

## *Chapter 6*

# *The Structure of the Banking System, and the Activities of the Banking Supervision Department*

Much of the work of the Banking Supervision Department consists of monitoring the banking corporations' exposure to actual and potential risks in the banking system, and ensuring that proper bank-customer relations are maintained. In addition to these activities, the Banking Supervision Department also engaged in the following in 2000: examining the eligibility of groups of candidates for the purchase of controlling interests in banks, and active involvement in the legislative process concerning money laundering; this includes the promulgation of the Prohibition of Money Laundering Order whose main objective is to prevent the banking system from being used for this purpose.

During 2000 the services provided by banks via the internet, especially in connection with the surge in share prices in the first nine months of the year, continued to grow. The Supervisor of Banks expanded the permit for activities extended over the internet to include third-party transfers, and several banks have already begun to utilize this facility. The decline in the number of branches evident in 1999 persisted in 2000. This trend accompanies the ongoing process of technological change, and is expected to continue in the future.

Foreign representative offices and investment banks continued their activity, and this year two foreign commercial banks opened branches in Israel.

The credit card market has been characterized by structural changes since mid-1998, when First International Bank's Alpha Card entered the credit card market, thus abolishing the duopoly formed by Isracard (fully owned by Bank Hapoalim) and Visa C.A.L. (owned jointly by Leumi and Discount banks). The structural changes gave rise to increased competition in issuance and clearing in 2000, reduced fees, and strategic alliances in the areas of consumer clubs and chains.

## 1. INTRODUCTION

The first part of this chapter reviews the main changes and developments in the structure of the banking system in 2000, while the second presents the main subjects dealt with by the Banking Supervision Department in the areas for which it is responsible: regulation, bank-customer relations, information and reporting of the banking corporations, applied research in the area of banking, as well as monitoring and evaluating the activity of the banking corporations. The second part of this chapter also describes the activities of the Banking Supervision Department with regard to international relations, licensing, payment systems, checks without cover, and banks' operation in times of emergency.

## 2. CHANGES IN THE STRUCTURE OF THE BANKING SYSTEM

### General

In the last few years foreign banks have shown greater interest in opening representative offices or branches in Israel, in view of the processes of liberalization and globalization, the reduction of inflation, and tighter fiscal policy. The entry of foreign banks into the domestic banking system could contribute to improving competition in the industry, importing banking technologies and new managing systems, and widening the access of Israeli companies and individuals to the international capital market. While the initial activity of foreign banks is characterized in Israel, as it is in other countries, by extending selected services to large customers, this is expected to expand so that in future foreign banks will also serve small companies and households.

**Table 6.1**  
**The Structure of the Banking System, 1980–2000**

	Banking corporations <sup>a</sup>	Commercial banks <sup>b</sup>	Mortgage banks	Investment finance banks	Other banking corporations <sup>b</sup>
1980	63	30	16	8	9
1990	57 <sup>c</sup>	25 <sup>c</sup>	9	8	15
1995	46	24	9	2	11
1996	45	24	9	1	11
1997	45	23	8	1	13
1998	45	24	8	1	12
1999	45	23	8	1	13
2000	45	23	8	1	13

<sup>a</sup> Includes commercial banks, a foreign bank, mortgage banks, merchant banks, investment finance banks, financial institutions, and joint service companies.

<sup>b</sup> In 1998, Bank of Jerusalem, which was a financial institution, became a commercial bank.

<sup>c</sup> Excluding banks in Judea, Samaria and the Gaza Region.

SOURCE: Returns to Supervisor of Banks.

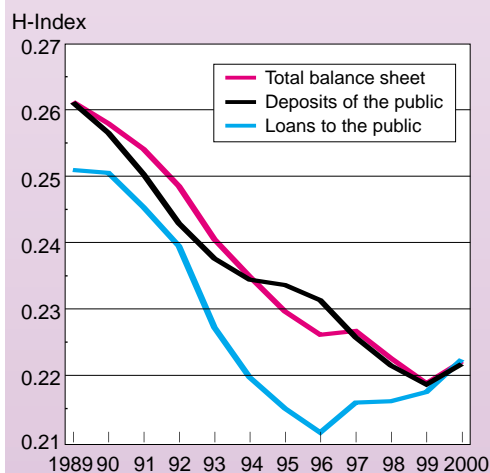
Alongside Israel's banking system, several large banks from Europe (France, Switzerland, Germany, and Austria) and the US undertake financial activities by means of representative offices and investment banks (in contrast to branches, which provide full commercial banking services, these do not have to obtain a license from the Supervisor of Banks to operate in Israel). Their principal areas of activity<sup>1</sup> involve investment banking; hedge funds in various areas especially technology; mergers and acquisitions; identifying business opportunities abroad for Israeli entrepreneurs and in Israel for foreign investors; making public and corporate offerings; and undertaking portfolio management. The representative offices contribute to competition both directly, by providing various services in Israel, and indirectly, by increasing contestability.

