



Sovereign Investors
Networking & Advisory

Should SWFs Consider Issuing Stablecoins?

We think so!

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Authors (with input from the members of the International Advisory Council of Sovereign Investors):

- Kristian Flyvholm, CEO of Institute of Sovereign Investors (www.sovereign-investors.com) and former CEO of IFSWF.
- Paul O'Brien, Trustee of the Wyoming Retirement System and former Deputy Chief Investment Officer at the Abu Dhabi Investment Authority. Member of International Advisory Council at Institute of Sovereign Investors.

US Treasury Secretary Scott Bessent has made several notable statements regarding stablecoins, emphasizing their potential to strengthen the US dollar's global dominance and their role in the future of digital finance. He has also highlighted the projected growth of the stablecoin market, potentially exceeding \$2 trillion by 2028.

This is an opportunity for Sovereign Wealth Funds to earn additional returns from stablecoin issuance and potentially provide a safe asset to protect their home economies from capital flight.

The two largest stablecoin issuers, Tether and Circle, collectively hold over \$140 billion in U.S. Treasuries and earned more than \$13 billion in profits in 2024 on their two stablecoins (USDT and USDC) with \$216 billion in outstanding. This makes them a force in financial markets, and a potential risk, as their holdings of US Treasury bonds are amongst the 20 largest globally - a “run” on these stablecoins would be a potential liquidity crisis event.

Stablecoins are a welcomed innovation, as they offer opportunities to investors around the world and connects the traditional assets to the crypto ecosystem. A few large players obtain networking effects in the process of democratizing finance and innovating digital assets on the blockchain. We study stablecoins from a positive point of view, but asks:

Why leave such a market opportunity to private-sector issuers, when reputable institutional investors, like Sovereign Wealth Funds, could also reap the benefit?

Stablecoins are here to stay

Stablecoins are an increasingly popular and important financial instrument. As an asset, we do not believe they are especially attractive for sovereign investors, as zero yield makes it un-attractive to a professional investor with access to invest at the US dollar risk-free rate (4% or more) and much better opportunities in riskier assets that increasingly will become digital asset classes.

SWFs are typically given a macro purpose - but also has a fiduciary role to maximize return. Thus, for an innovative SWF, there is a solid business opportunity from becoming a large issuer of a stablecoin backed by the credibility of a well-established investor like a SWF. The “carry trade” from obtaining costless funding and investing risk-free at say 4% would enhance returns, as a sovereign

fund could earn a safe income stream and enhance their return on equity by up to 2%, as we show in Appendix 1. Additionally, the sovereign fund could help protect its home economy from destabilizing currency runs or financial crises.

Operationally, investments in low-risk assets would be easy, as this is classical liquidity management at a SWF and part of core business for foreign exchange reserve managers at central banks. Staff moves frequently between these two major investors, so investment staff is already in place.

However, it may be a larger challenge to operationalize the issuance of stablecoins, where it may make sense to acquire an existing stablecoin issuer with technology in place. But this is surely one of the smarter business cases, where a SWF producing 8% return on equity would be able to produce 10%, if we introduce a stablecoin as part of its liabilities.

The major challenge will be in obtaining the volume needed for networking effect, where a local or regional champion is more likely than a global one. Or perhaps, a hybrid, if a SWF was to buy a major issuer like Circle that is still a clear number two to Tether. At the recent IPO in June 2025, there were SWFs amongst the portfolio investors buying into the IPO for Circle.

Pros and cons of stablecoins

Stablecoins offer several attractive features that make them appealing to investors:

- **Gateway:** Stablecoins like the USDT issued by Tether offers a bridge into the cryptocurrency ecosystem, as investor convert their fiat currency (US dollar) for dominant stablecoins like USDT. Next, they trade the USDT for any cryptocurrency. Thus, USDT has networking effect or “gateway” effect.
- **Price Stability:** Stablecoins are pegged to stable assets like fiat currencies which minimizes price volatility and provides a reliable medium of exchange and store of value. This is not the case for most crypto currencies.
- **Fast, Low-Cost Transactions:** They enable quick and inexpensive transfers, especially for cross-border payments, often settling in minutes with minimal fees compared to traditional banking systems.
- **Accessibility:** Users can access and transact with stablecoins anytime, without relying on banks or traditional financial institutions.
- **Integration:** Stablecoins are widely used in decentralized finance for lending, borrowing and liquidity provision, thanks to their predictable value.
- **Global Financial Inclusion:** They provide access to digital dollars and financial services for people in regions with unstable currencies or limited banking infrastructure.
- **Transparency and Security:** Transactions are recorded on public blockchains, offering transparency and reducing fraud risk.

