
How To Make \$3.2 Billion out of \$1.6 Billion by the Push of a Button



Coinbase/MakerDao USDC Rehypothecation Analysis

November 2022





Introduction

On October 24, 2022, Coinbase Prime announced entering into a partnership with MakerDao to become a custodian of USD1.6 billion worth of USDC, of which MakerDao is the largest holder. In return, MakerDao will earn a 1.5% reward on its USDC holdings while holding funds with a “trustworthy” institutional custodian. Through this deal, Coinbase regained control of the tokens held by its investors and utilized the tokens for re-lending

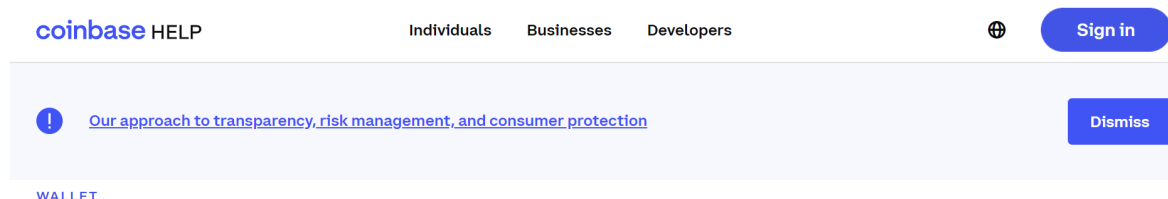
Analysis

Contrary to popular belief, Coinbase is a crypto asset broker/dealer, not an actual exchange. This misunderstanding is not through duplicitous actions of Coinbase, though. The term “cryptocurrency exchange” was most likely originally used by a software developer/tech enthusiast who did not understand the actual meaning of the parlance, and its usage has simply stuck over time.

Broker/Dealer: A broker is an individual or financial services company that enables the trading of assets for other individuals. A dealer is an individual or financial services company that enables the trading of assets for themselves. Coinbase does both of these:

3.21 Coinbase, Inc., which owns and operates Coinbase Pro and Exchange, also trades its own corporate funds on Coinbase Pro and Exchange – [Coinbase help site](#).

Exchange: Exchanges and brokerages are different types of markets with unique functionality. Exchanges match traders, allowing them to execute orders with each other. Brokerages transact with their clients directly.



What's the difference between Coinbase.com and Coinbase Wallet?

Coinbase.com is a crypto brokerage where you buy or sell crypto in exchange for cash. Coinbase.com stores your crypto for you after you buy it. You do not need a Coinbase.com account to use Coinbase Wallet.

Basically, Coinbase is more like JP Morgan or Goldman Sachs than the NYSE Euronext or NASDAQ.

What is Hypothecation?

Hypothecation occurs when an asset is pledged as collateral to secure a loan without giving up title, possession, or ownership rights. With a home loan, for example, you agree that your home is used as collateral to secure your loan; if you can't repay the loan, your lender can repossess the home.

According to [Circle's USDC Terms of Service](#), it appears as if Circle hypothecates USDC purchasers' capital:



USDC is fully backed by an equivalent amount of U.S. Dollar-denominated assets held by Circle with U.S. regulated financial institutions in segregated accounts apart from Circle's corporate funds, on behalf of, and for the benefit of, Users (the "Segregated Accounts"). This means that for every USDC issued by Circle and remaining in circulation, Circle will hold on behalf of Users either one U.S. Dollar ("USD") or an equivalent amount of USD-denominated assets in its Segregated Accounts (the "USDC Reserves"). USDC is not designed to intrinsically create returns for holders, increase in value, or otherwise accrue financial benefit to the USDC holder.

What is Rehypothection?

Rehypothection is a practice whereby banks and **brokers use, for their own purposes, assets that have been posted as collateral by their. Clients.**

Rehypothection **exacerbates** prime broker insolvency risk by **increasing the likelihood that the prime broker will have insufficient assets to satisfy customers' claims if such claims are called in unison, because there are now more claims than there is collateral backing the claims.** This is a very simple concept, yet still appears to be lost on many. This is what just happened to FTX!

