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Correspondent Banking Relationships in Palestine: Strengthening Financial Stability and Mitigating Disruption Risks

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**Correspondent Banking Relationships in Palestine:
Strengthening Financial Stability and Mitigating Disruption Risks**

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1. Background

Correspondent banking relationships (CBRs) are a fundamental pillar of the Palestinian economy, enabling banks operating in Palestine to process international payments, settle cross-border transactions, finance trade, and manage financial transfers. The significance of CBRs is particularly pronounced in the Palestinian context, given the absence of a national currency and the economy's heavy reliance on the Israeli shekel, in addition to the close dependence on foreign trade, financial transfers, and clearance revenues with Israel.

Since late 2023 in particular, CBRs have faced increasing risks amid repeated threats to halt or restrict banking relations between Israeli banks and banks operating in Palestine, raising genuine concerns over the continuity of payments, foreign trade, and financial stability. Although international and Palestinian efforts have succeeded in renewing the temporary legal guarantees that have allowed these relationships to continue, the situation remains marked by a high degree of uncertainty.

The fragility of the Palestinian context stems from three main factors: the extensive reliance on the Israeli shekel; the concentration of settlement and clearing arrangements among a limited number of Israeli banks; and the heavy dependence of trade and financial transfers on existing banking channels.

2. Key Findings

The background paper underpinning this policy brief finds that CBRs constitute a fundamental pillar of financial and economic stability in Palestine and that the growing risks to their continuity have implications across various economic sectors. Given the limited alternatives available and the heavy reliance on existing settlement channels, several key findings emerge:

1. **CBRs are fundamental to financial and economic stability**, and their role extends beyond facilitating international banking operations to supporting foreign trade, workers' remittances, clearance revenues, and the financing of essential goods and services. Consequently, any disruption to these relationships could have direct implications for the Palestinian economy.
2. **Heavy reliance on the shekel increases structural fragility**, as nearly half of banking facilities and deposits are denominated in shekels, while a substantial share of clearing operations and commercial transactions also depends on the currency. This heightened reliance increases exposure to risks associated with any disruption to the related settlement channels.
3. **The available alternatives are unlikely to provide a comprehensive solution in the foreseeable future**. Although alternative options for financial transfers and settlements exist, they cannot fully replace existing CBRs as long as shekel settlement remains linked to the Israeli financial system.
4. **The repercussions of any disruption extend beyond the financial sector**. Disruptions to payments and financial settlements can have broader effects on trade, supply chains, and financial transfers, with subsequent implications for economic growth, costs, and price levels.
5. **Compliance and governance represent a first line of defense**. International experience indicates that adherence to Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT) standards, alongside strengthened governance and risk management frameworks, is among the key factors in maintaining external banking relationships.
6. **International support has contributed to mitigating the risks of disruption**. International partners and financial institutions have played an important role in supporting the continuity of CBRs and reducing the potential repercussions of any disruption.

3. Policy Implications: Priorities for Stakeholder Intervention

The paper's findings indicate that preserving CBRs requires an integrated approach that combines the management of short-term risks with efforts to strengthen the long-term resilience of the financial system. This approach also requires effective coordination among regulatory, banking, and governmental bodies and international partners, with compliance and risk management underpinning all proposed interventions. Against this backdrop, the following priority interventions emerge:

First: The Palestine Monetary Authority (PMA)

In the Short Term:

- Establish a permanent unit or committee for managing CBR-related risks, comprising the PMA and banks operating in Palestine, to oversee risk indicators and develop early-response scenarios.
- Conduct periodic stress testing to assess banks' capacity to respond to scenarios involving partial or temporary disruptions to CBRs.
- Develop business continuity plans and alternative operational arrangements for cross-border transfers and payments.

