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CAPITAL MARKETS *monthly*

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GENERAL MARKET OVERVIEW

The innovation of a "stablecoin" in 2014 was marketing genius. A 2% decline in purchasing power per annum (the Federal Reserve's inflation target) was a desired respite from extreme cryptocurrency volatility. In March 2024, we introduced our monthly readers to the idea that policymakers were warming up to stablecoins as a strategic outlet for U.S. debt. A year and a half ago, we informed readers that stablecoin issuers amassed huge portfolios of U.S. Treasuries in an effort to peg their token at par to the U.S. dollar. At the time, the top stablecoins combined to be substantial holders of U.S. debt, and the new Guiding and Establishing National Innovation for U.S. Stablecoins (GENIUS) Act of 2025 reserve requirements only cements the continued accumulation of U.S. Treasuries.

Regulatory clarity has jumpstarted an era of action. Over the last 45 days, a slew of banking-related legislation, executive orders and reports set in motion a sea change in policy. Consider the timeline of policy moves on the following page. *Continued on page 2*

JULY 17

Dubbed "crypto week." Two major bills pass the House and pending Senate vote.

H.R. 3633 – Digital Asset Market CLARITY Act
Market-structure framework splitting responsibilities between SEC/CFTC

H.R. 1919 – Anti-CBDC Surveillance State Act passed the House

JULY 18

GENIUS Act becomes law

S. 394 – GENIUS Act of 2025: First federal stablecoin law signed by the president, establishing a national framework for payment stablecoins (reserve and disclosure requirements, federal oversight).

JULY 18

CRA rule rollback proposal (banking supervision)

The OCC, Fed and FDIC proposed to rescind the 2024 Community Reinvestment Act final rule and revert to prior regulations.

JULY 30

Digital assets policy report

The White House published "Strengthening American Leadership in Digital Financial Technology," outlining priorities on stablecoins, access to banking and regulatory clarity.

AUGUST 7

Executive Order 14331: Guaranteeing Fair Banking for All Americans

Directs banking regulators to strip "reputational risk" style concepts from guidance/exam materials and instructs Small Business Administration-regulated lenders to make efforts to reinstate customers previously "de-banked" unlawfully.

AUGUST 15

Federal Reserve Board announces sunset of novel activities supervision program

Fed discontinues program focused on policing banks on bitcoin, crypto and fintech activities.

The GENIUS Act and its implications are the primary focus of this month's letter. Also, the **White House report** on digital finance is long but worth the read as a contemporary primer on digital assets, their history and top regulatory concerns. The report includes a special section on credit unions beginning on page 78 that comments on their potential involvement in the digital asset ecosystem, including a call to action for clarity around what services credit unions can provide, and risk-management and compliance expectations.

The GENIUS Act is the U.S. government's first major stablecoin regulatory framework. But what is a stablecoin? Stablecoins are blockchain-based tokens designed to maintain parity with a reference asset, predominantly the U.S. dollar. Pre-GENIUS Act, protocols included a wide range of reserve assets and experimental stability mechanisms (like algorithmic stablecoins). Post-GENIUS Act, U.S. dollar-based stablecoins now have material guardrails.

Stablecoins grew in popularity for several key reasons, including:

1. Serving as a volatility shield for crypto investors
2. Global utility offering individuals in high-inflation economies a simple way to hold U.S. dollar equivalent value
3. Low cost, cross-border payments
4. Institutional adoption for a blockchain form of cash for trading and settlement

For credit unions, these factors are not purely theoretical. Our members, particularly younger and more digitally native ones, increasingly engage with digital wallets, international remittances and fintech services where stablecoins are already playing a role.

The GENIUS Act sets strict requirements for issuers of U.S. dollar-backed stablecoins. Perhaps the defining feature of the act is its requirement that stablecoin issuers maintain reserves equal to 100% of outstanding tokens, and importantly, those reserves must be held in ultra-liquid, low-risk instruments of bank deposits or U.S. Treasury securities maturing within three months. *Continued on page 3*

Under the act, stablecoin issuers will operate on a full-reserve basis, which is in stark contrast to banks and credit unions operating under a fractional reserve model. Supporters of the law emphasize its consumer protection benefits, while critics argue that its economic impact and disruption to the financial system is more complex and nuanced.

