

Principles for Stablecoin activity

Document for comments by the public



February 2023

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Introduction

A stablecoin is a type of digital asset that operates on a technological infrastructure, and its value is stable relative to some other reference asset. The stablecoin issuer operates a mechanism that protects the stability of the coin's value.

Since the invention of Bitcoin and blockchain technology, digital assets have not succeeded in turning into a common, widely used means of payment. The main reason for this is the considerable volatility in their value. This is in addition to other reasons—lack of a central entity, or at least a supervised or reliable central entity; the high costs; the low efficiency (for example, the length of time required to execute a transaction); and the concern that at times these assets have been used for illegal activity. For the public to use any asset as a widespread means of payment, meaning it will be used for retail payments and purchases at retail businesses, the value of the asset has to be stable in terms of the price of a typical basket of goods. Therefore, to date, digital assets have served mainly as speculative investments, and the stablecoin is intended to provide a response to such difficulties and serve as a means of payment.

In recent years, the use of digital assets has increased. In the past year, there were many failure events in the digital asset market, which emphasized the importance of regulating the use of such assets and imposing oversight on this area. Accordingly, the Bank of Israel led a steering committee¹, headed by Deputy Governor Andrew Abir, that examined the issue from several significant perspectives, such as prudential, regulatory, technological, monetary, and legal. Among other things, the Committee examined stablecoin regulation. As part of the Bank of Israel's function to regulate coins that will be used as means of payment and with the goal of allowing activity in stablecoins in parallel with the existence of an optimal risk management system, the Bank of Israel is publishing this Principles Document for comments by the public.

We note that the Principles Document does not describe the current regulation framework, but rather publishes a proposal for discussion as part of the formulation of a regulatory framework for stablecoin activity. This proposal is based on draft regulation published by various regulators worldwide, adjusted for the Israeli market. To the extent that there will be further developments, including international regulation, global market conditions, or relevant technology, there could be changes in this proposal. Preparing the proposed regulation framework included formulating rules for stablecoin activity that reference several aspects: how to manage customers' funds held in trust; consumer protections; and rules for regulating the technological infrastructure. The supervisory framework includes principles for licensing Israeli stablecoin issuers or foreign issuers that offer

¹ Members of the Steering Committee and the work team for cryptographic currencies: Deputy Governor Mr. Andrew Abir, Chair; Mr. Oded Salomy, Payment Systems and Settlement Department Director; Ms. Shulamit Geri, Bank of Israel Director General; Mr. Yair Avidan, Supervisor of Banks, Dr. Adi Brender, Research Department Director, Mr. Lior Georgi, IT Department Director; Dr. Eyal Rozen, Information and Statistics Department Director; Ms. Tida Shamir, Legal Department Director and Bank of Israel General Counsel; Payment Systems and Settlement Department: Noa Sheshinski, Netanel Tauber, Moriya Gov Solomon, Shiri Hadash, Ori Altalat; Banking Supervision Department: Dani Hahashvili, Oshrit Lin; Deputy Governor's Office: Yoav Soffer; Research Dept: Sigal Ribon, Roy Stein; Markets Department: Barak Ettinger; Legal Department: Michal Sinai Livyatan, Elitzur Weiser, Ronen Nissim; IT Department: Asaf Cohen, Yifat Davidi; Information and Statistics Department: Maayan Kellerman.

their services to Israeli customers; as well as an oversight framework for stablecoin activity that is included in the framework of payment system oversight.

As such, we emphasize that this paper should not be considered as obligating the Bank of Israel, and it should not be relied on for carrying out activity in the stablecoin market. After receiving comments to this report from the public, the Bank of Israel will integrate the required changes, will recommend legislation to the government in accordance with the principles in this document, and will formulate regulatory instructions for the entities supervised by the Bank of Israel.

The principles document refers to entities that will be supervised by the Bank of Israel, and it also recommends applying these principles on stablecoins that will be supervised by another regulator as well.

