



Directive 4—The Legal Basis of a Controlled Payment System and a Designated Controlled Payment System

1. Introduction

In accordance with Section 8 of the Payment Systems Law, 5668-2008 (hereinafter: “the Law”), the operator of a controlled system shall formulate rules that will ensure the stability, efficiency, and sound functioning of the system, including reference to the following:

- 1.1 fairness requirements in connecting to the system by those wishing to participate in it;
- 1.2 continued participation in the system of a participant against which liquidation proceedings are under way;
- 1.3 means of enforcing said rules.

The system operator shall act in a way that will ensure the stability, efficiency, and sound functioning of the system and shall ensure the existence of means of managing, preventing, or mitigating risks that may exist or that exist in the system and of backup arrangements of the system in the event of an emergency.

In accordance with Principle 1 of the Principles for Financial Market Infrastructures (PFMI), published in 2012 by the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO), a financial-market infrastructure shall rest on a firm legal basis in all relevant jurisdictions.

This Directive hands down a set of rules with which a controlled payment system and a designated controlled payment system must comply to ensure the existence of a strong, clear, transparent, and enforceable legal basis for every material aspect of system activity, and to spare system participants from exposure to risks originating in the system or to prevent them from transferring said risks to the system, such as may exacerbate system risk insofar as an appropriate, certain, and clear legal basis is lacking.



2. Definitions

“Payment system,” “controlled payment system” -	As defined in the Payment Systems Law ;
“Payment-system operator,” or “system operator” -	The operator of a controlled payment system or a designated controlled payment system ;
“Payment Systems Oversight” or “Oversight” -	The Payment Systems Oversight Unit at the Payment and Settlement Systems Division of the Bank of Israel;
“Participant,” “participant in a payment system” -	One who is defined as a participant under the rules of the system;
“System rules” -	The rules by which the payment system operates;
“Material aspect” -	A certain aspect that may affect the sound activity of the system and constitute a source of risks, particularly credit risk, liquidity risk, general business risk, custody risk, investment risk, or operational risk;
“Irrevocability” -	The point at which payment instructions, other obligations, or payments not settled can no longer be cancelled and/or modified by the participant;
“Finality” -	The point in time, specified in the system rules, at which the transfer of an asset or a financial instrument cannot be cancelled and is unconditional, or the



“Netting” -

point at which the financial infrastructure or its participants have discharged their obligations in accordance with the terms of the basic contract.

The offsetting of liabilities among participants in a netting arrangement in a way that reduces the number and size of payments or transmissions that are needed to settle a group of transactions;

“State of emergency” -

One of the following, singly and severally: a time of emergency—a period in which the Emergency Economic System operates in accordance with Government Resolution 1716 of July 6, 1986, Government Resolution 1080 of February 13, 2000, Government Resolution 5228 of November 16, 2012, Government Resolution 1842 of July 10, 2014, Government Resolution 2007 of October 27, 2016, and any other government resolution in the matter at hand; the proclamation of a Special Home Front Situation under Section 9c of the Civil Defense Law, 5711-1951; or the declaration of an emergency by the Supervisor of Banks; a critical event is an event that has a material and prolonged effect on the payments system and is



considered and declared as such by the
Bank of Israel.

3. Incidence

3.1 This Directive shall apply to the operator of any 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. Legal basis

4.1 A system operator shall establish rules and procedures (hereinafter: "the legal basis") that relate to all material aspects of system operation in routine times and in a state of emergency.

4.2 The legal basis of the system shall be clear, appropriate, transparent, and understandable, and shall provide enforceability and a high level of legal certainty to all material aspects of system activity, in accordance with the totality of relevant laws, rules, and directives that apply to the system.¹

4.3 The legal basis shall clarify and relate to the totality of rights, obligations, and interests of the system operator, the system participants, and relevant stakeholders² and shall include, *inter alia*, clear reference to the following parameters:

4.3.1 Rights and interests—

4.3.1.1 Full protection of participants' assets that are held in trust by the payment system and also, in certain cases, protection of assets of participants'

¹ Said laws, rules, and directives may include those that exist in places where the system conducts business, including by means of financial-market infrastructures with which it has relations, participants' places of incorporation, location, or conduct of business in some other manner for the purposes of participating in the system, as well as places where collateral is situated or held.

² Including participants' customers, trustees, and other service providers.



customers that are held by or via the payment system against risk of insolvency or other relevant risk of the system operator.