- **Programmability:** Smart contracts can automate payments and other financial operations using stablecoins.
- **Hedging Against Volatility:** Traders and investors use stablecoins to protect their portfolios during market downturns, quickly converting volatile assets into stablecoins.

Stablecoins, while useful, come with several notable drawbacks and risks:

- **Centralization and Counterparty Risk:** Many stablecoins are managed by centralized entities that control the underlying reserves (like Tether and Circle). This introduces counterparty risk - users must trust that issuers will maintain adequate reserves and facilitate redemption requests. If an issuer mismanages funds or faces insolvency, users may lose access to their assets. This is called redemption risk in combination with default risk.
- **Transparency Concerns:** Not all stablecoin issuers provide regular, audited proof of reserves. Lack of transparency can undermine user confidence and increase risk of fraud or mismanagement.
- **Regulatory Uncertainty:** The regulatory environment for stablecoins is evolving and varies by jurisdiction. New rules and enforcement actions can impact stablecoin operations and user activities, creating uncertainty for both issuers and holders.
- **Smart Contract Vulnerabilities:** Algorithmic and crypto backed stablecoins rely on smart contracts, which can contain bugs or be exploited by hackers. Exploits have led to significant losses in the past.
- **De-Pegging Risk:** Stablecoins can lose their peg to the underlying asset due to market stress, loss of confidence, or operational failures. Notable examples include the collapse of TerraUSD (UST) and USDC's temporary de-pegging during the Silicon Valley Bank crisis.
- **Limited Yield Potential:** Unlike more volatile cryptocurrencies, stablecoins generally do not offer significant capital appreciation, making them less attractive for investors seeking high returns.
- **Security Risks:** Stablecoins are vulnerable to hacking, phishing, impersonation, and other forms of cybercrime. Custodial breaches and smart contract exploits can result in large-scale losses.
- **Custody Risks:** In the event of issuer insolvency or fraud, stablecoin holders may become unsecured creditors, potentially waiting years to recover some portion of their assets.
- **Contagion and Systemic Risks:** The failure of a major stablecoin could have cascading effects across the broader crypto ecosystem and even traditional finance, especially as more institutions integrate stablecoins into their operations.
- **Geopolitical and Monetary Sovereignty Concerns:** Widespread adoption of private stablecoins could undermine national monetary policies and capital controls, leading to capital flight, regulatory backlash or political intervention

SWFs in the Middle East should be the first to consider issuing a stablecoin

A starting point for the analysis is to look at countries with a pegged exchange rate to the US dollar, as they benefit from the tailwinds that stablecoins have from the US authorities. These GCC countries are used to running their foreign exchange reserve management activities with the aim to keep their local currencies in a stable peg to the US dollar. To that end, their central bank would have an exchange rate framework aimed at keeping their local currency stable to the US dollar. The peg to the US dollar typically stands by the local central banks' ability and willingness to convert local currency to US dollar in "unlimited" amounts using their liquid foreign exchange reserves.

Indeed, one could argue that pegged currencies are already a form of stablecoin, as they are a liquid US dollar equivalent, backed by a portfolio of US dollar denominated assets. The new stablecoin differs primarily from an US regulatory requirement, the mandatory 1:1 reserve backing requirement and the ability to transact on a blockchain.

At least 18 countries peg their local currencies to the US dollar. The case is less obvious for "smaller" dollar pegs, like Bahamas, Bahrain, Barbados, Belize, Bermuda, Cayman Island, Djibouti, Eritrea, Jordan, Panama and Turkmenistan, as they do not have very large SWFs. In their case, the central bank is well placed to continue running prudent reserve management to support their peg to the US dollar. Stablecoin issuance would potentially be a consideration to augment foreign exchange reserves, if that is needed. This would supplement a commercial paper program and swap lines.

The case for Middle Eastern SWFs to issue a stablecoin linked to the US dollar would be substantial in Qatar, Kingdom of Saudi Arabia and the United Arab Emirates, who all peg to the US dollar and run a sovereign balance sheet with very large Sovereign Wealth Funds. The respective SWFs in Qatar (QIA is at \$524 billion), Kingdom of Saudi Arabia (Public Investment Fund is about \$1 trillion in assets) and United Arab Emirates (\$2.3+ trillion combined in various sovereign funds) are sizable and their institutions are very sophisticated.