Circle and Coinbase collaborate to bring you USD Coin (USDC)

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INTRODUCING USD COIN

A stablecoin brought to you
by Circle and Coinbase

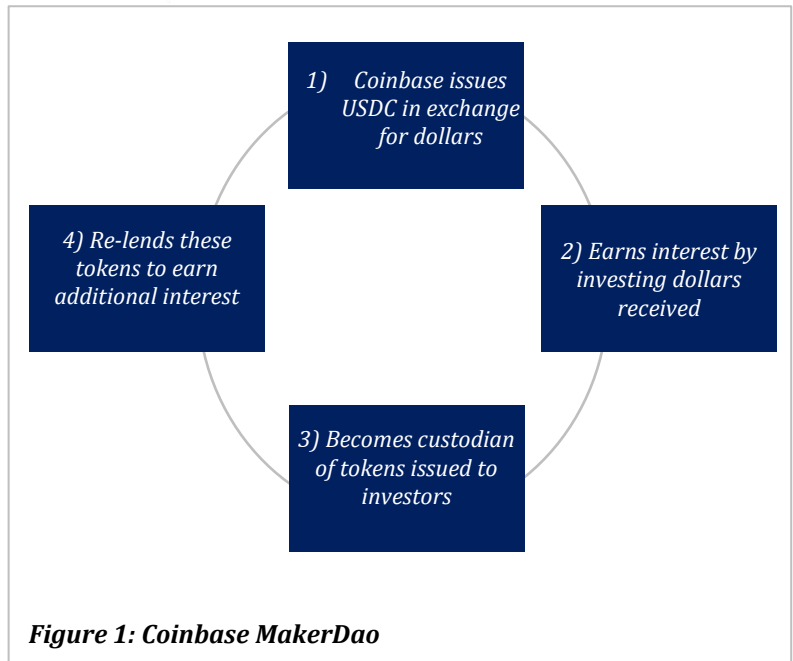


An open source, smart contract-based stablecoin

True financial interoperability requires a price stable means of value exchange. Centre's technology for fiat-backed stablecoins brings stability to crypto. The initial implementation is USD Coin (USDC), available as an Ethereum ERC-20, Algorand ASA, Avalanche ERC-20, Flow FT, Hedera SDK, Solana SPL, Stellar asset, and TRON TRC-20, and creating possibilities in payments, lending, investing, trading and trade finance — and the ecosystem will grow as other fiat currency tokens are added.

In light of the current events surrounding Celsius, Voyager, FTX, etc., the trust in the crypto market has been significantly impacted, and based on the initial understanding of the deal mentioned above, Coinbase has utilized the following scheme to rotate money in the market:

- 1) Coinbase issues USDC tokens to MakerDAO users (who consequently trade said tokens to MakerDAO), in exchange for dollars
- 2) Coinbase invests these dollars to earn interest income.
- 3) Then, it enters into an agreement with the USDC token holders (MakerDAO) and becomes the custodian of these tokens.
- 4) Once Coinbase regains control of the tokens, it re-lends them in the market and earns additional interest, but on the same economic principal amount. So, the company earns two rounds of income from a single principal amount.



In case of a default on the loans and/or obligations given in the market, the liability becomes 2X that of the collateral backing it, and there is just 1x the asset available to cover them, thereby giving rise to substantial risk and a dramatic potential shortfall in terms of losses given default.

Summary

Looking at Coinbase's MakerDao USDC deal, the company regained control of the USDC tokens from its investors and earned additional interest from the initial principal amount. This appears to be a transaction involving financial engineering, where the company rotates money in the market and earns twice from a single economic principal amount.

The risks of doing such feed directly back into the stablecoins (which are now potentially, and purposefully destabilized), by creating two separate and complete claims on the same economic collateral.

The result? MakerDAO DAI, of which USDC collateralizes over 30% (as of the time of this writing) is now that much riskier. At least 15% of DAI is essentially uncollateralized.

Further, the process upon which USDC is used and transferred is claimed to be patented by Veritaseum Capital, who currently has a [\\$350M+ lawsuit against Coinbase](#) – a lawsuit which it appears Coinbase has not disclosed to its investors and customers.

