that exchange - then any user will be able purchase newly issued ARC from www.arccy.org at a price equal to the NAV per coin and then immediately sell the same coins at the higher price on the relevant exchange. This will enable ARC to maintain its pricing close to NAV per Coin across any exchange. This activity is analogous to the prime brokerage market, and the participants are effectively being paid for providing liquidity and undertaking the price monitoring activity.

The SPV, and related parties, will be able to undertake this activity, and may choose to do so if there aren't sufficient participants doing this in the market (e.g. if the price on exchanges is materially out of line with the NAV per coin on an exchange).

4.4 Underlying lending partners and arrangers of debt finance

The SPV will allocate capital into loans and fixed income investments. The originators, distributors and managers of these loans and investments will conduct their own business models which will include fees arising from these activities.

The SPV is effectively a 'price-taker' in this market. The business models of the underlying lending partners are subject to competitive forces in their markets, and the SPV will act as a typical investment client.

The underlying lending partners may charge the borrowers fees, rather than the lender (e.g. the SPV). But essentially these fee payments will be from the total cost of borrowing and reduce the total return to the lender accordingly.

The SPV doesn't undertake any direct lending activity, and the Founders of ARC do not intend to undertake any lending activities in this way.

4.5 Underlying borrowers

The SPV will provide further funds into the lending and fixed income market. Given the large size of this market, it is not anticipated that the activity of ARC will have a material impact on the supply of capital. Therefore, the underlying borrowers are unlikely to see any direct impact (reduction) on their costs of borrowing (at least for the immediate or foreseeable future) arising from the activities of the SPV driven by the success of ARC.

5 Summary

A successful ARC coin could benefit many different market participants. It is expected to benefit the exchanges primarily. The Founders of ARC would benefit from a direct salary and payments made to BondMason for providing investment allocation and reporting services. All material payments, including payments to related parties will be disclosed on the www.arccy.org website.