

**PALESTINE MONETARY AUTHORITY**

**OVERSIGHT POLICY FRAMEWORK**

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## Acronyms and Abbreviations

ACH	Automated Clearing House
ATM	Automated Teller Machine
BIS	Bank for International Settlements
BURAQ	Automated Transfer System
CMA	Capital Market Authority
CPSS	Committee on Payment and Settlement Systems
CSD	Central Securities Depository
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commission
MOU	Memorandum of Understanding
NPC	National Payment Council
PMA	Palestine Monetary Authority
POS	Point of Sales
PSD	Payment System Department
RTGS	Real Time Gross Settlement
WB	World Bank

# PALESTINE MONETARY AUTHORITY

## OVERSIGHT POLICY FRAMEWORK

### I. Introduction

The Palestine Monetary Authority (PMA) is conducting a structured process of reform of the National Payments System (NPS) in Palestine. This process has been implemented through pillars, one for each component of the payment system. Box 1 summarizes the pillars.

#### Box 1. Palestine Payment Systems pillars of the reform

**Pillar I:** Payment Systems in Palestine work in a sound and robust legal environment able to support settlement finality and the efficiency of payment arrangements

**Pillar II:** Settlement mechanisms for large value and time critical payments in Palestine are safe and efficient and comply fully with the CPSS Core Principles for SIPS

**Pillar III:** Retail payment systems in Palestine are efficient, sound and interoperable and support the offer of a wide range of payments instruments and services.

**Pillar IV:** Government collections and disbursements are fully and efficiently integrated with the National Payments System in Palestine and support its smooth functioning

**Pillar V:** Effective, structured and fruitful cooperation is in place within the NPS

**Pillar VI:** Interbank Money Markets are fully developed and closely integrated with settlement systems

**Pillar VII:** Securities Clearance, Settlement and Depository Systems are safe and efficient, fully comply with international standards, and contribute to support the development of capital markets

**Pillar VIII:** International family remittances and other cross-border payments are distributed rapidly and conveniently in Palestine, and are also efficient from the perspective of the cost for end users at both ends.

**Pillar IX:** The oversight and supervisory framework for payments and securities settlement systems is clearly defined, and the PMA exercises its oversight authority effectively in cooperation with other regulators and supervisors

The NPS reforms has made remarkable progress, the important milestones have been: strengthening of the legal and regulatory framework with the adoption of the Payment Systems Law, and the start of operations BURAQ system that allows systemically important payment settlement in real-time, and ACH for clearing and settlement of direct debits and credits. The international experience shows that in all reform process the implementation of the oversight function is a responsibility of central banks or monetary authorities and this was envisaged also for the NPS reforms in Palestine. The present document constitutes the oversight policy framework in the PMA. With this document, the PMA intends to disclose its policy framework for the oversight function considering the best international practices. Each section of the document refers to a specific aspect of the framework including the objectives, the scope and tools to be used in the performing of the function.

## II. Oversight of the NPS

The growing volume and value of transactions in payment and settlement systems and the innovations in services and instruments require robust oversight of the clearing and settlement infrastructure and payment arrangements by the PMA. The PMA recognizes the importance of oversight over the National Payments System as part of the wider monetary authority responsibility of ensuring financial stability in the economy and ensure the safeness and efficiency of the payment system. Payment and settlement systems are a core element of the economy. They allow the financial markets to function smoothly and individuals, firms and the government to receive payments and to pay for goods and services. Disruptions in these systems may cause disruptions in the financial markets. Inefficiency in retail payments could increase costs for the users and add barriers for broader financial inclusion. The smooth and reliable functioning of funds transfer mechanisms has also an impact on the conduct monetary policy operations.

The role of the oversight function is to ensure that systems are sufficiently protected against risks that may arise, allowing funds to flow between individuals, business and financial markets efficiently and safely. The primary responsibility for ensuring a system's safety and efficiency lies with the system's owners and operator. Regulation and oversight are needed to ensure that the system's operators fulfill this responsibility, to address negative externalities that can be associated with systems, and generally to foster financial stability. Market forces alone may not achieve the objectives of efficiency and reliability of the payment system since participants and operators may not have adequate incentives to minimize the risk of their own failure, or the costs they impose on other participants. In addition, the institutional structure of the payment system may not provide incentives or mechanisms for efficient design and operation. These are the reasons why in all countries central banks' involvement in the payment system is an integral component of their overall mandate to ensure financial stability and to maintain confidence in the domestic currency. In this context, the oversight role of the central bank / monetary authority has been established in many countries as a key component of their activities.

The oversight function comprises a set of policies, objectives, scope, operating principles, standards, guidelines and benchmarks, and policy instruments. As a fairly recent function within central banks, the basic policy framework for oversight, and the best practice organizational and operational arrangements for implementing this new policy function, is still developing in many ways. However, over the past decade, the collective work of international financial organizations such as the Committee on Payment and Settlement Systems (CPSS) of the Bank for International Settlements (BIS), International Organization of Securities Commissions (IOSCO), the World Bank (WB), and the International Monetary Fund (IMF), payment and securities industry groups and leading central banks has contributed substantially to the development of the general framework and best practices for payments policy and oversight.<sup>1</sup> Box 1 provides the definition of central bank oversight as depicted in the CPSS report on oversight. Principles for effective oversight are included in Annex 1. The responsibilities of central banks, market regulators and relevant authorities according to the new Principles for Financial Market Infrastructures<sup>2</sup> are listed in Annex 2.