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Background

Stablecoin and why it exists

The first digital asset based on blockchain infrastructure—bitcoin—was issued in 2009. Since then, many other digital assets with similar characteristics have been launched. The value of these assets was very volatile, which led to concern among businesses and the digital asset holders of using them as means of payment. Therefore, the need arose for a digital asset that operate like bitcoin on the blockchain infrastructure, but also has a stable value. The first stablecoin, Tether², was launched in 2014. The stability of the coin was reflected in its value being pegged to the value of another stable asset. In the case of Tether, its value was pegged to the US dollar through the issuer's commitment to convert it, for any holder who requested it, into 1 dollar. This commitment was accompanied by the company's declaration to hold appropriate reserves. Since then, various types of stablecoins have been developed. It is possible to peg to legal tender such as the dollar or euro, or other assets such as gold, or other digital assets. Other "stablecoins" with a different stabilization mechanism have also been developed, based on an algorithm that buys or sells the coins in accordance with its market price.

Developments that led to the formulation of regulation

The activity in digital assets, including stablecoins, developed at an accelerated pace in recent years. In the past year, there have been several failure events in the unsupervised digital asset world: the collapse in May 2022 of stablecoin Terra Luna, which had committed to being pegged to the US dollar, and the mechanism to stabilize its value was based on using a stabilizing currency called "Luna" via an algorithmic mechanism; the collapse of the FTX crypto exchange in November 2022; the bankruptcy of Core Scientific, the largest bitcoin mining company in the US; the collapse of Celsius, the Israeli-American company that dealt with taking deposits and extending credit in digital currencies; break-ins to digital wallets, and numerous other events. These occurrences led to instability and uncertainty among the digital asset holders, including those holding stablecoins. These all emphasized the importance of regulation and supervision of the use of digital assets.

The Bank of Israel examined—within the framework of its functions of maintaining financial stability, conducting monetary policy, and regulating the payment systems in Israel—the activity in digital assets. This was due to their impact on the areas for which it is responsible. In this principles document we will propose a supervisory framework for the activity of stablecoins that serve as means of payment.

² For information on examples of stablecoins see Appendix A.

The Bank of Israel's approach to digital assets

Technological indifference

The main principle guiding the Bank of Israel in regard to digital assets is that the supervisory framework imposed on the legal tender currency operating on traditional infrastructures has to be implemented as well on digital assets that operate on blockchain infrastructures, subject to required adjustments.

The difference between a means of payment and an investment asset

Before examining the digital asset field, the accepted approach in financial activity currently is that in any case of means of payment or deposit of funds in an account designated for executing payments, the public does not refer to them in a speculative manner with the goal of profiting from an increase in the value of the currency, but as instruments intended to allow the orderly execution of payments. Therefore, in this area, tight prudential supervision that will ensure customers' funds and the stability of the means of payment is required. This function is an integral part of the Bank of Israel's main objective of maintaining price stability in the Israeli market.

In contrast, in the area of investments, the approach is that the public purchases assets with the goal of maximizing profits from this activity, where alongside with the possibility of profit, there is obviously also the risk of loss. The regulation in this area is intended, among other things, to ensure that the public is aware of the risks inherent in activity that involves financial investments.

How to refer to digital assets

In accordance with the technological indifference approach, the main question is, should these assets be viewed as means of payment or as an investment asset? The Bank of Israel is of the view that each digital asset should be referred to in accordance with its main use. To date, digital assets have mainly served as investment assets, and accordingly that is how the regulators have viewed them as well.

The Bank of Israel, the Capital Market, Insurance and Savings Authority, the Israel Tax Authority, the Israel Securities Authority, and the Israel Money Laundering and Terror Financing Prohibition Authority published a joint notice in February 2014 regarding the unique risks inherent in activity of digital or crypto assets that operate on the blockchain network, with the goal of enhancing awareness and caution among the public.