A popular circulating assumption, as outlined in a recent ***Financial Times* article**, is comparing the recent stablecoin framework to the era of "free banking" from roughly 1837 to 1863, when banks issued their own currency. However, this comparison is an oversimplification and gets several key distinctions incorrect. For one, free banking was lightly regulated and lacked standardization of bank notes. More importantly, the stablecoin act has strict 100% reserve requirements, whereas reserves went as low as 2% during the free banking era in the nineteenth century. The new GENIUS Act model is more akin to a "narrow bank." Narrow banking refers to a model where financial institutions are restricted to holding only highly liquid, low-risk assets, such as cash and short-term government securities. Unlike traditional banks, narrow banks do not extend credit into riskier, longer-term lending markets. The purpose is safety: protecting depositors and ensuring immediate redeemability.

Stablecoins, which are designed to maintain a stable value relative to the U.S. dollar, mirror this principle. Since the act requires U.S. stablecoin issuers to maintain 1:1 reserves in bank deposits or Treasuries maturing within three months, this mandate effectively enshrines a narrow banking model for digital dollars. The Federal Reserve has historically been cautious about narrow banks, in part because they do not channel deposits into loans, which reduces credit creation in the economy. Stablecoins raise similar concerns. If consumer funds flow into tokenized full-reserve products instead of insured deposits, that could impact bank and credit union liquidity over time. In fact, in 2019, the Federal Reserve denied the TNB USA Inc. application to create a narrow bank and cited the potential for narrow banks to "complicate the implementation of monetary policy," drain deposits from traditional banks and affect the broader financial system's liquidity. Another key regulation in the GENIUS Act draws additional historical parallel. Stablecoin issuers face limited yield opportunities, weakening their ability to offer interest or compete with traditional insured deposits.

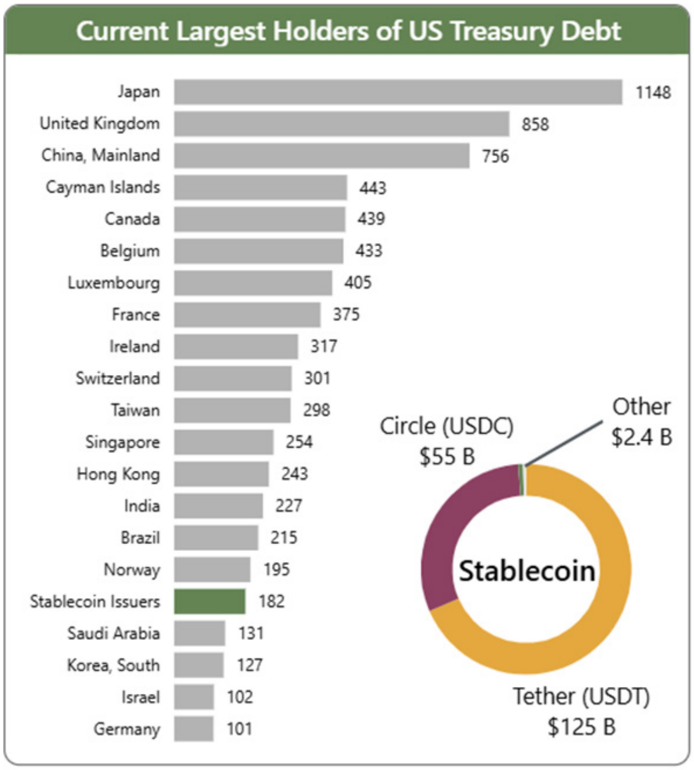
> ***No member bank shall, directly or indirectly by any device whatsoever, pay any interest on any deposit which is payable on demand.***
>
> **— Section 11(b) of the Banking Act of 1933**

Money market funds (MMFs) emerged in the 1970s when interest rates exceeded what banks could legally offer due to Regulation Q. Money funds bypassed Regulation Q by paying dividends instead of interest, attracting massive retail deposits away from banks. This shift weakened banks' ability to lend and destabilized the traditional banking system. Former Federal Reserve Chair Paul Volcker criticized MMFs for undermining financial stability. Regulators gradually phased out Regulation Q, culminating in its full repeal after the 2008 financial crisis.

To avoid repeating history, the GENIUS Act prohibits interest payments on stablecoins, aiming to prevent a new "rate war" and protect bank deposits. (There are potential loopholes that we will discuss below.) For credit unions, member shares and deposits remain the superior vehicle for earning returns, while stablecoins may compete primarily on convenience and digital accessibility.