During 2000 there was no change in the number of banking corporations operating in Israel, and this remained 45 (Table 6.1). Notwithstanding, as a result of mergers between foreign banks there were shifts in the ownership of two foreign banks<sup>2</sup> operating in Israel.

One of the accepted indices of competition is the Herfindahl Index (H-Index) of concentration, which reflects the distribution of the banks' assets within the system. In 2000 there was a slight increase in the H-Index—which is calculated on the basis of a bank's total assets—largely due to the inclusion of Otsar Hayal Bank in the Bank Hapoalim group.<sup>3</sup> This moderate change came in the wake of a steep fall in the H-Index in the first half of the 1990s, followed by a moderation in the decline in the second half of the decade. At the end of 2000 the index was 0.222, compared with 0.226 in 1997 and 0.256 in 1992 (Figures 6.1 and 6.3).

An international comparison of indices of concentration shows that concentration in Israel is one of the highest in the world. A high level of concentration (between 0.203 and 0.237), similar to Israel's (0.213), was found in 1999 in Sweden, Finland, Ireland, and Holland, but in those countries its significance is less serious due to the easy access to banking systems across the border and the fact that they belong to the euro

**Figure 6.1**  
H-Index of the Five Major Banking Groups and the Independent Banks,<sup>a</sup> 1988–99



<sup>a</sup> Union Bank has been an independent bank since December 1991. From December 1992 to December 1999 Otsar Hahayal Bank was classified as an indept bank.  
SOURCE: Published financial statements.

<sup>1</sup> See also the 1999 annual report of the Controller of Foreign Exchange, chapter 5.

<sup>2</sup> Standard Chartered Bank received a banking license in August 2000, and replaced ANZ Banking Group; HSBC Bank, Plc. received a banking license in December 2000, and replaced Republic National Bank of NY (Suisse).

<sup>3</sup> Bank Hapoalim increased its holdings in Otsar Hahayal to 66.1 percent. As of 2000:I, the financial statements of Otsar Hahayal are incorporated in the consolidated statements of Bank Hapoalim.

zone. By contrast, concentration is very low (between 0.039 and 0.089) in the US, Germany, Italy, the UK, and France (Figure 6.2 and Table 6.6).

There were two significant events in the credit card market in 2000. The first was the sale of Bank Leumi's share in the C.A.L. company to Discount Bank, following the demand made by the Supervisor of Banks and the Director-General of the Anti-Trust Authority. Exercising his authority under section 11a of the Banking Law, 5741-1981, the Supervisor of Banks permitted outside agencies<sup>4</sup> to purchase holdings in an auxiliary banking corporation in order to enable a third large clearer to remain in the credit card market in Israel, and thereby enhance competition.

The second event was the exit of the Alpha Card company<sup>5</sup> from the credit card market, the sale of its operational infrastructure to Leumi Card, and the transfer of its customer database to Visa C.A.L. Bank Leumi set up a new credit card company based on Alpha Card's infrastructures, implemented a pilot study at the end of 2000, and began to issue cards to its customers in January 2001.



<sup>4</sup> The Fishman family assets and Harel Hamishmar Holdings.

<sup>5</sup> Owned by the First International Bank.

## Branch structure

The Bank of Israel's policy on issuing licenses to open and move bank branches has been more liberal<sup>6</sup> in recent years. This policy contributes to making the banks more efficient by enabling them to merge branches, close those that are less profitable, and even alter the purpose of some, e.g., focusing activity on extending services to business and commercial customers only,<sup>7</sup> or providing private banking services.

