Crypto; FinTech; Regulation;

Principles for "Stablecoin" Activity in Israel

In recent years, the stablecoin market has experienced rapid growth. However, the year of 2022 “stood out” due to several unfortunate incidents involving stablecoins. Those incidents occurred, in part, due to a lack of sufficient regulatory supervision. The collapse of ‘Terre Luna’, which guaranteed its value by pegging to USD (through an algorithmic mechanism), may have played a crucial role in the triggering of a significant regulatory discussion around the world.

In view of this, on February 22, 2023 the Israeli Supervisor of Banks (“**Supervisor**”**)** published, for public comments, a draft of principles for regulating the stablecoin activity in Israel. The Supervisor clarified that the proposed principles are based on draft regulation documents published by various regulators around the world. The principles have been adjusted to the Israeli market, and may be further modified as global market conditions, relevant technology, and international regulations evolve.

The Supervisor defines a stablecoin as "a digital currency that operates on a technological infrastructure and aims to stabilize its value by pegging it to another asset’s value, and the coin’s issuer operates a mechanism that maintains the stability of the coin’s value".

The principles refer to stablecoins that meet two conditions:
A. Their value is linked to an asset (legal tender, digital asset, gold, etc.).
B. The linkage is backed by a collateral and not by an algorithmic mechanism.

In addition, at this stage, the Supervisor intends to focus on the activity of the stablecoin issuers. However, going forward, the Supervisor plans to look into the need to formulate a set of regulation principles for other players as well, including exchanges, stablecoin payment service providers, custodians, and more.

[1] For additional information, please find our client update which details the approach taken by the EU, as expressed in its comprehensive MiCA regulation.

<u>The main principles of the proposed regulation structure are:</u>

- Licensing – **stablecoin issuers will require licensing** from the Capital Market, Insurance and Savings Authority. Issuers of systemic stablecoins that are used as a common means of payment (or have the potential to become such) will require licensing by the Supervisor according to criteria that will be published in the future.
- Collateral scope and assets – **the reserve assets that will be held by a stablecoin issuer must cover 100 percent of its liabilities to the coin holders.** In addition, in order to guarantee the value of the collateral, the collateral must be held in the same asset as the stablecoin (USD, gold, etc.).
- Controlled payment system – stablecoin that is declared a controlled payment system will be overseen by the Payment Systems oversight function at the Bank of Israel.
- Consumer protections – **unique consumer protections will be developed,** for example, a broader due diligence obligation to disclose the risks associated with holding and using stablecoins. Additionally, a requirement for enhanced transparency by publishing a legal document to the public ("White Paper").

The principles document is a "first step" towards establishing regulation for stablecoin activity in Israel and therefore is significant. The exact nature of the regulation has yet been finalized, however, **the publication of the principles document is a substantial move by the Supervisor to enable and promote stablecoin activity in Israel, while taking into account the unique risks and consumer protections associated with such activity.**

Please feel free to contact us with any questions that you have on this matter.

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Timor Belan, Partner
timorb@gornitzky.com

Ido Malin , Partner
idom@gornitzky.com

Avital Haitovich, Associate
avitalh@gornitzky.com

* This client update was prepared with the assistance of Ms. Inbar Avrahami .