Another popular narrative missing the mark is that the "GENIUS Act makes crypto safer." On the contrary, the GENIUS Act makes stablecoins safer but not crypto writ large. As discussed, the GENIUS Act strips stablecoins down to a boring and "narrow," fully backed by pristine collateral token, but nothing in the GENIUS Act removes the risk and volatility from Bitcoin, Ethereum or the other tens of thousands of tokens gyrating on the alt-coin casinos. *Continued on page 4*

Stablecoins are essentially digital dollars that move on a blockchain and are pegged 1:1 with the U.S. dollar. While their use domestically has been largely for crypto trading (trading in and out of highly volatile cryptocurrencies without off-ramping to traditional money), stablecoins could emerge as a competitor to ACH, wires and even debit/credit rails in the long run. The GENIUS Act's requirements make them safer but less economically flexible. For credit unions, this could limit short-term disruption, but member demand for faster, cheaper payments may still drive fintech partnerships.



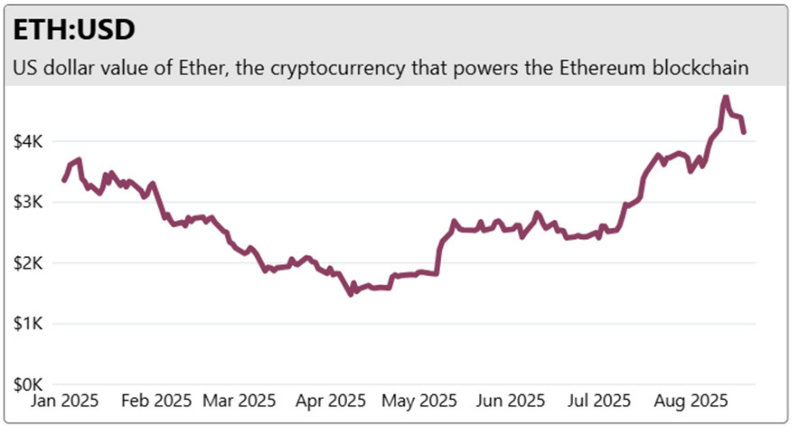
Stablecoin market capitalization is over $270 billion, with the two largest (USDT and USDC) capturing 85% of the market share. The largest U.S. dollar stablecoin issuer is Tether (USDT), followed by Circle (USDC), First Digital (FDUSD) and Paxos (PYUSD). These major stablecoin issuers collectively hold over $182 billion in U.S. Treasuries, surpassing many large nation-states. Tether alone has over $125 billion in Treasuries and was the seventh largest buyer of U.S. Treasuries in 2024, which helps explain why Tether's CEO Paolo Ardoino was present at the White House when the GENIUS Act was signed into law.

Tether will continue to be a big winner due to the extraordinary popularity and demand of their U.S. dollar product abroad. They have a generous runway of three years to come into compliance with the GENIUS Act for their domestic offering (likely a separate and distinct coin) but will continue operating their international business per usual. Tether has brought the U.S. dollar to emerging markets and unstable economies who urgently need dollar access. While their U.S. token will need to be short-dated U.S. Treasuries, Tether's emerging market operation can continue to hold a wide range of reserve assets, including long-dated U.S. Treasuries, making Mr. Ardoino very popular with U.S. Treasury Secretary Scott Bessent.

Some of the risks of eroding bank deposits and credit union shares are curtailed with the prohibition of stablecoin issuers paying interest. However, the ink on the GENIUS Act was barely dry before bankers began petitioning to close a loophole. While issuers cannot pay interest directly, the act does not explicitly prohibit affiliates, such as exchanges or custodians, from offering yield-like benefits to stablecoin holders on their platforms (echoing how MMFs innovated around Regulation Q). For example, Coinbase, the largest U.S. crypto exchange, offers 4-5% APY on USDC balances, and PayPal provides similar rewards on PayPal USD.

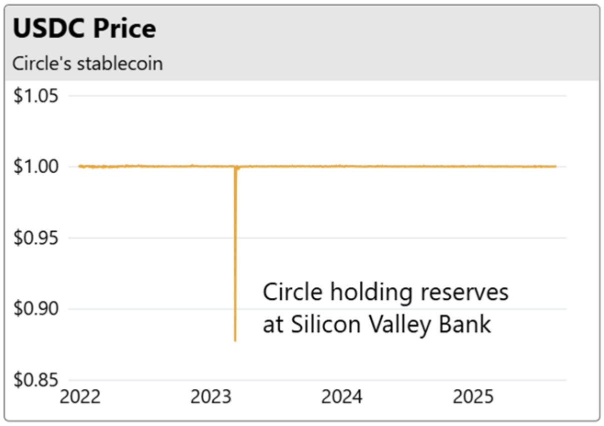
Stablecoins have been perceived as a threat to traditional payment networks. As expected, the big banks have blockchain and stablecoin token projects in the works. There is both regulatory and commercial tension between the ethos of the crypto industry (open, public, permissionless, decentralized and censorship-resistant) and the safety, soundness and focus on compliance with the Bank Secrecy Act of regulated financial institutions. Up until now, open blockchains Ethereum and TRON currently dominate the stablecoin market with roughly 84% of global stablecoin supply. Circle's USDC processes over $20 billion in daily transfers on Ethereum alone. These stablecoins have been operating on "Layer 2" as ERC-20 tokens, the technical standard for smart contracts on the Ethereum blockchain. *Continued on page 5*