- 4.3.1.2 Certainty in everything relating to interests and rights of the payment-system operator in use of collateral, operator's authority to transfer title to or interests in an asset, and operator's rights to make or receive payments in accordance with the system rules and any applicable law.
- 4.3.1.3 Priority of the payment system in the right of demand against collateral provided it by a participant over other creditors' right of demand.
- 4.3.1.4 The legal status of business records and data stored with the payment system and the rights of the payment system, its participants, and other relevant stakeholders in said records, such as access to information, use of information, ownership of information, and the like.
- 4.3.1.5 The extent and manner of disclosure of data to participants, relevant authorities, and the public. In this context, the legal basis shall respond to aspects associated with data protection and maintenance of data confidentiality.
- 4.3.2 Finality of settlement—setting dates of payment irrevocability and finality in the system.³
- 4.3.3 Netting arrangements—the manner of netting transactions of participants in the payment system, including cases of participant failure.
- 4.3.4 Treatment of failure and insolvency—
 - 4.3.4.1 Treatment of a failing or insolvent participant, with emphasis, for treatment purposes, on transfer or closure of assets and positions of direct or indirect participants.
 - 4.3.4.2 Application of a recovery plan for, or the orderly liquidation of, the payment system, with emphasis, for treatment purposes, on transfer or closure of the

³ See Directive 5 concerning finality of settlement in a controlled payment system and a designated controlled payment system.



assets and positions of the system and on transfer some or all rights and obligations of the system to another entity.

4.3.5 Clashing laws—identifying and analyzing clashing laws to which the payment system is subject and formulating rules and processes within the bounds of the legal basis in order to mitigate the legal risk emanating therefrom.

4.3.6 Mitigation of legal risk—the system rules and procedure shall provide means of mitigating legal risk in cases where full legal certainty is unattainable, by using risk-management tools. These means may include, *inter alia*, requirements and restrictions pertaining to participants' activity, limits on exposure to participants' activity, appropriate terms of access, collateral requirements, and pre-funded failure arrangements.

4.4 A payment-system operator shall examine whether its rights and obligations, those of its participants, and those of other relevant stakeholders, as reflected in the legal basis, are consistent with accepted standards in this field.

4.5 When uncertainty exists as to the meaning and enforceability of the legal basis in the various aspects that emerge in this Directive, the system operator shall solicit an independent opinion that responds to said uncertainty appropriately.

4.6 The system operator shall determine the manner, method, and form in which revisions of the legal basis of the system, and the way disputes among system participants will be settled, shall be determined and implemented.

4.7 The legal basis shall include objective and risk-based criteria allowing fair and open access to system participants and blocking, suspension, or cancellation of participation.

4.8 The system operator shall ensure that the legal basis allows it to gather information about system participants so that it can identify, monitor, and manage material risks to the payment system that emanate from participation arrangements in the payment system.⁴

4.9 The system operator shall sign participants who are subject to the system rules (after testing them for compliance with the system rules) to agreements of enlistment in the system and

⁴ This relates to identifying risks emanating from the activity of indirect participants that account for a meaningful share of payment-system activity and from direct participants' activity.



shall not allow access to the payment system absent the existence of a signed agreement of enlistment as aforesaid.

5. Information reported and reporting frequency

5.1 A system operator shall forward the legal basis of the system to Oversight at the time this Directive goes into effect.

5.2 A system operator shall forward the legal basis of the system to Oversight after any revision of the legal basis, in a clean copy and a "Track Changes" copy, a month before said revision goes into effect. Insofar as the system needs adjustments due to said revisions, said report shall include the requisite adjustments and relevant schedules for their implementation.

5.3 The system operator shall present Oversight with a legal opinion, if any, about the enforceability of the legal basis.

6. Forwarding information to the Bank of Israel

6.1 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.

6.2 The information in this Directive shall be forwarded by the system operator to the contact persons whom Oversight has appointed for this purpose.

6.3 A system operator who forwards information under this Directive shall ascertain receipt of the information by the contact persons set forth in Subsection 6.2 by telephone or by electronic mail from said contact persons, confirming receipt of the information.

6.4 Reports to Oversight shall be presented in the form of a digital document and not in handwriting.

6.5 Reports shall be presented by the deadlines established for each report. 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 postpone the deadline for the presentation of the report. Said request shall include, *inter alia*, the actions taken up to said request for postponement, the reasons for requesting the postponement, and the requested target date for the presentation of said report. A report presentation for which postponement is not approved by Oversight shall be presented by the deadline established for said report.

7. Promulgation and update of Directive

Date of promulgation	Essence of update
November 20, 2016	Promulgation of Directive
December 24, 2018	Update

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