



Directive 15—Credit Risk in a Controlled Payment System and a Designated Controlled Payment System

1. Introduction

In accordance with Section 8 of the Payment Systems Law, 5768-2008 (hereinafter: “the Payment Systems Law”), an operator of a controlled payment system shall formulate rules that will ensure the stability, efficiency, and sound functioning of the system.

In accordance with Principle 4 of the Principles for Financial Market Infrastructures (PFMI), published in 2012 by the Committee on Payment and Settlement Systems of the BIS (CPSS) and the International Organization of Securities Commissions (IOSCO), a financial-service infrastructure (FMI) should effectively measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes; furthermore, an FMI should maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence

This Directive regulates the requirement of controlled payment systems and designated controlled payment systems to construct a robust framework for management of credit exposures vis-à-vis system participants and for those originating in the system’s payment, clearing, and settlement processes.



2. Definitions

“Payment system”, “controlled system”, “designated controlled system”, “payment-system operator”-	As defined in the Payment Systems Law;
“Payment-system operator” or “system operator”-	Operator of a controlled payment system or a designated controlled payment system;
“Payment Systems Oversight” or “Oversight”-	The oversight unit for payment systems at the Payment and Settlement Systems Division of the Bank of Israel;
“Participant in a payment system”-	One who is defined as a participant under the system rules;
“System rules”-	The rules by which the payment system operates;
“Credit risk”-	the risk that a counterparty, be it a participant or an other, will be unable to meet its financial obligations in full when they fall due or at any future time;
“Creditworthiness”-	the ability to repay credit when due;



“Current exposure” -

a loss that the payment system (or its participants) will face at once in the event of a participant default;

“Deferred net system” -

A net settlement mechanism that provides for netting at the end of a predetermined settlement cycle;

“Net liquid assets” -

Cash and cash-equivalents less obligations due in the coming year.

3. Incidence

- 3.1 This Directive shall apply to the operator of every payment system that the Governor has declared a controlled payment system or a designated controlled payment system.
- 3.2 The Bank of Israel may, as circumstances shall indicate, absolve or exempt a payment-system operator from the incidence of certain sections of this Directive and may rescind said exemption.

4. Sources of credit risk

- 4.1 A payment-system operator shall act to identify indications of the realization of a credit risk to which the system and/or its participants are exposed in the context of their activity in the system and that may affect system activity.



5. Measurement and monitoring of credit risk

- 5.1 The system operator shall measure and monitor credit risks regularly and systematically throughout the day by using up-to-date information.
- 5.2 The system operator shall ascertain that the system has access to relevant information¹ that will enable it to measure and monitor its current exposures and its level of collateral coverage.
- 5.3 The operator of a deferred net system (DNS) without settlement collateral shall provide participants with the ability to measure and monitor their current exposures to each other within the system or shall adopt rules obliging participants to provide relevant information about exposures.
- 5.4 The payment-system operator shall monitor market conditions (e.g., changes in collateral value) in order to detect risks associated with current exposure in the payment system.
- 5.5 The payment-system operator shall invoke a model that allows him or her to test possible changes in collateral value and market conditions over an adequate term to realization in order to estimate the payment system's potential future exposure and related risks.
- 5.6 The payment-system operator, in relevant cases, shall track the existence of large exposures to system participants and their customers and of changes in system participants' creditworthiness.

6. Mitigation and management of credit risk

- 6.1 The payment-system operator shall act to mitigate the system's credit risks to the extent possible.
- 6.2 The payment-system operator shall limit the system's current exposures by limiting the issuance of intraday credit and, in relevant cases, disallowing carry-forward of these

¹ For example, collateral-adequacy assessments.



exposures to the next day by ordering participants to repay the credit given to them before the end of the day.

- 6.3 To manage participant-default risk, the payment-system operator shall examine the impact of a participant default and consider using appropriate collateral-management techniques.
- 6.4 The payment-system operator shall fully cover, with a high degree of confidence, its current exposure and potential future exposure, if any, to each participant, by means of collateral and other equivalent financial resources.²
- 6.5 The payment-system operator shall apply prudent collateral coefficients to mitigate future potential exposure caused by possible volatility in the value of collateral or of other equivalent financial resources.
- 6.6 The operator of a DNS payment system that includes explicit settlement collateral, provided either by the payment system itself or by its participants, shall maintain financial resources that suffice to fully cover all current and potential future exposures by means of collateral and other equivalent financial resources.
- 6.7 The operator of a DNS payment system that does not require settlement collateral and subjects participants to the possibility of credit exposures originating in the system's payment and settlement processes shall maintain, at the very least,³ sufficient resources to cover the exposures of the two participants that would create the largest aggregate credit exposure in the system.