As long as these digital assets serve mainly as investment assets, they should continue to be viewed with the caution required in accordance with the publication from 2014, as noted above. To the extent that a specific digital currency will serve mainly as a means of payment, it should switch to being referred to as a means of payment, as one that the public expects to conduct itself in a stable and efficient manner, and not in a speculative manner. Accordingly, the regulation that applies to a means of payment should be applied to it, with the required adjustments.

Extent of the stablecoin's stability

The value of the stablecoin depends on the value of the asset to which it is pegged. However, this does not mean that the value of the stablecoin is necessarily stable, as even the value of legal tender currency could fluctuate in value in accordance with changing financial and economic conditions. The stability refers to the fixed ratio between the currency and the reference asset to which it is pegged, and therefore it is only exposed to the fluctuations in the reference asset's value. We also emphasize that it is not the supervisor's function to be concerned about the stability of the asset to which the stablecoin is pegged, but to ensure that the issuer will be able to comply with its commitments to the stablecoin holders and to protect its value in accordance with the pegged asset.

In the existing payments market, the common payments in Israel and abroad are made almost exclusively through legal tender, out of the public's view that it is generally stable, is accepted in all businesses, is very negotiable, and secure. The assumption as of today is that the use of stablecoins as means of payment will be mainly via the ones that are pegged to legal tender, and less via others that are pegged to assets that are not legal tender.

Application of the stablecoin supervisory principles

The reasons for focusing on the stablecoins in this document

The Bank of Israel's function as defined in law requires the Bank's regulation and supervision of means of payment activity. By force of this function, the Bank of Israel is currently working to regulate the activity of digital assets used as means of payment. Accordingly, the Bank of Israel formulated principles only in regard to digital assets for which the main use is as a means of payment. Currently, the probability that the main use of digital assets that are not stablecoins and have a volatile value will become a means of payment is low. In contrast, stablecoins have a reasonable chance of serving mainly as a means of payment, as they are mainly used already today for buying and selling digital assets, and not as investment assets on their own, and therefore the document focuses only on this type of digital asset.

If, despite the assessments, the main use of other digital assets will be as a means of payment, their inclusion in the regulatory framework being formulated will be considered.

The stablecoins to which this document applies:

The document refers to activity of stablecoins that meet 2 criteria:

1. Their value is pegged to an asset (legal tender currency, a basket of legal tender currencies, digital asset, gold, etc.)
2. The linkage is backed by reserves and not by an algorithm.

These principles will also apply to stablecoins that will serve as common means of payment and will be supervised by the Bank of Israel. The Bank of Israel recommends also applying these

principles on stablecoins that will serve as common means of payment and will not be supervised by it.

We also note that later, specific rules will be formulated that distinguish between stablecoins pegged to the shekel and those pegged to other assets.

Participants in the stablecoin area to which this document applies

This document focuses on the activity of the stablecoin issuer, but later will examine the need to formulate supervisory principles for additional participants that deal with stablecoins such as: digital wallets, trading arenas, payment service providers that provide services in stablecoins, and entities that provide custodian services.

The principles do not apply to the following currencies/products:

1. Cryptographic currencies that don't have a stabilization mechanism: the principles that were formulated in this document do not refer to cryptographic currencies that are not stablecoins, such as bitcoin or ethereum.
2. Stablecoins for which the stabilizing mechanism is based on an algorithm³—the principles will not apply to stablecoins that are stabilized by an algorithm, due to the unique risks of such a currency and the difficulty in ensuring the issuer's compliance with its commitment under such a stabilization mechanism. Only recently there was the collapse of the TerraUSD⁴ coin, for which the stabilization mechanism was based on an algorithm. This case strengthens the Bank of Israel's assessment that the probability of such a currency being used mainly as a means of payment is very low. If despite this, a currency of this type becomes a common means of payment, it will be required to hold full reserves instead of using the algorithm mechanism. In effect it will be prohibited to issue a currency with an algorithmic stabilization mechanism.
3. Currency issued by the central bank (CBDC)—this document refers exclusively to business entities that issue stablecoins.
4. Smart contracts⁵—smart contracts are not a type of digital asset, but an additional service that might be provided with the stablecoins. The Bank of Israel will examine the regulatory tools that are available today or that will be available in the future, in order to supervise the activity in smart contracts.
5. Tokenized assets of the commercial bank's customers' assets—Banks around the world have begun to convert customers' assets such as current accounts into tokens.⁶ This issue is being examined by regulators around the world as well as in Israel. Rules have not yet been formulated in the issue.

