

Stablecoin Stability Assessment

# First Digital USD (FDUSD)

Dec. 3, 2024

## Summary

S&P Global Ratings assesses the ability of First Digital USD (FDUSD) to maintain its peg to the U.S. dollar at 4 (constrained). FDUSD is a fiat-collateralized stablecoin issued by FD121 Ltd. (First Digital Labs), a subsidiary of First Digital Group that is incorporated in Hong Kong.

**Our asset assessment is 3 (adequate) due to limited public information on the identity or creditworthiness of the financial institutions that hold the stablecoin's reserves,** and which thereby represent potential counterparty risk exposure. FDUSD is backed by reserves comprising low-risk assets, such as short-term U.S. Treasury bills, as well as cash and cash equivalents in U.S. dollars. The reserves are held by a custodian, which is a public trust company registered in Hong Kong, and at financial institutions in Hong Kong, Singapore, Australia, Canada, Luxembourg, and the U.S.

**Our stablecoin stability assessment of 4 includes a negative adjustment from the asset assessment.** FDUSD's white paper states that reserve assets held by the custodian are segregated from the custodian's own assets. However, it remains unclear to what extent FDUSD holders are protected in the event of issuer insolvency. Additionally, FDUSD is not currently subject to a regulatory framework, though Hong Kong is expected to introduce a new regime for fiat-referenced stablecoins by year-end 2024. We also note limitations regarding FDUSD's primary redeemability and its lack of a long-term track record of price stability.

**The stablecoin stability assessment could improve if there is increased transparency, allowing us to evaluate the creditworthiness of the financial institutions holding the reserves.** Factors such as regulatory oversight or supervision, and a demonstrated long-term history of price stability could also support a stronger assessment. Conversely, the stablecoin stability assessment could worsen if we observe a shift toward more high-risk assets.

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

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## Asset assessment

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

## Adjustment

<b>Negative (1)</b>
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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: 3 | Adequate

1   Very strong	2   Strong	3   Adequate	4   Constrained	5   Weak
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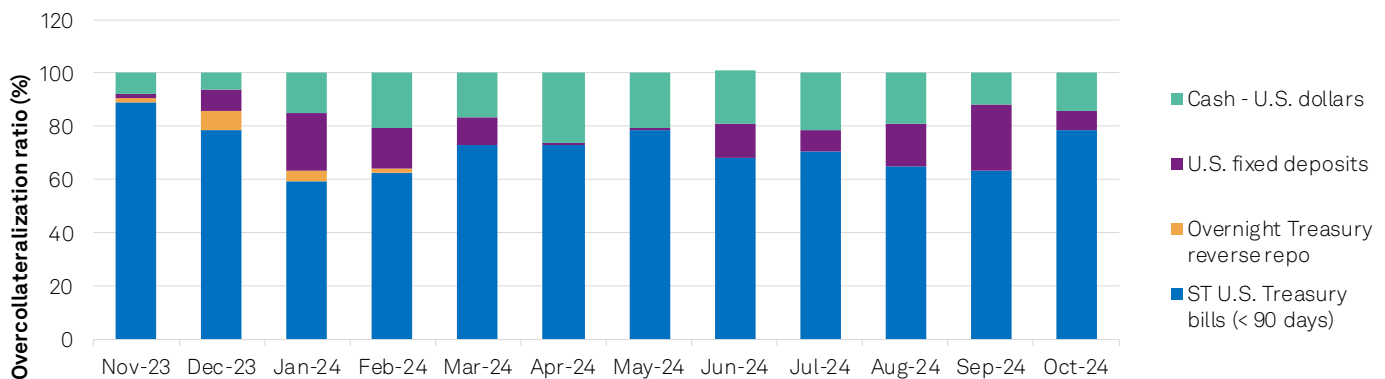
**FDUSD was issued in 2023 and is a fully fiat-collateralized stablecoin.** It is issued by FD121 Ltd. (First Digital Labs), which is part of Hong Kong-based First Digital Group. The reserves for FDUSD consist of highly liquid and secure assets, such as short-term U.S. Treasury bills, U.S. fixed deposits, and U.S. dollar cash deposits.

**FDUSD has published a monthly reserve report since July 2023.** Based on the most recent report published by First Digital Labs and audited by Prescient Assurance LLC, as of Oct. 31, 2024, FDUSD had \$ 2.552 billion of reserves backing \$2.539 billion of FDUSD in circulation. The overall collateralization ratio stood at 100.5%: 78.7% (\$1.998 billion) representing U.S. Treasury bills maturing in less than three months, 14.7% (\$374.3 million) cash deposits in U.S. dollars, and 7.1% (\$181.0 million) overnight/one-month U.S. dollar fixed deposits. The assets are held by the appointed custodian, a public trust company registered in Hong Kong, as well as by financial institutions in Australia, Singapore, Luxembourg, U.S., and Hong Kong. The identities and creditworthiness of these entities have not been disclosed.

**Exposure to currency or interest rate risks appears limited.** Since FDUSD's reserves are either held as U.S. treasury bills with tenors of less than three months, or as U.S. dollar cash deposits, there is no exposure to foreign currency risk. Exposure to interest rate risk is limited by the short-dated nature of these instruments.