The UAE has rapidly advanced its stablecoin ecosystem, positioning itself as a regional leader in regulated digital assets. The country's first Dirham-backed stablecoin, AE Coin, was issued in 2024 by Mbank and is regulated by the Central Bank of the UAE. AE Coin pegs 1:1 to the UAE Dirham that is pegged at 3.6725 Dirhams to the US dollar. In addition, a consortium of major Abu Dhabi entities—including Sovereign Wealth Fund ADQ, First Abu Dhabi Bank, and International Holding Company—plans to launch another Dirham-backed stablecoin, also regulated by the Central Bank of the UAE.

These innovative efforts are indirectly a stablecoin pegged first to the Dirham and then to the US dollar via the exchange rate policy. The major difference would be whether the regulator is local (like in the UAE) or in the United States (for US dollar stablecoin issues globally).

As the Middle Eastern SWFs are well known and have strong reputations, local and regional investors should be comfortable holding the stablecoins they issue.

Importantly, this SWF-issued stablecoin would offer a domestically issued, but USD-equivalent asset for domestic residents at times of crisis, capital outflows, or stress on the currency peg. This stablecoin would not prevent downward currency pressure on the local currency in such situations, as the SWF issuing the stablecoin would still have to acquire additional US dollar collateral to back new issuance. But that value would stay in the country, at the SWF, and so limit deterioration in national solvency and credit rating.

Should SWFs issue stablecoins?

The case in favor of SWFs issuing stablecoins rest on several competitive advantages, as SWFs are:

- **Trustworthy:** Creditworthy (some with ratings) and trusted by the public in most countries.
- **Experienced:** Seasoned institutional investors fully able to operationalize investment and risk management in line with best practice and regulatory requirements.
- **Infrastructure:** Able to put in place the system infrastructure for a successful stablecoin framework.
- **Stability:** Able to coordinate with the central bank to ensure monetary stability and reduce the impact of capital flight during crisis. Also, SWFs can work with the central bank to link commercial banks in the country to the US dollar stablecoin “wallet” at the SWF.
- **Social benefits:** Able to “claw back” the significant benefit from the private sector agents of this close to risk free trade. Higher profits to SWFs should benefit the owners and the public at large.

Finally, the SWF could offer a competitive yield on the stablecoin to its holders, as it is still perplexing why investors willingly exchange 4% yield on US dollar risk free asset for a stablecoin (like USDT) linked to the US dollar with no yield. We note that senior players like JP Morgan is entering the market with tokenized deposits and that the first tokenized money market funds are becoming available to investors. The networking effect will become the determining factor of success.

What are then the arguments against the SWFs issuing stable coins. Arguments may include:

- **Legal scope:** SWF stablecoins are potentially not permitted by the legal basis for the SWF or may be inconsistent with its macroeconomic objective. Also, some SWFs would not be permitted to borrow or take on such liabilities by legislation.
- **Crowding out:** The SWF would effectively compete with the private sector banking system for US dollar funding, transactions and investments. Given the tax free status of many SWFs, this may offer an unfair playing field.
- **Foreign Issuer Restrictions:** The GENIUS Act and STABLE Act are currently being considered as the cornerstone of the new US legal basis. Both bills prohibit non-U.S. entities from issuing stablecoins directly in the U.S. without meeting strict conditions. The GENIUS Act requires foreign issuers to:
 - Be subject to a regulatory regime deemed "comparable" to U.S. standards by the Treasury Department.

- Register with the Office of the Comptroller of the Currency and consent to U.S. supervision.
- Hold sufficient dollar reserves in U.S. financial institutions to cover U.S.-based redemptions.
- **Secondary Market Access:** Unlicensed foreign stablecoins may still trade on U.S. secondary markets, but only if they can:
 - Technologically freeze/seize transactions at the direction of U.S. authorities (e.g., for sanctions enforcement).
 - Comply with "lawful orders" from U.S. agencies.
- **Reserve and Transparency Requirements**
 - **Asset Backing:** Issuers must hold 1:1 reserves in high-quality assets (e.g., cash, Treasuries) for every stablecoin issued.
 - **Reporting and Audits:** Monthly reserve attestations and annual audits by U.S.-registered firms are mandated, with stricter scrutiny for large issuers (>\$50 billion).
 - **Redemption Guarantees:** Users must be allowed prompt redemption (within 2 business days), with reserves segregated from issuer operations.
- **AML/Sanctions:** Issuers must implement U.S. anti-money laundering (AML) programs, screen transactions, and certify annual compliance.
- **Enforcement Risks:** Failure to comply could trigger:
 - Bans on U.S. trading intermediaries.
 - Loss of "cash equivalent" status for accounting/collateral purposes.
 - Designation as a systemic risk by regulators like the FSOC.
- **Reciprocity Agreements:** US Treasury may negotiate bilateral agreements for interoperability, but foreign issuers must still meet U.S. standards.