In the Medium and Long Terms:

- Accelerate the development of instant payment systems and national digital payments infrastructure, while expanding the use of digital solutions for compliance, transaction monitoring, and risk assessment.
- Explore the establishment of a specialized entity to manage correspondent banking and settlement operations.
- Develop a centralized information base on correspondent banking risks to support effective monitoring and informed decision-making.
- Lead the development of a national framework for managing risks associated with external banking relationships, in partnership with the Ministry of Finance, the Banks Association, the private sector, and international institutions.
- Promote the gradual integration of Palestinian payment systems with regional and international cross-border payment platforms.

Second: Banks Operating in Palestine

In the Short Term:

- Reviewing operational contingency plans related to disruptions in correspondent banking services and updating them periodically.
- Strengthening institutional compliance and AML/CFT systems in line with international best practices and standards.

In the Medium and Long Terms:

- Diversifying the correspondent bank network wherever possible to reduce concentration risk.
- Expanding digital banking services and reducing reliance on cash transactions.
- Investing in advanced technological solutions dedicated to oversight, compliance, and risk management.
- Developing regional and international banking partnerships that enhance access to more diversified and sustainable settlement channels.

Third: The Palestinian Government

The government can support the resilience of the financial system through:

- Completing the implementation of the Law on Limiting Cash Transactions and gradually expanding electronic payments.
- Regulating informal economic activity to increase its integration into the formal financial system.
- Improving the legislative environment for e-commerce and digital payments.
- Encouraging the use of electronic means of payment in government transactions.
- Diversifying foreign trade partnerships in a way that reduces excessive reliance on a single trade route.
- Aligning financial legislation with international practices and standards.

Fourth: International Partners and International Financial Institutions

- Ensuring continued political and legal support for the continuity of correspondent banking channels.
- Providing technical support to the Palestinian banking sector in areas of compliance and risk management.
- Supporting Palestine's accession to regional initiatives on cross-border payments.
- Contributing to the building of more sustainable institutional arrangements for banking relationships, rather than continued reliance on temporary guarantees.

4. Policy Implications: Objectives of Intervention by Stakeholders

The interventions undertaken by stakeholders aim to achieve three main objectives:

1. Protecting and Sustaining Existing CBRs

Rationale for intervention:

Maintaining existing CBRs is an urgent short-term priority, given the Palestinian economy's heavy dependence on existing payment and settlement channels and the limited availability of alternatives capable of providing comparable levels of efficiency and reliability in the foreseeable future.

Intervention Priorities:

- Fostering institutional dialogue and coordination with regulatory bodies, the banking system, and relevant stakeholders.
- Continuing to strengthen compliance, governance, and risk management in line with international best practices.
- Preserving the transitional arrangements and guarantees that support the continuity of CBRs.
- Assessing institutional options that can support correspondent and settlement services and enhance their sustainability.
- Leveraging international legal, diplomatic, and economic tools to support the sustainability of payment and settlement channels.

2. Diversifying Financial Channels and Reducing Concentration Risk

Rationale for intervention:

Given the continued high concentration and heavy reliance on a limited number of shekel-linked correspondent banking and settlement channels, the financial system needs to diversify available alternatives to strengthen resilience and reduce risks from reliance on a limited number of channels and financial institutions.

Intervention Priorities:

- Diversifying the network of correspondent banks and financial institutions.
- Gradually expanding the use of foreign currencies in certain eligible commercial transactions.
- Diversifying trading partners and foreign trade routes.
- Developing supportive settlement and payment channels at the regional and international levels.

3. Developing Financial and Technological Infrastructure

Rationale for intervention:

Safeguarding the stability and continuity of the Palestinian financial sector while strengthening its capacity to withstand shocks, requires continued investment in modern payment systems, digital infrastructure, and innovative financial services, in a way that supports operational efficiency and strengthens institutional resilience over the long term.

Intervention Priorities:

- Enhancing the integration of the banking system with instant payment systems and cross-border payments
- Expanding the use of digital payments and electronic financial services.
- Strengthening integration with regional and international payment infrastructures.