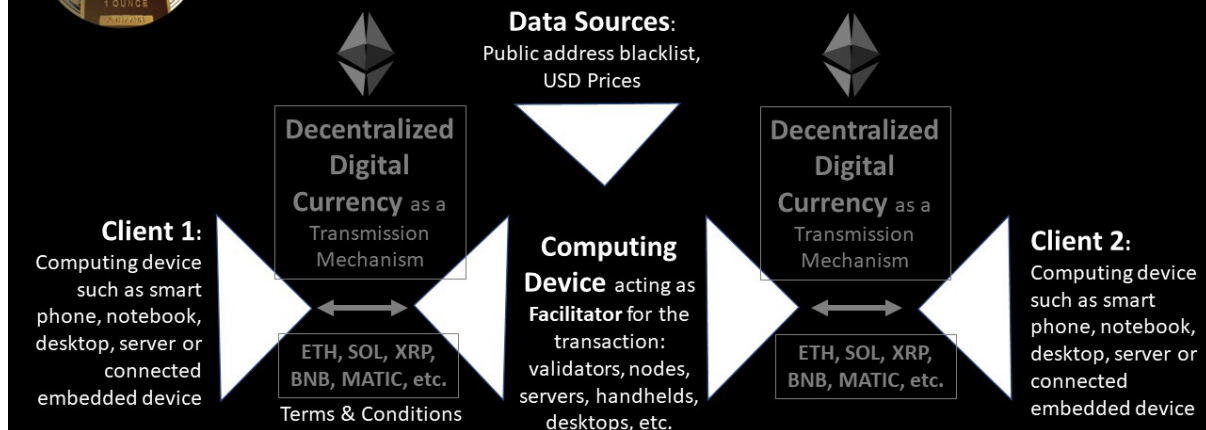


How USDC Infringes the Veritaseum '566 DeFi Patent



Reggie Middleton was awarded patent [US11196566](#) (& JP6813477), covering conditional value transfer through a decentralized currency.

USDC clearly infringes this patented, foundational technology.



As per [Coinbase's website](#):

By custodizing with Coinbase Prime, MakerDAO taps the safety and security of the leading end-to-end institutional platform for trading, custody, and financing. The Coinbase custody storage solution secures assets with a comprehensive system that combines physical security, consensus computation, and strict protocols – all designed for multi-user operations. Private keys use the best of distributed cold storage as well as advances in multiparty computation. In short, security is designed to ensure that clients are always in control of their assets.

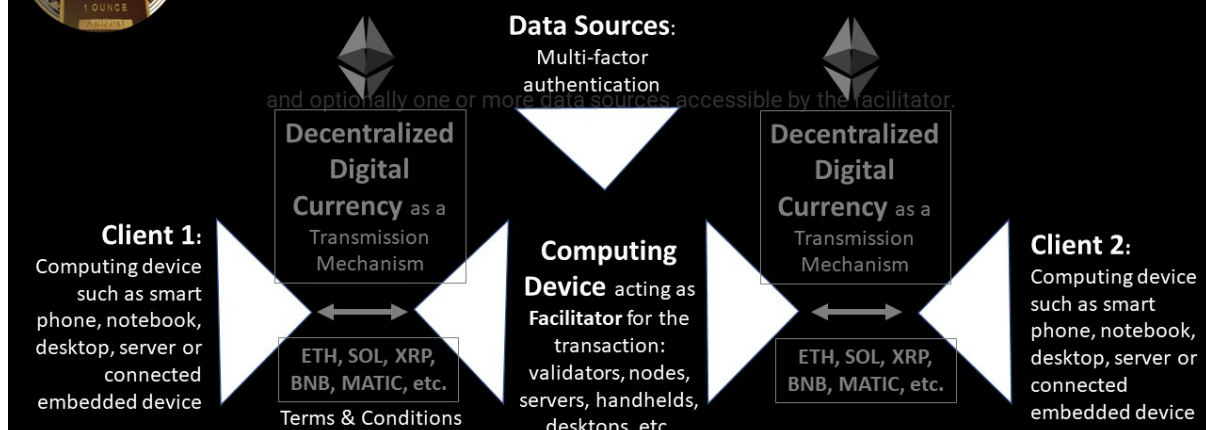
This cold storage system also, according to Veritaseum's research, infringes upon the '566 and '477 patents.

How Cold Storage Transactions Clearly Infringe the Veritaseum '566 DeFi Patent



Reggie Middleton was awarded patent [US11196566](#) (& JP6813477), covering conditional value transfer through a decentralized currency.

Institutional cold storage transactions clearly infringe this patented, foundational technology.



See the [117-page Coinbase Forensic Report](#) for more info. A Q3-2022 update will be available shortly.





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