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<sup>1</sup> *Principles for effective oversight have been developed in the CPSS Report Central bank oversight of payment and settlement systems, 2005. Other example is the focus on central bank's responsibilities in the CPSS – IOSCO Principles for Financial Market Infrastructures, 2012. See also the paper The oversight of the payments system – A framework for the development and governance of payment systems in emerging economies, 2001 by Bossone-Cirasino.*

<sup>2</sup> *The Principles for Financial Market Infrastructures were published by the Committee on Payment and Settlement Systems and the International Organization of Securities Commission in April 2012.*

**Box 2. Definition of the central bank oversight function**

**“Oversight of payment and settlement systems is a central bank function whereby the objectives of safety and efficiency are promoted by monitoring existing and planned systems, assessing them against these objectives and, where necessary, inducing change”**

*Central Bank oversight of payment and settlement systems, CPSS, May 2005.*

**Box 3. Definition of payment systems**

**“A payment system is a set of instruments, procedures, and rules for the transfer of funds between or among participants; the system includes the participants and the entity operating the arrangement. Payment systems are typically based on an agreement between or among participants and the operator of the arrangement, and the transfer of funds is effected using an agreed-upon operational infrastructure”**

*Principles for Financial Market Infrastructures, CPSS-IOSCO, April 2012*

A clear distinction exists between the payment system oversight and the supervision of financial institutions. Banking supervision authority regulates and supervises individual institutions, while the payments oversight looks at systems and their participants, and payment instruments. Differences exist also in the approach; the banking supervision has regulation-based and institution-based approach from a prudential solvency and liquidity viewpoint, while payments oversight is guidelines-based and resolution-based approach to dealing with payment system issues from a broad system-wide perspective. For example, the CPSS reports *Central bank oversight of payment and settlement systems*, May, 2005, indicates that payment system oversight is embedded within the broader context of a payment system policy function to support financial stability.

The key aspects of the oversight function are: (i) the legal and regulatory framework for oversight; (ii) strategic framework for oversight including objectives, scope, tools and activities; (iii) the governance arrangements, accountability and transparency of oversight; and (iv) cooperative arrangements. All these aspects will be considered in this policy document.

**A. Legal and Regulatory Framework for Oversight**

***The central bank or monetary authority should have the explicit legal authority and the powers to perform its oversight mandate and responsibilities in accordance with its stated oversight objectives.***

**Box 4. Legal and regulatory framework for oversight**

General Principle C for oversight states that central banks should have the powers and capacity to carry out their oversight responsibilities effectively. This includes statutory powers to obtain information from the overseen entities and adequate tools and powers to induce changes. A central bank powers should be consistent with its relevant responsibilities.

**The legal framework for the payment system policy and oversight is composed of:**

- Primary laws that define the central bank’s policy objectives, scope of authority in terms of institutional and infrastructure arrangements relating to the payment, transaction, clearing and settlement systems and services for monetary and other financial assets, powers to oversee and regulate, and the range of statutory instruments available to do so;
- Complementary laws that intersect or overlap with the primary laws for central bank oversight in the sense that they provide other public agencies or self-regulatory bodies with regulatory powers and authority over some aspects of financial institutions, services and market conduct that may affect the ability of the central bank to meet its oversight mandate;
- Explicit sections in the primary and secondary laws that can affect the central bank’s oversight of foreign resident or non-resident (i.e., cross-border) entities that use or provide payment, transaction, clearing and settlement services;
- Explicit requirements in primary (or secondary) laws that outline accountability and transparency practices and procedures for the central bank in the performance of its oversight function and that may provide for periodic review of the legal framework.

Central bank regulations/by-laws, guidelines or directives issued under the law are additional documents for the implementation of the payment system policy and oversight function.

The article 3 of the Banking Law approved in 2010 states that of the responsibilities of the PMA is “establish a national payment system, organize and supervise it” , Article 54 of the PMA Acts states that the “Monetary Authority shall provide banks with services for settlements and repayments”. The payment systems law approved in November 2012 gives to the PMA the power to oversee the payment systems in the country.

#### **Box 5. Payment System Law: Main aspects**

The law applies to all payment orders, to any institutions which provide payment services and includes the use of electronic signature and electronic records in payment transactions.

The PMA is the only entity authorized to oversee and supervise the payment services providers in order to achieve the safety and effectiveness of the payment systems and ensure financial stability.

Any company or institution is required to have and approval from the PMA before provide payment services

The payment systems law covers the following main payment systems issues:

- 1- Irrevocability and Finality of payments
- 2- Payment Oversight function
- 3- Payment services
- 4- Zero-Hour Rule
- 5- Gives the PMA BoD the power to issue regulations for the execution of the payment systems law

With the Payment System Law in place, the PMA is the unique overseer of the payment systems. The PMA is preparing secondary legislation necessary for the exercise of the function. The

regulation will contain, at a minimum, the objectives of oversight and the systems that will be under the scope of this function, as well as:

- Detailed requirements, documentation and procedures governing the systems under the scope of the oversight;
- The type and graduation of sanctions for systems and participants in case of non-compliance;
- Policies regarding access to systems;
- Minimum requirements to risk management (credit, liquidity, operational and any other risk that can arise and affect the stability of the payment system);
- Set of applicable (international) standards to each system according to the situation in the country;
- Contractual arrangements between systems operators and third-party providers of services critical to the systems' operations;
- Responsibilities of the PMA as an overseer of the National Payment System.

