



Directive 17e

Compliance-Risk Management at a Payment-System Operator

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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 and shall ensure the availability of measures with which to manage, prevent, and limit risks that exist or may exist in the system.

In accordance with Principle 3 of the Principles for Financial Market Infrastructures (PFMI), published in 2012 by the Committee on Payment and Settlement Systems of the BIS (CPMI) and the International Organization of Securities Commissions (IOSCO), a financial-service infrastructure (FMI) should design comprehensive internal processes that will help the Board of Directors and senior management to monitor and evaluate the adequacy and efficiency of the risk-management rules, policies, procedures, and controls. The control and compliance mechanisms should be evaluated regularly by means of independent compliance programs and independent auditing.

This Directive regulates the crucial role of the compliance function in ensuring the sound management of a controlled payment-system operator so that the rules laid down in the PFMI document may be applied.

2. Definitions

“Compliance instructions” —

the statutes, regulations, regulatory directives, ethical code, and internal procedures that apply to the activity of a payment-system operator;

“Compliance risk” —

the risk of legal or regulatory sanction, material financial loss, or degradation of image that the payment-system operator may sustain due to failure to abide by the



“Chief Compliance Officer” —	compliance instructions; the head of a payment-system operator’s compliance function;
“Compliance function” —	an independent function tasked with managing compliance risk at a payment-system operator;
“Compliance-function staff” —	employees of a payment-system operator who perform compliance tasks and are subordinate to the Chief Compliance Officer;
“First line of defense” —	the managements of lines of business and support functions that are responsible for detecting, evaluating, measuring, monitoring, mitigating, and reporting structural risks in products, activities, processes, and systems for which they are responsible, and for managing an appropriate control environment in the context of risk management
“Second line of defense” —	an independent risk-management function tasked with ongoing planning, maintenance, and development of risk-management frameworks;
“Third line of defense” —	the internal-audit function, which carries out independent review and challenges the risk-management controls, processes, and systems of the payment-system operator;
“Outsourcing arrangement for compliance” —	an agreement between a payment system and an outsource provider for the delivery



of compliance services.

3. Incidence

- 3.1 This Directive shall apply to every payment-system operator 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, establish certain instructions, different from those specified below, that shall apply to a certain payment-system operator, and may exempt a payment-system operator from the incidence of certain sections of this Directive.
- 3.3 In a payment-system operator that has no Board of Directors function due to its statutory, legal, or organizational structure, the obligations of a Board of Directors established in this Directive shall apply to the function that corresponds to a Board of Directors or the highest function that bears responsibility for the business and solidity of the payment-system operator.
- 3.4 In respect of systems that are run by the central bank, this Directive shall apply as tailored to the corporate-governance structure of the central bank.¹

4. Corporate governance—Board of Directors and senior-management responsibilities

- 4.1 Every payment-system operator shall establish a permanent compliance function.
- 4.2 The Board of Directors of a payment-system operator is responsible for:
 - 4.2.1 ascertaining the existence of an adequate and effective compliance function and overseeing the compliance-risk management framework.
 - 4.2.2 approving the letter of appointment of the compliance function, in which the status and powers of the function are defined;

¹ In this context, in August 2015 the BIS published a document titled “Application of the Principles for Financial Market Infrastructures to Central Bank FMIs,” with guidelines as to how the PFMI rules should be applied to payment systems run by a central bank.



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- 4.2.3 approving the compliance policy and determining the frequency and content of reports that shall be forwarded to it in compliance-related matters;
 - 4.2.4 discussing at least once per year, either in plenum or via a Board of Directors committee that it deputizes for this purpose (audit committee or risk-management committee) reports of the compliance function, findings presented, and evaluating the effectiveness of the payment-system operator's compliance-risk management.
 - 4.3 Senior management of the payment-system operator is responsible for:
 - 4.3.1 ensuring effective management of compliance risk, including assimilation of processes for detection and evaluation of key compliance risks and producing plans to mitigate them;
 - 4.3.2 taking requisite measures to ensure that the payment-system operator can rely on a permanent and effective compliance function, including allocation of appropriate resources for said function so that it can discharge its duties;
 - 4.3.3 ensuring that the compliance function is independent in the activities that it vets; said independence is based, *inter alia*, on allocating resources and ensuring direct access to every document, piece of information, and asset at the bank, as well as the right to approach any staff member for the discharge of its duties, all of which at its discretion;
 - 4.3.4 establishing a written compliance policy² that shall include the underlying principles by which management and staff shall operate, and updating said policy commensurate with changes at the payment system and outside it;
 - 4.3.5 specifying ways in which payment-system operator staff is apprised of the compliance policy and the importance attributed to it;
 - 4.3.6 taking meaningful corrective or other actions in regard to a violation detected as the compliance policy is applied;

² Including processes and methodologies for detection, evaluation, and mitigation of risks, purviews and responsibilities of the compliance function (at the level of topics), specification of lines of reportage to and from the function, and the function's organizational structure and working interfaces. Said policy should be updated periodically commensurate with changes within and outside the organization.