Criticisms and Loopholes

- **Regulatory Arbitrage:** Both bills face criticism for a "Tether loophole" allowing offshore issuers to avoid full U.S. oversight if not directly marketed in the United States.
- **Competitive Disadvantage:** U.S.-licensed issuers argue foreign competitors face lighter compliance burdens, incentivizing offshore operations.
- **Systemic Risks:** Large-scale foreign issued stablecoins could threaten dollar stability if reserve practices are opaque or jurisdictional conflicts arise.

Conclusion: Key Implications for Sovereign Wealth Funds

In the final analysis, SWFs and other Sovereign Investors would need to balance the opportunity (higher return, stability and innovation) with the legal challenges that issuing a US dollar stablecoin may bring. This needs further analysis, where the emphasis should be on:

- **Heightened Scrutiny:** As state-backed entities, SWFs would face intense U.S. regulatory scrutiny over reserve management (backing portfolio) and sanctions compliance. Also, their tax free status may be scrutinized, as the benefits are enhanced by using the SWF to issue stablecoins.
- **Technical Demands:** Infrastructure must support transaction freezing, real-time AML checks, and redemption guarantees.
- **Legal Exposure:** Non-compliance risks exclusion from U.S. markets, enforcement actions, or sanctions designations.

These frameworks prioritize U.S. financial stability and control over the dollar ecosystem, requiring foreign issuers to align with U.S. regulatory expectations or face market access limitation.

Whether the major SWFs sees more benefits than challenges are for them to decide.

At the Institute of Sovereign Investors, we stand ready to assist with more analysis. We are seasoned experts, who can assist SWFs in considering the merits and address the challenges, if they wish to consider stablecoin issuance as part of their operational mandate.

The Institute of Sovereign Investors is a global non-profit organization working with sovereign wealth funds, central banks and other sovereign entities to master best practice and operational excellence

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Appendix 1: Effects on Balance Sheet and Income Statement for SWFs issuing Stable Coins

Investment management and accounting: We assume that the SWF earns 8% on its assets and can place risk-free US dollar at say 4%, while not paying interest on its stablecoin liabilities. The SWF could increase its return on equity from 8% to 10% by financing parts of its liabilities with stablecoins and the remainder with equity as shown below.

Example 1: Traditional SWF funded only by owner's equity

Balance Sheet

Assets

\$1000 (SWF portfolio earns 8%)

\$1000

Liabilities

Equity: \$1000

\$1000

Income Statement

Income: \$80 (8% x \$1000) less cost of liabilities: \$0 = \$80

- Return on Assets: 8% (\$80/\$1000)
- Return on Equity: 8% (\$80/\$1000)

Example 2: SWF funded by owner's equity and stablecoin issuance

Balance Sheet

Assets

\$1000 (SWF portfolio earns 8%)

\$500 (backing portfolio: USD risk free asset earns 4%)

\$1500

Liabilities

Equity: \$1000

Stablecoins: \$500 (at zero yield)

\$1500

Income Statement

Income: \$100 (8% x \$1000) + (4% x \$500) less costs of liabilities: \$0 = \$100

- Return on Assets: 6.66% (\$100/\$1,500)
- Return on Equity: 10% (\$100/\$1000)

Risk management: To earn this return with minimum risk, the backing portfolio should have same interest rate risk as the liabilities, be invested in assets (like T-bills) with no credit risk and low liquidity risk. A ladder portfolio of T-bills (buying the 1-months T-bill every week) would largely eliminate any liquidity risk, as the T-bills keep on maturing and would not be impacted by lower market prices during crisis. A perfect hedge would include a deposit or repo facility. This hedges redemption risk. The rest is all about operational excellence, trained staff and strong governance, procedures and daily oversight.