³ An algorithmic stabilization mechanism should establish pegging for a crypto currency, the value of which can be volatile, and its stabilization mechanism based on an algorithm, which automatically adjusts and controls the supply of the stablecoins. If the price of a stablecoin increases, the issuer creates more stablecoins, and if the stablecoin's price decreases, the issuer buys back stablecoins, in order to stabilize the price.

⁴ For more information on TerraUSD see Appendix A.

⁵ Smart contracts – a distributed and public digital contract that operates on the blockchain network and executes transactions automatically as defined in the contract.

⁶ Tokenization process: A change in the technology existing today of a bank account to a tokenized assets format – the bank will issue a token worth one shekel each and will issue Tokens to each customer, per the number of shekels in the account.

A summary of an international survey

The Bank of Israel examined, as a background to formulating the document, the regulation emerging worldwide in the field of stablecoins, with an emphasis on the regulation in the EU, UK, and US. In general, when regulators around the world examined the regulation features that are appropriate for stablecoins, they identified that stablecoin activity incorporates two activities. One is essentially similar to managing an account, as the issuer receives money from the customer and in return makes a digital balance available to the customer. The second is essentially similar to the activity of a payment system, as the stablecoin incorporates technology that allows payment transfers. Accordingly, the general approach is formulation of a regulatory framework of licensing and a parallel regulatory framework of supervision over the stablecoins as a payment system, to the extent that they comply with the appropriate criteria.

Europe

The regulation emerging in Europe was arranged within the framework of the **MICA**⁷ directive that mainly regulates the licensing rules.⁸ The final version of the directive already passed a first reading in October 2022. The date it goes into effect will be, in accordance with various publications, in 2024.

The ECB⁹ formulated, in parallel, the **PISA**¹⁰ supervisory framework, which applies to payment instrument schemes and arrangements, and that went into effect beginning November 2022. In accordance with PISA, stablecoin issuers are included in the definition of a payment instrument scheme and the activity of digital wallets is included in the definition of arrangement.

UK

The British approach is also “dual regulation” of stablecoin activity. Accordingly, the UK Treasury¹¹ published a position paper that proposed legislation for stablecoin supervision regulation. The document referred to the various functions in the stablecoin activity chain and defined the participants that are required for licensing, as well as the entities that should be supervised as payment systems and on which the PFMI principles¹² should be imposed.

⁷ Markets in Crypto Assets

⁸ In accordance with MICA, in order to license an asset referenced token (the term refers to stablecoins), an Electronic Money Institution license is required. For a list of the intended regulators for licensing and supervising such entities, see Appendix B.

⁹ The European Central Bank.

¹⁰ Eurosystem oversight for payment instruments schemes and arrangements.

<https://www.ecb.europa.eu/paym/intro/news/html/ecb.mipnews211122.en.html>

¹¹ <https://www.regulationtomorrow.com/eu/ukstablecoins-consultation-and-call-for-evidence>

¹² Principles for Financial Market Infrastructures. These principles were established by the Bank for International Settlements (BIS) with regard to activity in financial market infrastructures including payment systems and other financial market infrastructures. The following is a link to the principles: https://www.bis.org/cpmi/info_pfmi.htm

The Bank for International Settlements (BIS)

The BIS¹³ published a position paper regarding stablecoin activity. The document refers to the need to apply the PFMI principles on the entities operating in this field and details the required adjustments.