4. Strengthening the Role of the Private Sector in Supporting the Sustainability of Trade and Financial Flows

Rationale for intervention:

The private sector is the principal beneficiary of payment, settlement, and trade-finance services, and its participation in documenting potential economic impacts and strengthening communication with trade and international partners contributes to supporting the continuity of official payment and trade channels.

Intervention Priorities:

- Strengthening consultation and coordination between the private sector, the financial sector, and government bodies.
- Documenting the potential economic impact of any restrictions on payments and trade, and using this documentation in international advocacy efforts.
- Supporting the diversification of trading partners and markets, as well as the associated payment and settlement arrangements.
- Encouraging companies to develop business continuity plans and strengthen financial risk management.

5. Priority Actions Matrix for the Next 12–24 Months

Intervention Area	Priority Action	Responsible Entity	Key Partners	Timeframe
Protecting and Sustaining Existing CBRs	Establishing a regular institutional mechanism for dialogue and coordination between the PMA, banks, and relevant regulatory bodies to monitor the operational and regulatory risks associated with CBRs.	PMA	Banks operating in Palestine and relevant regulatory bodies	0–12 months
	Implementing a programme to strengthen compliance, governance, and risk management, including independent reviews and the strengthening AML/CFT and Know Your Customer (KYC) procedures.	PMA	Banks operating in Palestine	0–12 months
	Supporting the continuity of transitional arrangements and guarantees, and exploring more sustainable and predictable alternatives over the medium term.	PMA	Government bodies and international partners	Ongoing
	Assessing the feasibility of establishing specialized institutional arrangements or entities to support correspondent banking and settlement services and strengthen operational risk management.	PMA	Banks and legal and technical experts	6–24 months
Legal and International Framework	Mobilizing economic, legal, and diplomatic efforts to support the continuity and sustainability of payment and settlement channels, and placing the issue on the agenda of economic and financial dialogues with international partners.	Palestinian Government	PMA, private sector, and international partners	6–24 months
Diversifying Financial Channels and Reducing Concentration Risk	Implementing a structured programme to expand the network of correspondent banks and financial institutions and reduce concentration risks.	PMA and banks	Regional and international financial institutions	6–18 months
	Gradually expanding the use of foreign currencies in commercial transactions where feasible, alongside developing tools to manage exchange rate and liquidity risks.	PMA	Banking sector and private sector	12–24 months
	Diversifying trading partners and foreign trade routes, along with associated payment and settlement arrangements, thereby strengthening the Palestinian economy's access to a broader range of financial markets and channels.	MoNE	Private sector and chambers of commerce	12–24 months
	Assessing and developing alternative and complementary regional and international payment and settlement channels to expand the options available to the Palestinian financial sector and reduce concentration risk.	PMA	Banks and financial partners	12–24 months

Intervention Area	Priority Action	Responsible Entity	Key Partners	Timeframe
Developing Financial and Technological Infrastructure	Preparing a roadmap for gradual integration with instant payment systems and cross-border payment arrangements.	PMA	Banks and regional and international payment partners	12–24 months
	Expanding the use of digital payments and e-wallets while reducing reliance on cash.	PMA	Banks and payment partners	12–24 months
	Assessing opportunities for integration with regional and international payment infrastructures and incorporating these opportunities into future national plans.	PMA	Central banks and regional financial institutions	12–24 months

6. Key Message for Policymakers

The sustainability of CBRs is not merely an operational matter concerning the banking sector, but a fundamental precondition for preserving economic and financial stability in Palestine. Given the limited alternatives available in the foreseeable future, national and international efforts should focus on two parallel and complementary tracks:

First, protecting existing relationships and strengthening their sustainability by raising levels of compliance, governance, and risk management, and intensifying coordination with international partners;

Second, building greater structural resilience in the financial system through developing payment infrastructure, diversifying financial channels, and reducing excessive dependence and concentration risk over the long term.