4.3.7 ensuring appropriate treatment of the compliance function's findings.

5. Chief Compliance Officer

- 5.1 Payment-system management shall appoint a Chief Compliance Officer who shall head the compliance function.
- 5.2 The Chief Compliance Officer shall be an employee of the payment system who has the status of a member of senior management or is directly subordinate to the Chief Executive Officer, is not responsible for an area in which business activity takes place, and has an organizational status that neither creates nor is liable to create a potential conflict of interest with responsibility for compliance.
- 5.3 The Chief Compliance Officer shall have no other duties that may impair or limit his or her ability to properly discharge her or his duties as Chief Compliance Officer.
- 5.4 The Chief Compliance Officer shall participate in Board of Directors discussions of compliance-related matters.
- 5.5 The service of the Chief Compliance Officer shall not be terminated, and the Chief Compliance Officer shall not be removed from his or her position, for any reason whatsoever, except with the prior approval of the Board of Directors.
- 5.6 If the Chief Compliance Officer decides to resign his or her position, he or she shall serve the Chief Executive Officer, the chair of the Board of Directors, and the chair of the audit committee and/or the risk-management committee with written notice to this effect, explaining in detail the motives behind said resignation.

6. Duties and frame of the compliance function's work

- 6.1 The risk-management function is responsible for helping senior management effectively manage the compliance risks that the payment system faces.



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- 6.2 The work of the risk-management function shall take place, at its discretion, vis-à-vis all departments of the payment-system operator.
- 6.3 The duties of the compliance function shall include the following, *inter alia*:
- 6.3.1 advising the Board of Directors, senior management, and officers of the payment-system operator in compliance matters, developments applying thereto, and measures to be taken to ensure that the payment-system operator is compliant with the compliance instructions;
 - 6.3.2 helping senior management to assimilate the compliance instructions and establish adequate controls, including making policy and laying down principles for risk-assessment methodology, writing procedures, regulating work processes, and assimilation of other controls;
 - 6.3.3 ascertaining the existence of a training program in compliance matters, responsibility for which comporting with types of duties and at a frequency commensurate with the level of risk, and answering questions and inquiries from staff in compliance matters for which it is responsible;
 - 6.3.4 detecting, documenting, and evaluating, on a regular basis, compliance risks intrinsic to the payment-system operator's business activities in accordance with a work plan to be determined and approved by the Board of Directors and in accordance with material developments or changes relating to new products, business practices, lines of business, and new participants;
 - 6.3.5 locating internal procedures and processes in need of correction and revision in order to improve compliance, issuing warnings about them, and helping to correct them in existing work processes and new processes and lines of activity;
 - 6.3.6 monitoring compliance risks at the payment-system operator by carrying out sufficiently large representative sampling and reporting the outcomes of the samples including recommended corrections, to the Chief Executive Officer;
 - 6.3.7 monitoring the implementation of its recommendations in order to determine whether they are being applied;



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- 6.3.8 The Chief Compliance Officer is responsible, *inter alia*, for the following: conflict of interest, system-operator fairness toward system participants, protection of privacy (with the exception of IT aspects), and code of ethics.
- 6.3.9 The system operator may manage compliance risk that originates in the aforementioned compliance topics by means of other functions on the second line of defense in the same manner as set forth in this Directive. If the system operator chooses to act in this manner, he or she shall explain in writing the division of responsibilities for compliance among the various functions, and this Directive shall apply to each function, *mutatis mutandis*.

7. Avoidance of conflict of interests

- 7.1 The compliance-function staff shall accept instructions in compliance affairs only from the Chief Compliance Officer or his or her deputy.
- 7.2 The Chief Compliance Officer and the compliance-function staff shall have no additional duties that create, or may create, a conflict of interest with their duties at the risk-management function.
- 7.3 Remuneration of compliance-function staff shall be consistent with the objectives of the function and shall not be made contingent on the performance of the payment-system operator except under a general remuneration policy that applies to all payment-system staff.

8. Professional qualifications

- 8.1 The Chief Compliance Officer and the compliance-function staff shall have adequate knowledge, expertise, and experience for their duties and responsibilities.



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- 8.2 The Chief Compliance Officer and the compliance-function staff shall have comprehensive understanding of the compliance instructions and the impact of their practical application on the activities of the payment system.
- 8.3 The professional qualifications of the compliance-function staff shall be preserved and enhanced by means of regular study and training.