US

The bill¹⁴ that regulates the activity of digital assets, including stablecoins, was submitted in June 2022. The legislation regulates, among other things, the licensing and supervision requirements as well as the reserves required from stablecoin issuers and how to manage them. The reserves will be held in accordance with the legislation in institutions that are properly supervised and in a manner that will allow maximum protection of the depositors' funds, including a requirement for deposits insurance.

In addition, a report published in November 2021 by the FDIC and the OCC¹⁵ regarding stablecoins recommended granting the authority to the Federal Reserve to apply the PFMI principles on any entity for which the activity is critical to the functioning of the stablecoin.

The supervisory structure recommended in Israel

The supervision in Israel will also be carried out in parallel via the two supervisory frameworks, and subject to uniform rules of activity. This is similar to the supervisory framework generally accepted worldwide, with an emphasis on the supervisory framework in the EU, and in accordance with the generally accepted practice today:

1. Supervisory frameworks:

Licensing

It is proposed that the licensing of stablecoin issuers beginning with the first shekel should be by the Capital Market, Insurance and Savings Authority.¹⁶ The Banking Supervision Department will give licenses to systemic issuers of stablecoins that serve as common means of payment or that have the potential to become a common means of payment, in accordance with the criteria detailed below.

The terms of the license will be determined based on the MICA directive and with adjustments required for the Israeli market. We note that MICA regulates license terms for a regular stablecoin

¹³ Bank for International Settlements - <https://www.bis.org/cpmi/publ/d198.htm>

¹⁴ S.4356 – Responsible Financial Innovation.

¹⁵ Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency.

¹⁶ This proposal is consistent with the Bank of Israel's stance, according to which the Supervision of all nonbank payment service providers should be carried out by the Capital Market Authority.

issuer and establishes additional supervision by the EBA for stablecoin issuers that serve as significant means of payment.

Payment systems oversight

The Payment Systems Oversight Division at the Bank of Israel will oversee the stablecoin that was declared recognized payment system. The oversight will be carried out based on the PISA oversight framework that is implemented in the EU and with required adjustments for Israel.

2. Activity rules

The Bank of Israel recommends to the government to promote legislation of stablecoin activity rules in accordance with this principles document, and to apply the legislation to all stablecoin issuers, unrelated to the identity of the regulator.

3. Criteria for defining an entity as systemic, which is subject to the oversight of the Banking Supervision Department

Due to the impact of the activity of a stablecoin issuer that becomes a systemic entity on financial stability, on monetary policy, on the payment systems in Israel, and due to the systemic risks that could accompany its activity, a tighter level of oversight is required by the Bank of Israel. This requires, in the first stage, assessing and identifying the issuer as a systemic entity.

Following are the criteria for deciding if a stablecoin is systemic and serves as a common means of payment. Later, the appropriate thresholds for meeting the criteria will be examined:

1. The number of stablecoin holders;
2. Par value of the issued currency or the scope of size of the reserve of assets;
3. The number or value of transfers using the currency as a means of payment in Israel and for cross-border payments;
4. The scope of additional financial services provided using the stablecoin;
5. The “substitution principle”—the scope of factors that rely on the currency as a single payments solution

It is emphasized that unrelated to the definitions of systemic, the Bank of Israel will be able to declare stablecoins as a recognized payment system, to the extent that they comply with the criteria for declaring a payment system as recognized.

4. Coordination mechanism between regulators

Coordination mechanisms will be established between the Banking Supervision Department and the regulator that will oversee the stablecoins that are not systemic. The coordination mechanisms will include processes of reporting and consultation in order to ensure an effect on the emerging arrangements vis-à-vis the said entities, as well as to follow their development. In addition, a Bank of Israel opinion will be required before another regulator approves the issue of stablecoins.