Stablecoin issuers do not own the Layer 1 (L1) blockchain. Instead, stablecoin transactions require "gas" fees to transact on the Ethereum blockchain. This means stablecoin users face additional friction because they must also maintain a sufficient balance of ether (ETH), the cryptocurrency that powers the Ethereum blockchain, in their digital wallets to complete transactions. The "gas" transaction costs range from $0.10 to $0.50 depending on network congestion.



While stables are supposed to stay at $1, Ethereum is designed to capture value based on its utility as the mother of all blockchains for smart contracts.

While stablecoin tokens are designed to maintain their 1:1 peg to the U.S. dollar, market forces could force the stablecoin out of range akin to "breaking the buck" for a money market fund. Famously, in September 2008 during the Great Financial Crisis, the Reserve Primary Fund "broke the buck" with its net asset value falling to $0.97 as it wrote down nearly $800 million in Lehman Brokers commercial paper. Similarly, during the Silicon Valley Bank (SVB) deposit run in March 2023, Circle revealed they had $3.3 billion of USDC's cash reserves held at SVB, causing big players like Coinbase and Jump Trading to rush to redeem large amounts of USDC at any price. The sudden surge in redemptions led to a massive selloff, causing USDC to de-peg from $1 and drop as low as $0.87 before recovering after a full government backstop of SVB.



Until recently, the stablecoin issuers' business model was not to compete with L1 technology. Tether and Circle were happy to use L1 rails and collect the interest margin between the reserve assets they hold that are backing the peg and the operating expenses of managing their respective Layer 2 (L2) tokens. Using someone else's L1 rails, Tether generated an impressive $14 billion in 2024, a whopping $93 million per their 150 employees. Using someone else's rails doesn't require a large team. However, Tether and competitors are now launching their own L1 blockchains, which is an entirely different proposition requiring new expanding resources and capabilities. Despite the White House warming to these decentralized blockchains, major stablecoin issuers are launching their own L1 infrastructure. On August 12, Circle announced plans to launch Arc, an Ethereum-compatible L1 blockchain designed for more regulated stablecoins. And with Tether launching an L1 called Stable and Stripe launching Tempo, the emergence of new L1 blockchains could potentially erode Ethereum's market share and valuation.

Questions remain and the debate between L1 and L2 technology will continue. We have been here before in 2015 to 2017 when the sentiment of "blockchain not bitcoin" was particularly strong. Companies like IBM and Accenture experimented with blockchain technology in various industries like supply chains and healthcare, but most of those initiatives have faded. It remains to be seen if these corporations succeed with their respective private L1 blockchains or if they discover that the technological difficulty is so high, they revert to L2. *Continued on page 6*

One emerging solution for smaller institutions is the white label stablecoin, a model that allows organizations to issue their own stablecoin without building the technology themselves. The benefits are reduced development costs, regulatory compliance, scalability and time-to-market. However, drawbacks include brand risk, limited customization and a dependence on the technology provider. For credit unions, a white label model presents both opportunities and risks. The model allows for innovation in member payments and remittances without requiring new in-house expertise. However, outsourcing technology and compliance introduces dependence on external providers, raising governance and vendor management considerations. As members increasingly expect fast, digital-first solutions, white label stablecoins may become another tool in the credit union toolkit. The best approach requires careful evaluation of providers, risks and strategic fit.

The GENIUS Act is a milestone in the regulation of digital money with disruptive consequences to payments, liquidity, member services and competition. By requiring full-reserve stablecoins, lawmakers have chosen a model that emphasizes safety but at the cost of economic competitiveness. For credit unions, this legislation represents both a shield and a signal. On one hand, it dampens direct competition from stablecoins; on the other, it underscores the need to engage with digital innovation. Member expectations around payments, accessibility and global connectivity will continue to rise. Credit unions that prepare now by monitoring stablecoin developments, exploring partnerships and strengthening their digital offerings will be best positioned to thrive in this evolving landscape.