9. Letter of appointment

- 9.1 A letter of appointment for the Chief Compliance Officer shall be drawn up.
- 9.2 Said letter of appointment shall relate to the following matters at the very least:
- 9.2.1 the Chief Compliance Officer's duties and the extent of his or her activity;
 - 9.2.2 the Chief Compliance Officer's status, powers, and responsibilities in the organization;
 - 9.2.3 establishing a mechanism for cooperation and reportage between the compliance function and functions on the first line of defense, functions on the second line of defense, and the internal-audit function on the third line of defense;
 - 9.2.4 the means with which to ensure the independence of the compliance function;
 - 9.2.5 formal obligation of reportage to senior management and the manner of reportage.
- 9.3 The letter of appointment shall ensure the Chief Compliance Officer's right and authority:
- 9.3.1 to enjoy direct access to any document, information, and asset, and to approach any member of the payment-system staff for the purpose of discharging his or her duties;
 - 9.3.2 to perform checks relating to possible breaches of compliance policy, appoint outside experts to carry out this task where necessary, and obtain professional support from in-house or outside experts for the performance of any task required;



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- 9.3.3 to report, independently, his or her findings on irregularities or possible violations to senior management and, when necessary, to approach the Chief Executive Officer, the Board of Directors, or one of the Board of Directors committees directly.
- 9.4 The letter of appointment shall be worded, reviewed, and updated periodically and approved by the Board of Directors.
- 9.5 The payment-system operator shall keep all staff members up-to-date about the appointment of the Compliance Officer.

10. Work plan of the compliance function

- 10.1 The compliance function shall perform its duties in accordance with a work plan that shall itemize planned activities including their timing and frequency.
- 10.2 The annual work plan shall be presented to management for discussion and shall be approved by the Board of Directors.
- 10.3 The work plan shall be risk-focused and shall be subject to the oversight of the Chief Compliance Officer in order to ensure coverage of all business activities and coordination among risk-management functions. The plan shall also relate to expected developments and innovations and to the high risk that usually comes with new activities.
- 10.4 The work plan shall be reviewed and updated regularly whenever necessary and in accordance with developments at the payment system.

11. Documentation of compliance work

- 11.1 Compliance work shall be documented in supportive working papers.
- 11.2 The compliance function shall retain documentation of tasks performed and compliance reports completed.



12. Outsourcing of compliance activities

- 12.1 The requirements set forth in this Directive shall apply, *mutatis mutandis*, to compliance activity carried out via outsourcing.
- 12.2 If activity is outsourced, the Compliance Officer shall make sure that the knowledge acquired from the expert is assimilated into the compliance function wherever possible.
- 12.3 A payment-system operator who wishes to outsource meaningful compliance activity shall serve Oversight with prior notice to this effect and shall explain the reason for its stance.
- 12.4 The payment-system operator shall ascertain that all documents and records pertaining to the outsource provider's tasks, including its work plan, reports, and working papers, are the property of the payment-system operator.
- 12.5 The system operator shall ensure that the arrangements for outsourcing of compliance activity will not impair the effectiveness of Oversight.
- 12.6 The Board of Directors and senior management of the payment-system operator are responsible for ensuring that the compliance function's tasks are carried out appropriately and effectively even if some are outsourced.
- 12.7 The Chief Compliance Officer shall oversee compliance tasks that are outsourced.

13. Information reported and frequency of reportage

- 13.1 Once per year at the very least, the Chief Compliance Officer shall submit a written report to the Board of Directors or to a committee deputized for this purpose, and to senior management, in regard to compliance matters, making reference to the assessment of compliance risk carried out in the course of the reporting period, including changes in the compliance-risk profile, a summation of deficiencies or violations detected, recommendations for their correction, the status of implementing the recommendations, and a detailed account of measures taken to correct deficiencies.



13.2 The Chief Compliance Officer shall immediately submit a written report to the Chief Executive Officer and senior management about material breaches of compliance.

System operator's reports to Oversight:

13.3 The system operator shall forward the Compliance Officer's letter of appointment to Oversight when it is approved and also by March 31 of the successive year if it has been revised.

13.4 The system operator shall forward to Oversight a copy of the minutes of the annual Board of Directors discussion of the about compliance-function activity and the findings presented, attaching the annual reportage and related materials to the discussion.

13.5 The system operator shall immediately report to Oversight the end of the Chief Compliance Officer's term of service, attaching a detailed description of the circumstances.

14. Forwarding information to the Bank of Israel

14.1 The 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.

14.2 The information under this Directive shall be forwarded by the system operator to the contact persons whom Oversight shall appoint for this purpose.

14.3 A payment-system operator who forwards information under this Directive shall ascertain by telephone or by electronic mail that the contact persons referenced above received the information.

14.4 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.

14.5 Reportage to Oversight shall be carried out in digital form and not in handwriting.



14.6 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.

15. Promulgation and update of Directive

Date of promulgation	Essence of update
April 3, 2024	Promulgation of Directive

The translation is intended solely for the convenience of the reader. This translation has no legal status and although every effort has been made to ensure its accuracy, the Bank of Israel does not assume any responsibility whatsoever as to its accuracy and is not bound by its contents. Only the original Hebrew text is binding and the reader is advised to consult the authoritative Hebrew text.