## B. Strategic Framework for Oversight

*A central bank requires a comprehensive and up-to-date strategic policy framework, consistent with its legal mandate and authority, to anchor and guide the implementation of oversight.*

### Box 6. Strategic framework for oversight

The strategic framework for payments oversight contains: (i) the philosophy and guiding principles for oversight; and (ii) objectives, scope, standards and instruments used to frame the implementation of oversight.

#### **Guiding principles for oversight policy generally include among others:**

- **Credibility** – oversight policy is reflective of the realities and practicalities of the systems and their purposes;
- **Consistency** – oversight policy is applied consistently over time and over similar systems, including systems operated by the central bank;
- **Cooperation** – policy is formulated and generally implemented in a cooperative manner with major stakeholders,
- **Minimalism** – policy intervention occurs only where a specific need arises and cooperative policy solutions and implementation rely as much as possible on market initiatives;
- **Proportionality** – policy requirements, intervention and actions are proportional and targeted to the immediate policy needs;
- **Transparency** – the oversight policy principles, policy framework and general policy decisions are publicly accessible to interested parties.

#### **The oversight policy framework contains at a minimum:**

- **Strategic goals** – strategic goals refer to high-level policy goals such as financial system stability, systemic risk mitigation, and safe and efficient payment systems.
- **Control objectives** - control objectives refer to specific elements of efficiency, safety, risk mitigation on which the oversight of specific types of payment, transaction, clearing and settlement systems will focus in practice and the related control benchmarks refer to the minimum quantitative or qualitative measures against which to evaluate, in part, compliance

with the objectives and targets for oversight.

- **Scope for oversight** – the scope for policy and oversight refers to: (i) the types of systems by characteristics (e.g., systemically important, system-wide important; large-value or retail payments; securities, foreign exchange settlement systems) that will be covered by the oversight function; (ii) service functions (provision of payment instruments and of transaction, clearing and settlement services); (iii) properties of the service arrangements (e.g., financial and operational risk management, participation requirements, and governance of infrastructure systems); and (iv) service market conduct (contractual arrangements with respect to service levels, pricing schemes and transparency of user risks and liabilities, consumer protection).
- **Oversight standards** – refer to the minimum standards and guidelines that particular types of systems are required to satisfy to meet the strategic policy objectives.
- **Oversight tools** – these include: (i) monitoring instruments used to acquire information and data from systems subject to oversight; (ii) mechanisms used for consultation and for moral suasion when policy intervention is deemed necessary due to non-compliance; and (iii) legally authorized mechanisms for policy actions to deal with non-compliance issues, such as central bank directives and/or regulations, and oversight agreements with other relevant regulatory bodies.

The following box summarizes the PMA policy in exercising the oversight function:

#### Box 7. Payment Systems Oversight in Palestine: Policy Framework

<b>Strategic Goal</b>	◆ Ensure the safety and efficiency of payment systems
<b>Control Objectives</b>	<ul style="list-style-type: none"> <li>◆ Maintain sound risk management policies;</li> <li>◆ Promote an effective legal and regulatory framework;</li> <li>◆ Establish adequate protection of users and participants;</li> <li>◆ Expand the range of payment services;</li> <li>◆ Ensure a competitive environment for payment services.</li> </ul>
<b>Scope</b>	<ul style="list-style-type: none"> <li>◆ Large value payment system;</li> <li>◆ Retail payment systems;</li> <li>◆ Remittances</li> <li>◆ Securities and Derivatives Clearing and Settlement Systems</li> <li>◆ Any new payments, remittances or securities settlement system introduced in Palestine.</li> </ul>
<b>Types of Activities</b>	<b>Tools</b>
<ul style="list-style-type: none"> <li>◆ Monitoring</li> <li>◆ Research and development</li> </ul>	<ul style="list-style-type: none"> <li>◆ Regulations, incentives and sanctions;</li> <li>◆ Policy dialogue and cooperation;</li> <li>◆ Collect, process and analyse information;</li> <li>◆ Governance structure requirements.</li> </ul>

### 1. Strategic goals and control objectives

Strategic goal of the PMA focus on the *safety and efficiency of the payment systems*. To achieve this goal, the PMA has considered as its control objectives for the oversight function:

- a. *Maintain sound risk management policies;*** this is perhaps one of the most important objectives of the payment system oversight. Risks within all payment systems must be kept at a minimum through prudent management by system owners, operators and participants. The PMA in its oversight role, monitors risks across all systems.

According to the new Principles for Financial Market Infrastructure (PFMI) the payment system risks are systemic, legal, credit, liquidity, general business, operational, custody and investment. They grow with the volume, value, and composition (domestic compared to cross-border) of financial transactions made possible by technology. The speed with which funds can be used and reused in the system before final settlement takes place also increases these risks manifold.

Controlling risks involves individual and collective action. Individual participants should be required to identify ways to measure risks appropriately and to allocate an adequate level of economic capital to them. The overseer will not interfere directly with the determination of individual risk positions: it should make sure that participants adopt consistent methods to manage their risks and that systems have enough incentives and safeguards against excessive risk-taking by individual participants.

The PMA, as overseer, will induce collective action from participants in the area of risk control (such as collateral arrangements and liquidity- and loss-sharing agreements between participants in netting systems) this may achieve various important objectives simultaneously.

Under the oversight function, the PMA will develop a detailed framework to assess risks and benefits of innovative payment schemes (such as payment switch card, issuance of e-money or provision of mobile payment services). The PMA is drafting a Risk Management Policy Document which will address the identification and possible measure of mitigation of the different risks.