To the extent needed, and in order to avoid double regulation between the regulator arranging the stablecoin license and the oversight of them as payment systems, a MOU will be advanced that arranges the division of the supervisory fields, the collaboration, and the information sharing between the regulators.

Rules for stablecoin activity

In addition to the stablecoin licensing and supervision framework, this document sets rules in several material issues that regulate the activity of issuing the stablecoins. These rules will be promoted in legislation or will be established as part of Supervision's directives. The rules refer to activity by issuers of stablecoins that are pegged to the shekel and are supplied in Israel. Later, the adjustments for foreign stablecoin issuers will be formulated, as well as the adjustments for stablecoins in which the value is pegged to foreign exchange or to another asset that is not legal tender.

Holding the reserves by the currency issuer

Scope of reserves: The reserves will cover 100 percent of the stablecoin issuer's liability.¹⁷ Note that according to the principles formulated, a stablecoin issuer is required to hold 100 percent of reserves, while the digital assets that are not stable are not required to hold any reserves at all. The requirement for reserves derives from the issuers of the currency presenting it to the public as a stablecoin, and it is committed to peg its value to the value of another asset.

Later we will examine the question of whether banks are required to hold 100 percent of securities as an issuer of stablecoins. It should be noted that this issue is also being examined at this time among most regulators worldwide.

Reserve assets

The reserves are to be held in the same asset to which the stablecoin is pegged, in order to ensure that the reserves' value will be maintained in accordance with the issuer's undertakings. To the extent that the currency is pegged to legal tender, the collaterals are to be held in the same currency, in order to reduce the exposure to exchange-rate differentials between the redemption value and the amount of the liability. If the stablecoin is pegged to a basket of currencies, the collaterals are to be held in the same currencies and at the same ratio in which the linkage was established.

¹⁷ One hundred percent refers to reserves held in cash. It could be that subject to asset types that the regulator will allow to hold, the issuer will have to hold more than 100 percent of the liability in order to cover the risk of a decline in the value of such reserves.

Liquid assets with low risk

The reserves can be held in liquid assets such as cash/deposits, short-term government bonds (Israeli or foreign), "makam" (central bank bills), or deposits at the Bank of Israel.¹⁸ The Bank of Israel will determine the composition of assets that can serve as reserves and will also examine if haircut coefficients¹⁹ are required for each one of them. In determining the composition, it will take into account the requirement that the issuer is to enable the redemption of the stablecoin at any time and to credit the account of the holder within a maximum of 2 business days after the redemption request. To remove any doubt, it is clarified that the positive or negative differentials that will be created as a result of fluctuation in the value of the liquid asset will be attributed to the stablecoin issuer's account, and the issuer will be able to benefit from the profits that the deposited collaterals will maximize.

How to manage the reserve funds

1. **Custody** – The BOI recommends that within the framework of the legislation on the issue, a fundamental requirement to hold the reserves in trust will be established. Additional requirements regarding how to hold the funds in trust will be established by the BOI in directives, taking into account the standards accepted worldwide.
2. **Separating the funds**
 - a. The collateral is to be held separately from other funds of the issuer that are used for its ongoing activity.
 - b. If the issuer has several types of stablecoins, the reserves for each type of currency are to be held separately
3. **The entity in which the funds will be held** – the reserves shall be held in trust entities similar to what is accepted worldwide in this issue.
4. **Ensuring customers' funds**
 - a. In a insolvency situation, customers will have direct rights to the reserve assets and they have precedence over repayment of other creditors
 - b. Rules will be formulated for issuing, creating, or destroying stablecoins, which will ensure the rights of the customers
5. **Periodic reporting of balances of the reserve assets** – will be to the Bank of Israel and within the financial statement

Principles of consumer protection

In addition to the common consumer issues in traditional financial areas, the following consumer protections, which are unique to the stablecoin field, shall be promoted:

1. **Transparency (white paper)** – The commitments to the customer, peg terms, and stabilization mechanism shall be anchored in a legal document that will be published.

