



Directive 19—General Business 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 15 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 identify, monitor, and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that it can continue operations and services as a going concern if those losses materialize. Further, liquid net assets should at all times be sufficient to ensure a recovery or orderly wind-down of critical operations and services.

The financial condition of an entity may deteriorate due to the materialization of a range of business risks that include, *inter alia*, poor execution of business strategy, negative cash flows, or unforeseen and excessive operating expenses. General business risk may also originate in the materialization of other risks such as legal risk (lawsuit), custody and investment risk, and operational risk (fraud, theft, or loss).

This Directive regulates the requirement of controlled payment systems and designated controlled payment systems to maintain appropriate management and control systems for the identification, monitoring, and management of general business risk.



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;
“General business risk”-	any potential impairment of the financial condition (as a business organization) of a payment system due to declines in its revenues or growth in its expenses, e.g., a situation in which expenses exceed revenues such as to create a loss that must be charged against capital;



“Liquid net assets funded by equity”-

cash and cash-equivalents less obligations due in the coming year that originate in equity;

“Risk profile”-

the aggregate level of risk embodied in payment-system activity at a specific point in time.

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. Identification and assessment of general business risk

- 4.1 The system operator shall identify and assess the origins of business risk and their potential effect on system operations and services in consideration of previous loss events and financial outlooks.
- 4.2 The system operator shall correctly assess and understand the system’s business risk and the potential impact of its materialization on cash flows, liquidity, and capital positions. For this purpose, the system operator shall make combined use of a range of tools such as:
 - 4.2.1 assessment of internal controls—the system operator shall identify key risks and controls and estimate both the impact and the probability of the risks and the effectiveness of the controls;



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- 4.2.2 scenario analysis—the system operator shall examine how specific scenarios may affect the system;
 - 4.2.3 sensitivity analysis—the system operator shall examine how changes in one risk will affect the system’s financial condition.¹
 - 4.3 The system operator shall consider carrying out an independent assessment of specific business risks.
 - 4.4 The system operator shall correctly understand the system’s business-risk profile in order to be able to assess the system’s ability:
 - 4.4.1 to prevent, mitigate, or pass on specific business risks, or:
 - 4.4.2 to accept and manage these risks;
 - 4.5 The system operator shall adopt available tools with which he or she may identify possible ways of mitigating risks as a response to changes in the system’s business environment.
 - 4.6 When planning to expand activity, the system operator shall perform a comprehensive assessment of company risk. When a new product, service, or project on a substantial scale is at issue, the system operator shall predict potential income and expenses, identify additional capital requirements, and plan how to satisfy said requirements to the extent necessary. Said risk assessment shall also include reference to the foreseen effect of the entry of a new product, service, or project on the stability and efficiency of the oversight system as well as compliance with all regulatory requirements. Before a procedure for the implementation of the new product, service, or project is set in motion, it shall be presented to Oversight for its approval.
 - 4.7 The system operator shall act to mitigate or eliminate said risks, *inter alia* by assimilating appropriate internal controls or by obtaining insurance or indemnification from a third party.

¹ For example, analysis of the effect of losing a key customer or service provider on the system’s business activities.



5. Measuring and monitoring general business risk

- 5.1 The system operator shall regularly measure and monitor identified and assessed business risk and develop appropriate information and control systems as part of the company's comprehensive risk-management plan.
- 5.2 Key components of the company's comprehensive risk-management plan shall relate to the establishment of internal and financial control systems for monitoring, managing, and controlling cash flows and operating expenses and for mitigating losses associated with business aspects.
- 5.3 The system operator shall lower the probability of the occurrence of losses associated with business aspects and their impact on the system's operations under a range of business conditions and adverse market conditions, including a scenario that raises doubt about the system's continued viability as a going concern.

6. Determining a sufficient level of net liquid assets

- 6.1 The system operator shall ascertain that the system holds enough net liquid assets funded by equity to enable it to continue operations and services as a going concern while absorbing general business losses.²
- 6.2 The system operator shall determine and maintain a level of net liquid assets funded by equity that is commensurate with the system's profile of general business risks and the amount of time needed to attain recovery or orderly wind-down of its critical operations and services in the event that such a step is taken.³
- 6.3 The system operator shall formulate a practical recovery or orderly-wind-down plan and shall hold enough net liquid assets funded by equity to implement it.⁴

² Insofar as the company's structure is such that it cannot raise enough equity, it must make sure that enough financial resources to absorb the loss are available to it.