- b. *Promote an effective legal and regulatory framework;*** the legal framework underlying payment activities bears relevant implications for the oversight function. It affects the efficiency, reliability, safety, and stability of the payment system, and the protection of participants and users from unfair rights allocation and criminal abuse. It also underpins any public policy attempt to expand services to underserved users. Especially in developing economies, payment system oversight objectives may be hindered by an inadequately articulated general commercial law; the lack of bankruptcy rules may hold up the handling of provider and user insolvencies, and poor sanctioning systems may make fraud a recurrent feature of payment transactions.

Payment systems legal rules will be established to govern the transfers of payment in ways that serve the interest of commercial and consumer parties who use the payment system to settle their financial obligations in a predictable, timely, safe, and efficient manner. The PMA as overseer will take the necessary action with the relevant authorities to promote the establishment of clear and certain legal codes for payment systems, and should cooperate with them to ensure law enforcement. In their capacity as payment system overseers, central banks and monetary authorities play a key role in supporting and advising domestic lawmaking authorities in developing and strengthening payment system legal provisions.

- c. *Establish adequate protection of participants and users*** from risks of monopolistic practices by dominant service providers. When benefiting from the presence of multiple service providers, users must be protected from contractual constrictions that limit their freedom to choose or change provider. Users should also be informed of customer rights and obligations, and of service features and options, and should be given the opportunity to lodge complaints about unsatisfactory service or unfair treatment.

The PMA will ensure users of the reliability of the payment instruments and systems used. More

generally, the oversight will be directed at verifying that the payment services offered are in compliance with the law and support public confidence in the payment instruments' ability to fully discharge obligations and to circulate smoothly in the system.

The PMA have to be confident that payment systems are fair, that is, that rights and obligations to parties to the funds transfers are allocated in an equitable manner. An over allocation of duties to system providers or users can be unfair and can also lead to a unfair playing field. Where liabilities are skewed toward, say, users, providers may enjoy extra-rents and weaken the incentives for the provision of reliable services. In the end, when potential users or providers perceive a system as unfair, they might be reluctant to use or provide payment services.

- d. Expand the range of payment services* is another objective for the oversight function. This concept refers to assuring availability of minimum or essential services to underserved users. This could be achieved either through provision of public service or by contracting out the provision of basic services to private sector institutions, or by encouraging participants to extend service delivery to areas that are not attended. The overseer must look to achieve a fair balance between the need to guarantee universal access to basic services, on one side, and the tendency, on the other, to achieve this objective through public sector systems and through mandating provision of certain services, which in the long term may retard innovation and development, inhibit competition, and distort resource allocation.

Among the activities to be performed to fulfill this goal, the PMA, in its role as overseer, will encourage the development or expansion of innovative payment instruments that can be used by a larger number of people.

- e. Ensure a competitive environment for payment services, and achieving appropriate balance between co-operation and competition.* Competitive market conditions for most payment services, including interbank payment services, offer the most promising results in terms of efficiency and innovation. The PMA, as overseer, will make all efforts to ensure that market forces are free to operate in the payments system. Participants will be protected from restrictions on freedom to offer new services or competitive prices on existing services. In addition, participants should not be inhibited from launching new technical platforms or networks, or from joining in ventures that could improve overall system performance and quality of services, provided that the new infrastructure and services are in line with the accepted standards (or that they can improve on them), do not violate contractual freedom between participants and users, and do not discriminate access to services from users and other participants. Finally, the market for payment services must be open to the entry of new operators.

## 2. Scope of oversight

The PMA will oversee all systems that pose systemic risks and will ensure they are fully compliant with international standards. Since retail payment systems have a significant importance for the overall efficiency of the payments system, their impact on the public's confidence in money, and their relevance for economic growth, PMA will extend its oversight authority over them as well.

In light of the increasing attention being given to securities clearance and settlement systems as relevant components of the overall NPS, which resulted recently in joint CPSS/IOSCO recommendations for the safety and efficiency of securities settlement systems, the oversight of these systems will be a cooperative effort with the Capital Market Authority (CMA).

PMA has considered the implementation of the oversight function for all systems focus on the technical infrastructure, system rules and procedures, contract among participants and all aspect that can affect the risk of the systems.

The implementation will be made in stages (short, medium and long term) to ensure the proper performance of the function. Instruments of oversight might vary depending on the nature of each system.

The systems and instruments that will be included in the oversight scope are:

- The RTGS element of the BURAQ system. The high value payment systems are always under the oversight function giving its importance for the continuous transmission of funds and possible effects of systemic risk.
- The Cheque Clearing House. Cheques have been the most used payment instruments different of cash, while it is true that the use of electronic payments in Palestine is growing rapidly and is estimated the development of new services on the market, the use of cheques continues to be important. The PMA has considered include the Cheque Clearing House under oversight
- Retail Payments Systems (the ACH element of BURAQ and the retail payment systems operated by the private sector). However to meet the objectives of the oversight function, specially ensuring adequate competition in the market, protecting participants and users and increasing access to payment services, is essential to carry out the oversight of the retail payment systems. Those systems and instruments are relatively new in the Palestine market or are under development. The oversight function will include all relevant statistics if the planned payment switch.
- Central Securities Depository (CSD) of the Palestine Exchange. The operations in the stock market, the clearing and settlement of securities are under the direct supervision of the CMA. However, if the CSD becomes an indirect participant of BURAQ, the PMA will exercise the oversight of the CSD through a cooperative agreement with the CMA.
- International Remittances. The PMA will give special attention to the oversight of remittance service providers so that the remittance service complies with the World Bank General Principles for International Remittance Services.
- Any other system or new developments. The PMA will be aware of any innovation which by its nature can somehow affect the safety and efficiency of the payment system (CSD operated by the PMA, mobile payments, card payment switch, etc.).