**The limited disclosure regarding the financial institutions holding FDUSD reserves continues to weigh on our asset assessment.** While the reserves consist of highly liquid and secure assets, such as U.S. Treasury bills and cash deposits, the identities and creditworthiness of the financial institutions holding these assets remain unknown. The October 2024 attestation report specifies a minimum 'A-2' short-term issuer credit rating for financial institutions rated by S&P Global Ratings, but does not confirm if this applies to all institutions or establish a minimum long-term rating. These gaps in transparency imply potential counterparty risk for the reserves and constrain our asset assessment, which remains at 3 (adequate).

## FDUSD--Asset composition



# Adjustment: Negative

Neutral

Negative

## Overall adjustment

We applied a negative adjustment to reflect certain weaknesses: In particular, the extent to which FDUSD holders are protected in the event of the issuer's insolvency remains unclear. Additionally, FDUSD is not currently subject to a regulatory framework, though a new regulatory regime for fiat-referenced stablecoins in Hong Kong may be introduced by the end of 2024. We also note limitations regarding FDUSD's primary redeemability and its lack of a long-term track record of price stability, particularly under significant market volatility.

## Governance: Transparency of reserves through monthly reporting and third-party attestations

- The founders and core team at First Digital Labs comprise Vincent Chok (CEO) and Gunnar Jaerv (chief operating officer). FDUSD's white paper states under its investment mandate that the reserve is to be composed of cash; very short-dated, highly liquid U.S. Treasury bills, and overnight reverse repos.
- Transparency is maintained through monthly reporting of reserve holdings and third-party attestations. First Digital Labs publishes a monthly reserve report outlining the composition of reserves.
- In addition, these assets are subject to monthly review and attestation by an independent auditor. The most recent attestation was in October 2024 and conducted by Prescient Assurance, a U.S.-based accounting firm. The auditor reviews the assets of the company at the end of each month.

## Regulatory framework: Uncertainty around holder protections and current lack of regulation

- FDUSD's reserves are held in segregated bank accounts in the name of First Digital Labs through the custodian. We understand from FDUSD's white paper that the reserve assets are segregated from the assets of the trust provider in the event of the trust provider's bankruptcy. However, the extent to which FDUSD holders are protected in the event of insolvency of the issuer, First Digital Labs, remains unclear.
- FDUSD is not currently subject to regulation or supervision by a regulatory authority. We see this as a weakness compared with other stablecoins that are subject to regulation and/or supervision. We note though that in July 2024, the Hong Kong Monetary Authority (HKMA) and the Financial Services and the Treasury Bureau published its consultation conclusions for its proposed regulatory regime for fiat-referenced stablecoin (FRS) issuers. The legislative proposal is being finalized, with a bill expected to be introduced into the Hong Kong Legislative Council by the end of 2024, after which the new regulatory regime is anticipated to take effect. We understand from the First Digital team that they are actively preparing to align with the proposed regulatory framework. Once FDUSD becomes regulated, we will assess the implications on our SSA.

## Liquidity and redeemability: Restricted primary redeemability

- FDUSD can be redeemed directly with First Digital Labs. However, redemption is restricted to institutional clients of First Digital Labs that comply with specific requirements, including anti-money-laundering and counter-terrorism-financing checks. Details of the redemption terms--such as minimum amounts, associated fees, and processing time--are not disclosed.
- Retail holders of FDUSD must use the secondary market for redemptions. Binance remains the dominant platform facilitating FDUSD trading, with limited volumes observed on other exchanges. Nevertheless, there has been a notable increase in the trading volume and market capitalization of FDUSD over the past 12 months.
- The availability of parties that can support redemption payments 24 hours a day, seven days a week, remains limited. Therefore, FDUSD's redemption is constrained by the banking system's operating hours.

## Technology and third-party dependencies: The smart contract has recently been audited but the code is not open source

- FDUSD was deployed on the blockchain networks Ethereum and BNB Smart Chain as the standard tokens ERC-20 and BEP-20, respectively.
- The FDUSD smart contract was audited by Peckshield in May 2023, which did not find any major issues. However, the auditors pointed to potential risks associated with using a centralized, externally owned account as an owner's wallet. The issuer has addressed this by switching to a multi-signature wallet, which requires more than one private key and thus adds a layer of security. The smart contract was also audited more recently in May 2024 by EtherAuthority, which did not find any vulnerabilities.
- The smart contract for FDUSD is not open source, unlike that for most other stablecoins. Hence there is also no bug bounty program offering incentives for identifying and reporting vulnerabilities. The smart contract has, however, been verified and is written in the industry's standard programming language, Solidity. There is no dependence on oracles to connect to data and information from external market systems.
- Since all FDUSD's reserves are held and managed outside the blockchain network, there is less reliance on blockchain technology. Therefore, a major disruption of the blockchain network is likely to have a limited impact on FDUSD's stability.

## Track record: Market capitalization has increased significantly after one year in circulation

- Since its launch in June 2023, FDUSD has maintained a generally stable price. There is no long-term track record of price stability, and it has not been tested by any major market volatility.

FDUSD's market capitalization increased by more than 6x to \$2.54 billion as of Oct. 31, 2024, from \$406.5 million on Sept. 30, 2023.

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