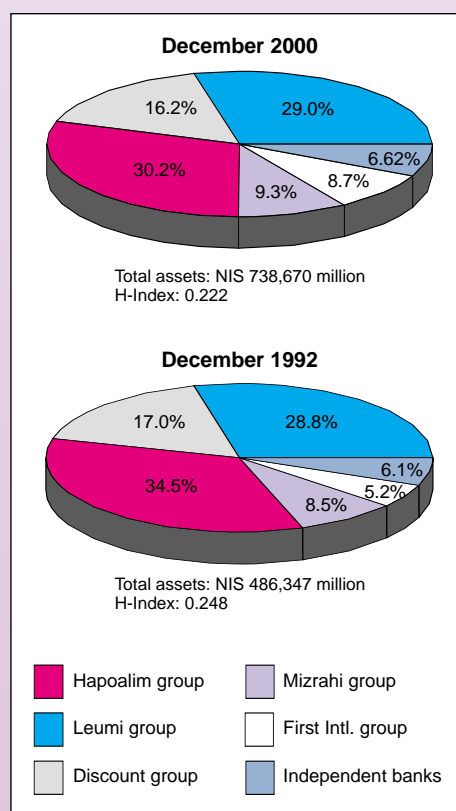
Technological developments in the area of communications and computerization have enabled banks to offer a range of banking services (substitutes and new ones) while improving services for customers, and especially the ability to serve them without requiring their physical presence in the branches. Concurrently, customers are becoming increasingly accustomed to making use of these services (see following section). As expected, the trend of closing branches has continued, and during 2000 a net total of 23 branches was closed<sup>8</sup> (35 in 1999). A net total of 16 branches was closed in the two largest banking groups in 2000—down by 2.8 percent from 1999, and a cumulative fall of 8.9 percent from 1995. In the group of medium-sized banks a net total of 7 branches was closed—down by 1.5 percent from 1999, and a cumulative fall of 3.5 percent since 1995. In the group of small banks, however, the number of branches remained unchanged (Table 6.3). Despite the more rapid closure of branches in the group of large banks, leading to the gradual erosion of their share in the total banking system, they still account for 55 percent of all the branches. It is reasonable to assume that the number of branches will continue to decline, and that branches that are opened in the future will generally feature advanced technology and fewer staff.

<sup>6</sup> In contrast with the past, see a comprehensive review in chapter 6 of last year's edition of this publication.

<sup>7</sup> Such as concentrating integrated services for businesses in regional centers.

<sup>8</sup> Excluding Bank of Jerusalem, most of whose activity is still in the field of mortgages (one of its branches was closed in 2000, and another was closed in 1999).

**Figure 6.3**  
Distribution of Assets of Banking Groups, 2000 vis-à-vis 1992



SOURCE: Returns to Supervisor of Banks.

**Table 6.2**  
**Overseas Banking Offices, Branches and Employee Posts, 1991–2000**

	Total number of offices	Number of branches and representative offices <sup>a</sup>	Number of subsidiaries' offices <sup>b</sup>	Number of employee posts <sup>c</sup>
1991	128	70	58	
1992	126	70	56	3,210
1993	123	73	50	2,962
1994	114	73	41	2,717
1995	108	72	36	2,418
1996	105	72	33	2,225
1997	95	62	33	1,972
1998	93	60	33	2,055
1999	94	60	34	2,044
2000	98	62	36	2,125

<sup>a</sup> Branches and representative offices abroad of Israeli banking corporations.

<sup>b</sup> Branches of subsidiaries abroad.

<sup>c</sup> Number of full-time posts (including weighted part-time posts) in branches, representative offices, and subsidiaries abroad.

SOURCE: Returns to Supervisor of Banks.

**Table 6.3**  
**Number of Offices of Commercial Banking Groups,  
by Size of Group,<sup>a</sup> 1995–2000**

	Number of offices by size of bank			Total <sup>b</sup>	Relative share (percent)		
	Large	Medium	Small <sup>b</sup>		Large	Medium	Small
1995	608	462	13	1,083	56.1	42.7	1.2
1996	598	464	13	1,075	55.6	43.2	1.2
1997	593	470	13	1,076	55.1	43.7	1.2
1998	592	466	13	1,071	55.3	43.5	1.2
1999	570	453	13	1,036	55.0	43.7	1.3
2000	554	446	13	1,013	54.7	44.0	1.3

<sup>a</sup> Large banks: Leumi and Hapoalim, including subsidiaries (Otsar Hahayal, American Israel, Yahav, Massad, Arab Israel, and Israel Continental).

Medium banks: Discount (including Mercantile Discount and Mercantile Israel), Mizrahi, First International (including Poalei Agudat Israel), and Union

Small banks: Investec Clali, Maritime, Euro-Trade, Trade, Industrial Development, Agriculture, Global Investment, Polska, and Kupat Haoved Haleumi.

<sup>b</sup> Excluding the 19 branches of Bank of Jerusalem (20 in 1999 and 21 in 1998), most of whose activity is in the area of mortgages.

SOURCE: Returns to Supervisor of Banks.