¹⁸ For entities that are permitted to manage deposits at the Bank of Israel.

¹⁹ Haircut coefficients require a higher percentage of holding than required, in order to compensate for the risk of losses in that same liquid asset. The riskier the asset is, the higher the required percentage holding will be.

2. **Repayment date** – The issuer shall repay the money at any time and immediately and the customer's account will be credited within 2 business days at the latest.
3. **Full disclosure** – The issuer shall publish full disclosure to customers regarding the following issues:
 - a. The risks inherent in holding or using the coin
 - b. The activities that are involved in charging a fee, and the fees amount
 - c. The balances of the reserves and profits/losses in reports that will be published

Rules for regulating the technological infrastructure

The Bank of Israel will establish rules and standards regarding the technological infrastructure on which the stablecoin will operate. Thus, for example, if a stablecoin acts on a blockchain infrastructure of bitcoin, the regulator will be able to establish that this infrastructure is not secure and it must operate on a different infrastructure. The regulator will also confirm the compliance of the infrastructure with the standards it establishes regarding the stability and reliability of the infrastructure, and regarding its compliance with data security, cyber, and privacy protection requirements.

Principles of licensing stablecoins

The Bank of Israel recommends promoting legislation that will require the holding of a license for issuing stablecoins and the services included in such a license. The licensing conditions shall be based on the accepted international standards, with an emphasis on Europe's MICA directive, among others, in regard to the requirements that are appropriate to the issuer of the stablecoin that serves as a significant means of payment. The possibility of exempting entities that already have a license for appropriate financial activity will be considered, with the required adjustments.

We note that at this time the government is promoting legislation for regulating the activity of nonbank entities that provide payment services, including account management. As the activity of the stablecoin issuers has similar characteristics to the activity of entities providing payment services, the regulation of the stablecoin areas has to take note of regulation regarding the activity of providing payment services.

The license is to include, among other things, the following requirements:

Requirement to be incorporated in Israel

Supervision rules that are similar to other financial entities: such as risk management including corporate governance risks, honesty and integrity, capital, liquidity, anti-money laundering;

Rules for publication of the prospectus (white paper)

Formulation of a policy that describes the backing mechanism and the fees

Regulating the consumer protections

Obligation to report to the regulator

Principles of supervision over stablecoin as a payment system

A stablecoin that will comply with the criteria for being declared a payment system, will be declared as a recognized payment system, meaning it will be supervised in accordance with the appropriate regulatory framework that will be formulated for such activity. This supervision shall be carried out by the Payment System Oversight Division at the Bank of Israel and in parallel with the licensing and supervision that will be carried out by the appropriate regulator.

Formulating a supervisory framework based on the PISA²⁰ supervisory framework and its adjustment to the domestic market

The Payment System Oversight Division shall formulate a supervisory framework for activity in stablecoins, based on the PISA supervisory framework formulated by the ECB in Europe. The PISA supervisory framework applies the international Principles for Financial Market Infrastructures (PFMI) with the adjustments required for payment instrument schemes and arrangements.

In accordance with this supervisory framework, stablecoin issuers are included in the definition of payment instrument scheme, and digital wallets are included in the definition of arrangement.

Criteria for declaration

The criteria for declaring a payment system as recognized and accordingly applying the Payment System Oversight Division's control on it, appear in the Payment Systems Law, 5768-2008. Following are the criterial ones:

1. The system's activity is essential to the overall payments system in the market
2. There is a concern that the payment system acts improperly, inefficiently, or unreliably to adversely impact the payment systems in the market.

²⁰ Payment instruments, schemes and arrangements:
<https://www.ecb.europa.eu/paym/intro/news/html/ecb.mipnews211122.en.html>

Appendix A: Examples of stablecoins

Tether (USDT) – the first and most common stablecoin, owned by Hong Kong’s Tether Holdings Limited, a company that is connected to the popular crypto exchange BITFINEX. The coin operates on an independent blockchain network that the company operates. According to the company’s declaration, it backs the USDT fully (100 percent) via dollar reserves.