The PMA will publish, at a frequency to be determined and included in the regulation, the systems under the scope of the oversight function.

### 3. Oversight tools (Policy Instruments)

The PMA will use a large set of instruments at its disposal to promote the safety and efficiency of the payment systems. Some of the tools are:

- a. **Regulations and incentives** are the typical tools used by overseers. The exercise of regulatory powers may involve administrative acts of general application and specifically addressed provisions. Regulations may be aimed at defining organizational, functional, and technical features of payment systems. For large-value payment systems, regulations could establish infrastructure security standards (such as for information transfer, use of intraday liquidity and queues, cancellation of payments, and account reconciliation). Regulations for retail payment systems (which are usually characterized by lower levels of systemic risk) may determine minimum reliability and efficiency requirements for service providers. Regulations may also be used to set criteria for technical security and interoperability of payment instruments and

services. Competition could be supported by regulation to ensure transparent and full cost-recovery pricing policies by service providers.

Regulations will cover access criteria, business conduct, sanctions for rule noncompliance, and commitments from participants. Rules on access should define objective and transparent criteria for participant selection. *Sanctions* should be gradual and proportional to misconduct, and should provide misbehaving parties with enough incentives for self-correction, including threats to suspend and revoke business licenses.

Incentives may also involve commitments from participants to take pre-specified (costly) action in the event of specific contingencies. Net settlement systems, for instance, may require participants to pre-agree on liquidity-sharing and loss-sharing arrangements whereby they commit to mobilize own resources (say, in the form of deposited collateral) in the event of illiquidity or insolvency by any of them. Resource pre-commitments obviously give participants an incentive to monitor each other's performance, to anticipate each other's risk attitude, and to adopt risk-control measures. They thus help boost market discipline.

The PMA will always retain the freedom to intervene through available regulatory tools whenever competition, market discipline, and cooperation fail to produce the improvements felt necessary to serve the general interest. In some cases, the overseer may even engage in direct service provision. However, both forms of intervention should be steps of last resort.

- b. ***Policy dialogue.*** Regulations and incentives will be complemented by the overseer's capacity to maintain a continuous policy dialogue with all the actors of the payment system, including users. This is necessary to secure a fair representation of the public and private interests involved in payment activities, and to create consensus for policy choices. The dialogue, which can take place at both formal and informal levels, offers a multi-way channel for the overseer to provide participants and public with indications on its policy orientation and to exert moral suasion; to shape its policy agenda by using feedback from the market; and to check through the users on the efficiency, reliability, and fairness of the payment services delivered by the system. The National Payment Council (NPC) offers an appropriate forum for such dialogue (please refer to Box 10, section D for details of the NPC).

The PMA will use the policy dialogue channel to exert moral suasion on participants and providers. This complements, and may very often supplement, the resort to rigid regulatory action. In fact, in its role as payment system overseer, the PMA makes extensive use of this channel to pass through recommendations of best practices and promotion of self-regulation in critical areas.

- c. ***Cooperation*** is essential, and the overseer is especially well placed to solicit sufficient cooperative efforts from the payment system participants. Cooperation between participants is the most effective means of identifying efficient system technical features. Also, cooperation between the overseer and the participants may ensure that rules, standards, and collective action are designed in ways that optimize system efficiency. Such cooperation may also induce participants to internalize the overseer's public objectives within their own decisional functions. Among the instruments to ensure cooperation within the payments systems, the PMA attaches a particular importance to the NPC which will have to become the forum for discussion for all stakeholders in the payments system.

Finally, cooperation between the overseer and other regulatory authorities or departments inside the PMA must guarantee the mutual exchange of information and the action coordination necessary for each agency to intervene promptly and appropriately, when necessary. The PMA will foster this cooperation through the creation of appropriate mechanisms (e.g. Memorandum of Understanding, working groups, etc.) Equally important,

cooperation must also aim at minimizing the regulatory costs to participants of complying with various forms of control and of duplication of control, and ensuring consistency of all public interventions and rules insisting on the payments system. (Please refer to section D).

- d. **Collecting, processing and analyzing information.** The PMA will periodically review system integrity by collecting and processing information regarding the functioning of the technical and risk-management infrastructure (including backup facilities). The overseer may request service providers and participants to submit selected information on the various stages and phases of the payment process. Information may cover payment volumes and values by types of instrument, data on costs, pricing, capacity use, breaches of credit/debit caps, settlement and payment delays, length of queues, gridlock, liquidity shortfalls, back-office problems, and technical or operational failures. The overseer could receive information through regular (off-site) data reporting by participants, complemented if necessary by on-site inspections. For systemically important systems, the overseer may also adopt online monitoring of real-time payment and settlement flows and of risk levels across the payment circuit, and use automatic warning signals to detect abnormalities. Where such systems are privately run, the overseer should be provided by the owners with access to timely and relevant information on daily key operations. During operational periods, contact points should be established in all relevant entities that could be readily activated in the event of emergencies.