**Table 6.4**  
**Offices and ATMs, 1986–2000**

	Number of offices <sup>a</sup>	Number of ATMs	Number of information machines	Number of residents per office <sup>b</sup>	Number of residents per ATM
Average 1986–90	1,049	555	1,320	4,311	8,043
Average 1991–95	1,063	722	1,695	5,017	6,787
1996 <sup>c</sup>	1,075	1,056	2,000	5,357	5,454
1997	1,076	1,131	2,055	5,488	5,221
1998	1,092	1,241	2,133	5,537	4,872
1999	1,056	1,292	2,111	5,874	4,801
2000	1,032	1,322	2,170	6,160	4,857

<sup>a</sup> Regular branches, counters, and limited branches in Israel.

<sup>b</sup> Excluding offices of commercial banks operating in Judea, Samaria and the Gaza Region.

<sup>c</sup> Since 1996 the number of residents has been determined on the basis of the *de jure* population, and updated for previous years.

SOURCE: Returns to Supervisor of Banks.

**Table 6.5**  
**Number of Employee Posts and Over the Counter Debits,<sup>a</sup> 1996–2000**

	Number of branches <sup>a</sup>	Number of employee posts	Number of employee posts per branch	Monthly average	
				Number of over the counter debits per branch <sup>b</sup>	Number of cash withdrawals per ATM <sup>b</sup>
1996	1,075	35,400	32.9	2,080	7,294
1997	1,076	35,595	33.1	2,045	7,300
1998	1,071	35,259	32.9	1,911	7,015
1999	1,036	34,823	33.6	1,940	7,043
2000	1,013	35,020	34.6	1,850	7,074

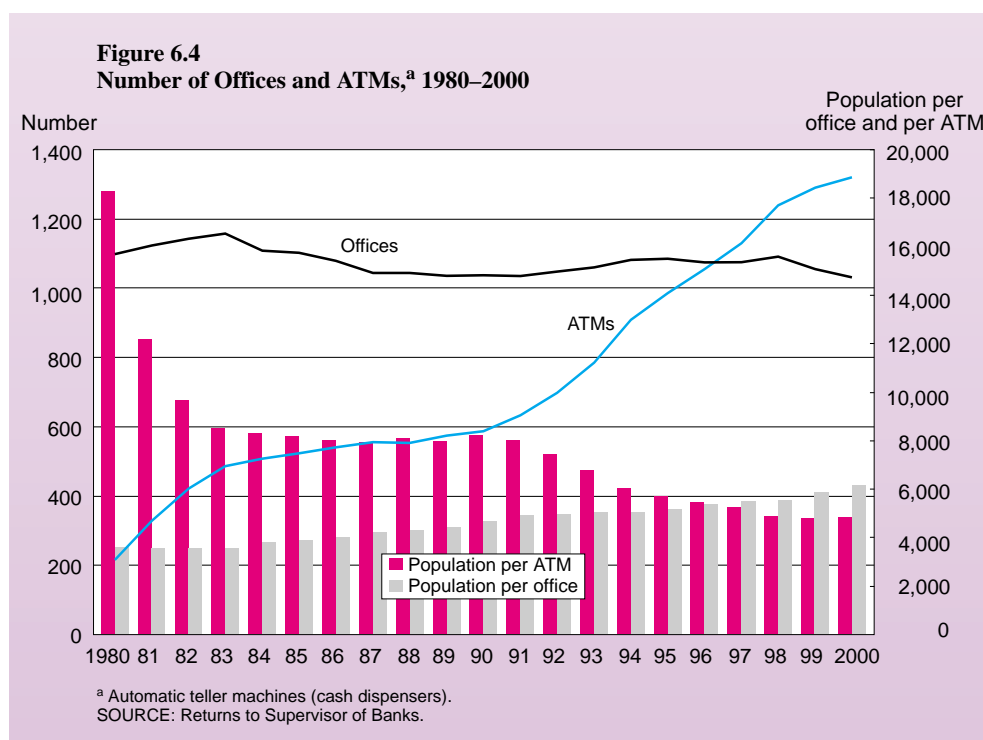
<sup>a</sup> Excluding the branches of Bank of Jerusalem.

SOURCE: Returns to Supervisor of Banks.

The introduction of technological advances and their adoption by banks' customers has led to a decline in the number of visits to branches. This is indicated by the 11 percent drop in the number of debits made at the counter<sup>9</sup> (monthly average per branch), which is one of the indices of visits to branches, in the last five years (Table 6.5). The monthly average of cash withdrawals via ATMs also fell slightly in that period. In 2000 each branch served approximately 6,200 customers—a 5 percent rise over 1999 (Table 6.4 and Figure 6.4).

<sup>6</sup> For cash withdrawals.

According to reports submitted to the Supervisor of Banks, the number of staff positions<sup>10</sup> in the banking system remained stable in 2000. Due to the reduction in the number of branches, the average number of positions per branch rose by a moderate 3 percent over 1999 to stand at 34.6 (Table 6.5).