Tether’s blockchain infrastructure also supports three other stablecoins: EURT, which is pegged to the euro; CNHT, which is pegged to China’s yuan; and XAUT, a stablecoin that is pegged to the value of an ounce of gold.

USDC – the second most common coin. The digital coin was invented by a supervised technology company called CIRCLE and holds a Licensed Money Transmitter license. Similar to Tether, USDC declares that the coin is fully (100 percent) backed by the US dollar.

Binance USD (BUSD) – this is a coin issued by Binance, the largest digital asset exchange in the world. BUSD is also fully (100 percent) backed, according to the company’s declarations, by US dollar. The coin is approved by the New York State Department of Financial Services, the NYDFS.²¹

DIEM - formerly known as LIBRA, issued by the META company (previously Facebook), that was supposed to be pegged to a basket of legal tender currencies (dollar, euro, and pound). Later, the characterization was changed so that it was supposed to issue the Diem currency, pegged to fiat money, such as euroDiem, dollarDiem, etc. The coin was planned to be 100 percent backed by quality and liquid assets in the legal tender currencies to which it was pegged. The initiative was closed and it is not expected to go into actual operation.

TerraUSD (Luna) – a stablecoin with a DLT mechanism that collapsed

The Terraform Labs company issued a coin called UST (hereinafter, “Terra”, that undertook to be pegged to the US dollar at a 1:1 ratio. The way the company attempted to create the stabilization mechanism was not through dollar reserves, but through the use of a coin called “Luna”. The basic idea was that a change in the supply of “Luna” coins relative to the “Terra” coins is what created the stabilization mechanism. For example, issuing the Luna coin when the Terra coin value declined to below a dollar.

In order to generate demand for the coins, the company created a loans and deposits platform—Anchor—which paid close to 20 percent interest per year on Terra deposits, with notable fees to the company that were financed by new capital that entered the system.

A withdrawal of 500 million Terra coins from the platform in May 2022 led to a wave of additional withdrawals, to breaking the pegging with the dollar, and eventually to the collapse of the platform,

²¹ New York State Department of Financial Services

as well as of many other platforms and companies that depended on it, occurrences that led to a steep decline in the price of bitcoin and other digital assets.

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Appendix B:

The intended regulators for the Electronic Money Institution

Country	Regulatory entity
Austria	Financial Market Authority
Belgium	National Bank of Belgium
Bulgaria	Bulgarian National Bank
Croatia	HNB-Croatian National Bank
Cyprus	Central Bank of Cyprus
Czech Rep.	Czech National Bank
Denmark	Financial Services Agency
Estonia	FINANTSINSPEKTSIOON -Estonian Financial Supervision and Resolution Authority
Finland	Financial supervisory authority
France	Prudential control and resolution authority-Banque De France
Germany	BaFin - Federal Financial Supervisory Authority
Japan	Bank of Greece -Central Bank
Hungary	Magyar Nemzeti Bank - Central Bank
Iceland	Sedlabank Island - Central Bank
Ireland	Central Bank of Ireland
Italy	Bank of Italy - Central Bank
Latvia	Latvijas Banka - Central Bank
Liechtenstein	Financial Market Authority
Lithuania	Bank Of Lithuania - Central Bank
Luxembourg	Commission de Surveillance du Secteur Financier
Malta	Malta Financial Services Authority
Netherlands	DeNederlandscheBank - Central Bank
Norway	FINANSTILSYNET - Financial Supervisory Authority
Poland	Narodowy Bank Polski - Central Bank
Portugal	Banco DE Portugal - Central Bank
Romania	National Bank of Romania - Central Bank
Slovakia	Narodna Banka Slovenska - Central Bank
Slovenia	Banka Slovenije - Central Bank
Spain	BANCODEESPANA - Central Bank
Sweden	FI - Financial Supervisory Authority