To facilitate the information gathering for oversight purpose, the PMA will develop Guidelines/Directives for each of the payment systems it oversees. The Guidelines will ensure effective transparency of the key elements of the oversight policy for the payment systems. The Guidelines will be designed to outline the following oversight procedures, taking always as a reference the principles for financial market infrastructures and any other international standard applicable to the Palestine market:

- Guidelines against which the PMA will assess the safe and efficient performance of the payment system and against which the PMA will require the payment system operator to self-assess their own system's performance on a regular basis.
- The type of routine information about the payment system's governance, financial status and policies operational rules, procedures and performance, risk controls and risk management tools, and participation arrangements that will need to be reported. Usual types of information include:
  - Board of director information, structure of the Board, Board meetings reports (with material changes in the organization, operations and financing of the system), and financial and operational reports of internal and external auditors, including at least an audited annual report.
  - Volume and value of payment flows, outage reports, usage of intraday liquidity - where relevant, and fundamental operational changes such as new business services. For card operators, additional relevant information includes data for the physical infrastructure (e.g., the number of POS terminals and ATMs), and types of transactions (e.g. cash withdrawal, fund transfers, use of e-money function, etc.).
  - Up-to-date rules and procedures manuals for the core payment services provided by the system and any proposed new rule changes and the time-frames and procedures for delivering these proposed changes to the PMA. These would include changes in the risk control mechanisms for operational activities (e.g., resiliency and business continuity measures and targets) and participation rules and requirements.
  - Self-assessments against oversight principles.

- The frequency, timing, and procedures for reporting the information to the PMA.
- Other information that is worth collecting from banks and/or from operators is the type of payment instruments used, such as cash, cheques, electronic transfers, mobile payment, and on-line services;

Regarding efficiency of payment instruments, the PMA will consider collecting from banks price information about retail payment transactions, as well as information about coverage of payment services.

Through *analysis* of data and information, the overseer plans to develop full awareness of the weaknesses and any action plan for the system. The analysis should cover a broad spectrum of topics including:

- Interpretations of the results of the statistics;
  - New development in the payment system in the country or abroad;
  - Determination of new payment systems that will be monitoring the PMA;
  - Analytical reporting on the different payment systems and, special situations that may affect the smooth functioning of the payment system.
- e. The PMA will be involved in on-going analyses of the desirable payment system *governance structure requirements*. This involves issues such as the ownership structure of payment systems; their rules, control mechanisms, and incentives; and their obligations and accountability to the public. It was repeatedly emphasized the need to involve the private sector in technical decisions where issues relating to payment system efficiency/safety tradeoff arise. Identifying the appropriate governance structure of the payment system is thus a most crucial operational instrument available to the overseer to steer the system toward the oversight operational objectives.

The PMA will define a payment system governance structure that supports the greatest involvement of the private sector in decisions of common interest and systemic relevance (for example, infrastructure standards and risk-management features), while protecting the competition or contestability of the domestic market for payment services. The governance framework should contemplate a clear division of duties and responsibilities among payment institutions, and the adoption of protocols for system monitoring functions and for dealing with system malfunctions, irregularities, and emergencies.

#### 4. Type of activities

The PMA, as overseer of the payment system, will perform a set of activities on a routine basis

- a. *Monitoring activities*, though, which the PMA monitors the everyday operations of the system and runs all review for abnormalities and sources of risk. Adequate technical and human resources must be devoted to these activities, which require excellent timing, continuous contacts with the market, and a full understanding of the mechanics of the system. Risk or crisis prevention is the core of the overseer's routine. In crises, such as large-scale technical or financial failures that halt or break the payment circuits, the overseer is involved with no delay and be part of the crisis management process, whereby emergency procedures are activated and decisions taken to reestablish orderly conditions in the system. Strict coordination and fluid information exchange with system participants and providers are essential.

- b. The PMA, as overseer, will carry out *research and development activities* on payment-system-related issues ranging from operational to institutional, technological, and long-term development areas of interest. These activities include the structural activities aimed at building the foundations of the payment systems, and shaping the quality and quantity of services it delivers to the economy. Its role in designing the system's rules and incentive structure clearly belongs to the structural dimension of public policy. The overseer will also catalyze resources for external technical assistance from experts, institutions, and specialized agencies to address problems including use of new infrastructure, legal and regulatory innovations, personnel training and technical and institutional capacity building.

## 5. Oversight standards

The PMA will translate its oversight objectives into specific standards and requirements that payment systems in the country should meet. Regarding the standards, a central bank or monetary authority usually defines a set of general guidelines and standards and allows the payment system to design its architecture, rules and procedures so as to meet those standards. This provides some flexibility in the specific design of the system but in a manner consistent with public policy objectives. The PMA as overseer reviews the proposed architecture, rules and procedures as formulated by the payment system itself and assesses if it meets the standards.

International standards for payment and securities settlement systems have been developed by the CPSS alone or in conjunction with IOSCO or the WB. Such international standards include the *CPSS-IOSCO Principles for Financial Market Infrastructure*. Other relevant standards regarding the mitigation of operational risk in Systemic Important Payment Systems are the *High-level principles for business continuity*, Joint Forum, Basel Committee on Banking Supervision, 2006.<sup>3</sup>

It is commonly accepted that systems of systemic importance should comply at a minimum with the internationally recognized standards. This is one of the central bank responsibilities in the CPSS-IOSCO Principles, one of the CPSS Principles for Effective Oversight. The PMA considers the RTGS-BURAQ systemically important payment system; therefore this system should comply with the above-mentioned standards.

The oversight requirements should be applied consistently. The PMA should apply the same principles regardless who the system operator is (i.e. private entities or the PMA itself).