CAPITAL SOLUTIONS MARKET

There's a new investment in town. As of this writing, Alloya's Capital Markets Group is in the process of completing a $20 million subordinated debt issuance that has been very well received by credit unions. The structure of the offering is a 10-year fixed-to-float (7.50% for five years/three-month term Secured Overnight Financing Rate +400 thereafter). This issuance is non-callable for five years and callable thereafter.

Credit unions have always had a sense of community by investing in other credit unions by way of credit union service organizations (CUSOs) and credit union certificates of deposit issuance. In that regard, why not look at credit unions that issue subordinated debt (previously known as secondary capital) as another investment option? We are again reminding you that Alloya's Capital Markets Group will have additional subordinated debt offerings available from well-capitalized credit unions. By acting and getting board approval now, you will be ready for these additional subordinated debt offerings. You will also have complete access to the structure, financials and all the due diligence to review. *Continued on page 7*

While this opportunity to enhance your investment portfolio is already above two times oversubscribed, additional deals will become available upon approval of the application. Prepare by completing the documentation now. Once the non-disclosure agreement (NDA) is completed and approved, you will gain full access to new issuers' financial details to make the appropriate investment decision.

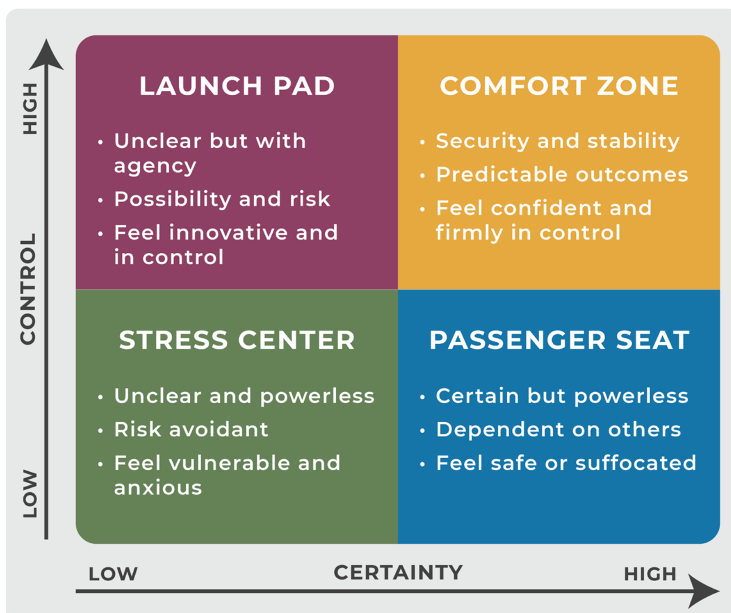
It's easy to get started. Now is the time to get your board "on board" with subordinated debt investing:

- ✓ Broker-dealer agreement signed (if not already a credit union ISI client)
- ✓ Alloya NDA signed (one time)
- ✓ Subordinated debt policy in place (can be included in investment policy). If needed, Alloya Investment Services has a template.

Want more information or need additional assistance to get started? Visit **www.alloyacorp.org/sub-debt** or contact Alloya's Capital Markets Coordinator, Parker Hausknecht, at **Parker.Hausknecht@alloyacorp.org**.

FINAL THOUGHTS

With the onslaught of banking-related legislation and executive orders, it is important to take a step back and consider strategic frameworks for approaching difficult decisions while innovating beyond existing business models. The big winners from the legislation will be the larger banks and asset managers that benefit from growth, use and custody of stablecoins, as well as smaller institutions and payment companies that adapt to the changing landscape.



Peter Atwater's Confidence Quadrant offers food for thought and introduces a framework for understanding how perceptions of certainty and control shape decision-making. The intersection of these two forces produces four distinct "zones" of experience: Comfort Zone, Stress Center, Passenger Seat and Launchpad. Atwater argues that recognizing where we are on this map helps us better manage both our emotions and financial decisions. For credit unions and capital markets participants, applying this lens can shed light on member behavior, institutional strategy and investor psychology. What box are you in regarding stablecoins and other recent regulatory policy changes?

With the GENIUS Act and stablecoins, we are transitioning from a speculative phase to one of action. And with action comes tremendous learning. It is too early to pick winners, but this should be a win for consumers. Let us remember that our members will benefit from the increased competition and innovation in the financial industry, potentially leading to better services and lower fees. The GENIUS Act is just the beginning. The industry will continue to evolve and adapt to the changing regulatory landscape, and Alloya will be keeping a close eye on industry developments.