7. Use of financial resources

- 7.1 The payment-system operator shall establish explicitly, within the system rules, the order of realization of resources and the circumstances under which specific system resources may be used in the event of a participant default.

² Equity may be used, after subtraction of the sum designated to cover general business risk, up to the sum that is maintained to an adequate extent in net liquid assets.

³ A payment-system operator shall consider a higher level of cover in the event that the system creates large exposures or may trigger a major systemic effect if more than two of its participants default.



- 7.2 The payment-system operator shall not include among the resources that are “available” to cover credit losses originating in participant default, resources that are needed to cover current operating expenses, general potential business losses, or other losses from other activities in which the payment system is involved.
- 7.3 The operator of a payment system that serves several markets (within one jurisdiction or in several jurisdictions) shall ascertain that the system is able to use the resources provided to it by participants in one market to cover losses caused by a participant default in another market, in a manner that:
- 7.3.1 rests on an appropriate legal foundation;
 - 7.3.2 is clear to all participants;
 - 7.3.3 creates no major contagion risk between markets and participants.
- 7.4 When devising stress tests, the payment-system operator referenced in Section 7.3 shall consider merging resources between markets in the event of one or more participant defaults across several markets.

8. Emergency planning for uncovered credit losses

- 8.1 The payment-system operator shall analyze and plan out his or her method of dealing with any uncovered credit losses.⁴
- 8.2 The payment-system operator shall establish explicit rules and procedures to deal with credit losses that the system may sustain due to one or more participant defaults commensurate with any liability they may have to the system. Said rules and procedures shall relate, at the very least, to the following:
- 8.2.1 allocation of credit losses that may be uncovered;
 - 8.2.2 reimbursements that the payment system may borrow from liquidity providers;
 - 8.2.3 a process for replenishing financial resources that the system may utilize in the course of an extreme event as aforesaid, for the purpose of continuing to operate soundly.

⁴ Under certain extreme circumstances, the value of collateral after realization and other financial resources may not suffice to fully cover the credit losses.



9. Information reported and frequency of reportage

- 9.1 When this Directive goes into effect and by March 1 of each year, the system operator shall forward the following documents to Oversight:
- 9.1.1 existing or potential sources of credit risk;
 - 9.1.2 the way the system operator measures, monitors, and manages credit risk;
 - 9.1.3 the way financial resources are used to cover credit risk—order and circumstances of realization;
 - 9.1.4 the system operator's emergency plan in the event of uncovered credit losses;
 - 9.1.5 a report that compares credit exposures (current and future-potential) of each participant and in the aggregate with the value of collateral or other equivalent financial resources provided to the system.

10 Forwarding information to the Bank of Israel

- 10.1 A payment-system operator shall forward the information under this Directive by means of secured communication (the Kasefet application). Said application shall be used after prior coordination with Oversight. Oversight may allow the information to be forwarded in other ways.
- 10.2 The information to be presented under this Directive shall be forwarded by the system operator to the contact persons whom Oversight shall appoint for this purpose.
- 10.3 A system operator who forwards information under this Directive shall ascertain by telephone that the contact persons specified in Subsection 10.2 received the information.
- 10.4 A payment-system operator who sits within a Bank of Israel structure and makes use of Bank of Israel systems shall forward the information under this Directive by means of the internal electronic-mail system of the Bank of Israel.
- 10.5 Information under this Directive shall be presented to Oversight in digital form.
- 10.6 Reportage shall be carried out in accordance with the deadlines established in this Directive. Insofar as a payment-system operator believes that a given report will not be



presented by the specified deadline, he or she shall present Oversight, by electronic mail, with a written request to revise the deadline for the presentation of the report. Said request shall include, *inter alia*, the actions taken up to said request for revision, the reasons for requesting the revision of the reporting deadline, and the requested target date for the presentation of the report in question. A reporting deadline for which revision is not approved by Oversight shall be presented by the deadline established for said report.

11. Promulgation and update of Directive

Date of promulgation	Essence of update
December 22, 2019	Promulgation of directive

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