Central banks often require RTGS systems to specify performance metrics that meet benchmarks consistent with their systemic importance to the financial system. Such metrics can be found for the operational risk management and could include: (i) system overall availability and system performance; (ii) maximum failover interval; (iii) full compliance with service level agreements during hours of system operations and in contingency modes. Regarding liquidity risk, RTGS system operators typically monitor and report to the overseer the average usage of liquidity (e.g. intraday liquidity usage to value of settled transactions ratio), or the usage of intraday credit (e.g. intraday credit to value of settled transactions ratio), settlement time (e.g. the average and maximum time between the moment the payment order is sent to the system for settlement and the time the payment is settled), total usage of liquidity and usage per participant, etc.

The PMA will decide, and publish which international standards can be applied to retail payment system in Palestine. The PMA will consider the standards that have been published by international organizations. Some of them: the *Oversight Principles for Euro Retail Payment Systems*.<sup>4</sup>; the CPSS-WB report entitled *General Principles for International Remittances*, 2007,

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<sup>3</sup> These standards can be found on the Bank for International Settlements' website [www.bis.org](http://www.bis.org).

<sup>4</sup> Oversight Principles for Euro Retail Payment Systems, ECB, 2003.

and the CPSS report entitled *Policy Issues for Central Banks in Retail Payments*, 2003, and the recent documents of the World Bank *Developing a comprehensive national retail payments strategy and a practical guide for retail payments stocktaking*.

### C. Governance, Accountability and Transparency

*Effective governance of a central bank's payments policy and oversight function promotes the credibility of the function and the efficiency and effectiveness of its implementation.*

#### Box 8. Governance, accountability and transparency

A sound governance and a transparent accountability process for the central bank's payments policy and oversight function help assure the public credibility of the central bank in performing the function and the efficiency and effectiveness with which the policy and oversight Division implement the function's strategic framework. There are three basic elements to governance and accountability:

- internal governance process to guide and review the operations of the function;
- external governance to assure that the PMA's strategic policy framework and implementation procedures are consistent with its legal authority and with the general interests of public policy for financial systems;
- accountability processes involving internal and external business audits of the function and the publication of findings based on those audits as well as published annual reports on the activities of the central bank, and its policy and oversight Division particularly, with respect to the function.

The PMA will establish all necessary internal procedures to ensure governance in the Oversight Unit and avoid any conflict of interest in the performance of their duties, especially in the aspects related to the oversight of the systems where the PMA is the operator. The NPC will be a forum in which the Oversight Unit will have to the opportunity to alert on those aspects that can affect the safety and efficiency of payment systems, this action will lead in another way to assure the governance and accountability.

The PMA will also maintain a policy of transparency and accountability through the publication of reports and statistical bulletins. The PMA is planning to start issuing bulletins on payment systems to analyze trends and provide statistics of large-value and retail payment systems and instruments. An annual oversight report is another measure that is a standard practice of many countries. The report will help provide the interested stakeholders with a general view of the role, objectives and practices of on-going oversight activities.

Moreover, the PMA has published this Oversight Policy Framework is a tool for improving oversight transparency and accountability by describing oversight objectives and outlining the principles, scope, and instruments for the implementation of this key function. Such transparency enhances the public trust in oversight policy and in the credibility of the rationale for policy actions.

Transparency is also vital to both competition and participants' protection. It enables agents to make rational choices and to express their preferences as to competing services. It forces participants and service providers to try to win market favor by producing better, and more convenient and reliable services than their competitors. Information transparency also gives correct incentives to potential entrants to evaluate the convenience of entering the market. The overseer will induce providers to inform users of all relevant aspects concerning the legal, operational, financial, and cost profiles of their services. Providers should regularly disclose updated information on their financial and technical status and performance, and on their risk position and capital.

The PMA plans to increase its information channels to collect service evaluations and complaints from users, which would convey inputs to providers or require corrective action by the overseer. The PMA intends to ask for independent evaluations of the domestic payment systems from international expert bodies and use the evaluations to feed its policy agenda.

By having regular access to information from service providers on payment costs and volumes, as well as by maintaining close and continuous contact with the market, the overseer will monitor the evolution of pricing policies across the system and make sure that no unfair practices are implemented against users. Information transparency offers crucial support in this respect, because informed users naturally choose payment services and instruments which minimize costs relative to the benefits received.

## D. Cooperative Arrangements

### Box 9. Cooperative Arrangements

The effective policy and oversight function requires consultation with other participants in payment, clearing and settlement systems. This includes cooperation with:

- other regulators with which the monetary authority shares some responsibilities for oversight of relevant aspects of payment, transaction, clearing and settlement systems;
- the operators and major participants in the systems designated for oversight; and
- other central banks and international organizations for the cooperative development of oversight policies and standards that can be applied multi-nationally.

Cooperation in the oversight payment systems has three very distinct dimensions all necessary:

1. Cooperation agreements with other regulators and authorities such as the CMA;
2. Cooperation agreements with other PMA's departments performing functions that are somehow related to the oversight of the payment systems;
3. Cooperation and collaboration framework with all market participants, both regulators and private sector.

Cooperative and information-sharing agreements with other local or foreign regulatory agencies that share some responsibility for the oversight of payment and settlement systems will be formulated and formalized. A lack of harmonization and coordination of regulation can result in different treatment of market participants undertaking the same activities, which may give rise to regulatory arbitrage and a distortion of market activity. Therefore, the PMA and other regulatory authorities will aim to minimizing duplication, insofar as this is consistent with their statutory duties. Furthermore, by cooperating and coordinating, each of the authorities has another source of relevant information, from a different perspective, on their regulated entities.