³ Recovery may include raising new capital, replacing the management, effecting a merger, revising the business strategy (including the structure of costs or fees), and introducing structural change in services delivered.

⁴ Notwithstanding this principle, the requirement relating to net liquid assets funded by equity ensures that assets held the purposes of this principle will be liquid enough to be available to mitigate the full range of possible business risks



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- 6.4 The adequate level of net liquid assets funded by equity shall depend on the contents of the plan, the size of the system, the extent of its activity, the types of operations included in the plan, and how long it will take to implement the plan.
 - 6.5 The system operator shall also assess and examine the operational, technological, and legal requirements that participants must meet in order to connect with and shift to an alternative arrangement in the event of orderly wind-down.
 - 6.6 The system operator shall hold net liquid assets funded by equity that are equal to six months of ongoing operating expenses at the very least.⁵
 - 6.7 To estimate the level of net liquid assets funded by equity that the payment system may need, the system operator shall regularly examine and understand how the system's operating income and expenses may vary in a range of adverse business scenarios and how they may be affected by aberrant nonrecurrent losses.
 - 6.8 The system operator shall perform this examination whenever the underlying assumptions, the financial scenarios, and the components of the model undergo a material change, whether this occurs due to revisions of the system's business model or due to externalities.
 - 6.9 The system operator shall examine not only possible declines in income but also possible increases in operating expenses, as well as the possibility of unusual nonrecurrent losses, when he or she weighs a decision on the level of net liquid assets that the system must hold to cover general business risk.
 - 6.10 When calculating the level of net liquid assets that is available to cover business risk, the system operator shall not include assets held by the system to cover non-business risks and losses or to cover other losses unrelated to its activity as a payment system.
 - 6.11 To cover general business risk, the system operator shall hold assets of high quality and adequate liquidity such as cash, cash-equivalents, or liquid securities, so that the payment

at the requisite time, may be used only for business-risk purposes, and are funded by equity and not by long-term obligations.

⁵ Not including depreciation and amortization expenses.



system may cover its current and foreseen operational expenses under a range of scenarios including adverse market conditions.

- 6.12 To ensure the adequacy of the system's resources, the system operator shall regularly estimate net liquid assets funded by equity against possible business risks.

7. Maintaining adequate equity

- 7.1 The system operator shall formulate a practicable capital plan for the maintenance of an adequate level of equity. Said program shall:
- 7.1.1 specify how the payment system will raise new capital if its capital verges on or falls below the requisite level;
 - 7.1.2 be approved by the board of directors (or by an appropriate board committee);
 - 7.1.3 be regularly updated.
- 7.2 When developing a capital plan, the system operator shall weigh several factors including ownership structure and insured business risks. For example, she or he shall determine whether, and to what extent, specific business risks are explicitly covered by insurance or indemnification that may be realized within the period of time of recovery or orderly wind-down. Given the conditional nature of these resources, the system operator shall apply conservative assumptions when relating to these resources in said capital plan.
- 7.3 The system operator shall refrain from taking insurance and indemnification arrangements into account when assessing the system's capital adequacy.

8. Information reported and frequency of reportage

- 8.1 When this Directive goes into effect and by March 1 of each year, the system operator shall report to Oversight his or her reference to:
- 8.1.1 the origins of business risk that have been identified and their potential effect on the system's operations and services;



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- 8.1.2 information and control systems that have been developed to monitor identified business risks;
 - 8.1.3 the level of net liquid assets funded by equity that the system operator holds and maintains in order to cover:
 - 8.1.3.1 general business losses;
 - 8.1.3.2 six months of ongoing operating expenses;
 - 8.1.3.3 implementation of a recovery or orderly-wind-up plan.
 - 8.1.4 the company's capital plan.
 - 8.2 The system operator shall apprise Oversight of his or her references as required in Section 4.6 before implementing a new product, service, or project on a meaningful scale, as soon as it is approved by the relevant competent player.

9. Forwarding information to the Bank of Israel

- 9.1 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.
- 9.2 The information under this Directive shall be forwarded by the system operator to the contact persons whom Oversight shall appoint for this purpose.
- 9.3 A payment-system operator who forwards information under this Directive shall ascertain by telephone or by electronic mail that the contact persons specified in Subsection 9.2 received the information.
- 9.4 Information under this Directive shall be presented to Oversight in digital form and not in handwriting.
- 9.5 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.



9.6 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.

10. Promulgation and update of Directive

Date of promulgation	Essence of update
November 3, 2019	Promulgation of directive

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