Such cooperative oversight arrangements shall describe the purpose of the agreement, the scope, procedures and terms and conditions for information-sharing and the procedures for policy consultation and coordination. The appropriate structure of a particular cooperative arrangement will depend on the statutory responsibilities of the authorities involved. It is a common practice that the central bank and other authorities sign a Memorandum of Understanding (MOU), whereby both undertake to cooperate in carrying out their tasks with due respect to their mutual responsibilities. The sharing of information can include the exchange of supervisory information (i.e., assessment reports, statistical reporting and crisis management arrangements), public and non-public, as well as the exchange of perspectives on risk management controls.

Oversight of securities settlement systems is typically conducted alongside the regulation and supervision performed by securities regulators. Oversight activities of central banks or monetary authorities increasingly relate to securities clearing and settlement systems, as relevant components of the overall national payment system. The PMA has an interest in the safe and efficient functioning of securities settlement systems, because of their relevance to financial stability. An MOU with CMA, may content the purpose of the agreement, the scope, the information to be share; the type and frequency of the meetings, the confidentiality.

All these considerations are applied in the same way within PMA. The PMA has various departments engage in functions that are related with the payment system. The Oversight Unit will take a leadership role and co-ordinate the payments system-related activities of these different departments in order to be able to have a full picture of the payments system and use resources in the most efficient manner, taking advantage of the expertise of the personnel in the different departments.

PMA is leading the National Payments Council's activities regarding the payments and securities settlement systems. Effective cooperation among market participants and between regulators and market participants is essential for the development of a sound and efficient payments system. A National Payments Council has been established in Palestine and will be one of the best tools for the oversight function.

#### **Box 10. National Payment Council**

##### Members of the NPC:

- Chair: PMA Governor
- Deputy Chair: Director, Payment System Department, PMA
- Six commercial bank representatives, electing according to a formula that takes into account size, domicile and Islamic banks
  - Banking Association of Palestine, representing the rest of the banks
  - Ministry of Finance, Capital Market Authority and Palestine Exchange (non-permanent member, only by invitation)

##### Functions:

- Apply CPSS and IOSCO recommendations to support payment systems in the country.
- Follow up the establishment of new payment systems in the country.
- Follow up the process of link the RGTS and the clearing system.
- Develop principles for retail payment system.

## ANNEX 1

### CPSS Principles for Effective Oversight

#### **Part A General Principles for Oversight**

**General oversight principle A: Transparency**

Central banks should set out publicly their oversight policies, including the policy requirements or standards for systems and the criteria for determining which systems these apply to.

**General oversight principle B: International standards**

Central banks should adopt, where relevant, internationally recognised standards for payment and settlement systems.

**General oversight principle C: Effective powers and capacity**

Central banks should have the powers and capacity to carry out their oversight responsibilities effectively.

**General oversight principle D: Consistency**

Oversight standards should be applied consistently to comparable payment and settlement systems, including systems operated by the central bank.

**General oversight principle E: Cooperation with other authorities**

Central banks, in promoting the safety and efficiency of payment and settlement systems, should cooperate with other relevant central banks and authorities.

#### **Part B Principles for international cooperative oversight**

**Cooperative oversight principle 1: Notification**

Each central bank that has identified the actual or proposed operation of a cross-border or multicurrency payment or settlement system should inform other central banks that may have an interest in the prudent design and management of the system.

**Cooperative oversight principle 2: Primary responsibility**

Cross-border and multicurrency payment and settlement systems should be subject to oversight by a central bank which accepts primary responsibility for such oversight, and there should be a presumption that the central bank where the system is located will have this primary responsibility.

**Cooperative oversight principle 3: Assessment of the system as a whole**

In its oversight of a system, the authority with primary responsibility should periodically assess the design and operation of the system as a whole. In doing so it should consult with other relevant authorities.

**Cooperative oversight principle 4: Settlement arrangements**

The determination of the adequacy of a system's settlement and failure-to-settle procedures in a currency should be the joint responsibility of the central bank of issue and the authority with primary responsibility for oversight of the system.

**Cooperative oversight principle 5: Unsound systems**

In the absence of confidence in the soundness of the design or management of any crossborder or multicurrency payment or settlement system, a central bank should, if necessary, discourage use of the system or the provision of services to the system, for example by identifying these activities as unsafe and unsound practices.

## ANNEX 2

### Responsibilities of central banks, market regulators, and other relevant authorities for financial market infrastructures

***Responsibility A: Regulation, supervision, and oversight of FMIs***

FMIs should be subject to appropriate and effective regulation, supervision, and oversight by a central bank, market regulator, or other relevant authority.

***Responsibility B: Regulatory, supervisory, and oversight powers and resources***

Central banks, market regulators, and other relevant authorities should have the powers and resources to carry out effectively their responsibilities in regulating, supervising, and overseeing FMIs.

***Responsibility C: Disclosure of policies with respect to FMIs***

Central banks, market regulators, and other relevant authorities should clearly define and disclose their regulatory, supervisory, and oversight policies with respect to FMIs.

***Responsibility D: Application of the principles for FMIs***

Central banks, market regulators, and other relevant authorities should adopt the CPSS-IOSCO *Principles for financial market infrastructures* and apply them consistently.

***Responsibility E: Cooperation with other authorities***

Central banks, market regulators, and other relevant authorities should cooperate with each other, both domestically and internationally, as appropriate, in promoting the safety and efficiency of FMIs.