A comparison with the members of the G10<sup>11</sup> for 1999 shows that in Israel the number of banking institutions and branches of commercial banks is very low. In countries with a population density similar to Israel's (Belgium and Holland, with 334.6 and 465.1 persons per square kilometer respectively, compared with Israel's 269.6) there are three times as many banking institutions with six times as many offices. In addition, the number of persons per branch (5,874) is higher in Israel than in the US (3,469) and the other European countries in the G10 (ranging from 1,097 in Belgium to 2,523 in Holland). These figures may indicate that Israel's banking system is more efficient in operational terms as the level of operating expenses per branch in Israel is similar to the average in the reference group.<sup>12</sup> The number of ATMs from which cash may be withdrawn is also relatively low in Israel (1,292), so that the number of persons per ATM (4,808, Table 6.6) is higher than it is in the G10 countries.

<sup>10</sup> Weighted (i.e., full-time positions equivalent).

<sup>11</sup> The BIS (Bank for International Settlements) publishes a statistical annual of the payment systems of the eleven countries in this group: Belgium, Canada, France, Germany, Italy, Japan, Holland, Sweden, Switzerland, the UK, and the US.

<sup>12</sup> Average operating expenses per branch in several countries (Denmark, Finland, Greece, Ireland, Norway, and Portugal) in the reference group (note d in Table 3.3) was about NIS 11 million a year in 1998, compared with NIS 11.4 million a year in Israel.



**Table 6.6**  
**Indicators of the Structure of Banking Systems, an International Comparison, 1999**

	Number of institutions	Number of branches	Number of residents per office	Number of residents per ATM	H-Index
Israel <sup>a</sup>	45	1,056	5,874	4,808	0.213
Belgium	121	8,372	1,221	1,645	0.170
Canada	2,108	13,696	2,233	1,144	0.158
France	1,672	25,144	2,350	1,821	0.089
Germany <sup>b</sup>	2,995	55,492	1,481	1,779	0.056
Italy	878	41,209	1,400	1,912	0.071
Japan	3,169	64,614	1,961	875	0.059
Netherlands	123	6,282	2,523	2,364	0.203
Sweden	123	3,940	2,249	3,436	0.237
Switzerland	336	6,528	1,097	1,527	0.193
UK	506	34,146	1,743	2,101	0.079
US	21,070	77,983	3,469	1,203	0.039
Average G-10	—	—	1,975	1,801	0.123

<sup>a</sup> The H-Index was calculated for the five major banking groups.

<sup>b</sup> In Germany this includes post offices.

SOURCE: *Statistics on Payment Systems in the Group of Ten Countries* (1999), Bank for International Settlement.

### Technology, computerization, and banking services

To a great extent the banking industry is based on data analysis and communication, and hence technological developments affect it substantially.

The advances of the last few years in information technology and communications have contributed to the increased efficiency of banking activities and the services offered to the public, and the aforementioned decline in the number of branches and employees in the industry is one of its results. The banking system continues to utilize technology in order to improve, change, and adapt banking activities, as well as to enhance business activities and attain strategic objectives in the various spheres of banking. Providing banking services through the use of technology-intensive channels has been made possible by technological change, but the extent to which they have been utilized over time is largely the result of their adoption by the public, and this tends to be slow.<sup>13</sup>

Internet banking services continued to expand in 2000, to some extent at the expense of services provided by other methods of communication. In addition, banking services began to be extended via cellular phones, albeit on a limited scale.

<sup>13</sup> It took many years before ATMs were widely used.

**Table 6.7**  
**Number and Composition of Debits in Current Accounts, the Seven**  
**Major Banks, 1991-2000**

(monthly average)

	Number of debits (percent of total)						Total (mill.)
	By check	At counter	ATM	Author- ization	Credit card	Other	
1991	40.2	5.5	9.6	14.3	2.4	28.0	41.6
1992	39.6	4.7	10.3	14.1	2.5	28.8	45.7
1993	37.3	4.3	11.3	14.7	2.7	29.7	47.4
1994	36.3	3.8	12.4	15.1	2.9	29.9	51.4
1995	35.8	3.5	13.3	15.7	3.2	29.0	53.7
1996	32.1	4.6	15.9	16.1	4.0	27.9	48.5
1997	29.6	4.3	16.0	16.8	4.2	29.2	51.5
1998	28.4	3.9	16.6	17.1	4.6	29.5	52.6
1999	27.2	3.7	16.9	18.0	4.6	29.5	53.8
2000	26.1	3.4	16.9	18.2	4.8	30.6	55.3

SOURCE: Returns to Supervisor of Banks.

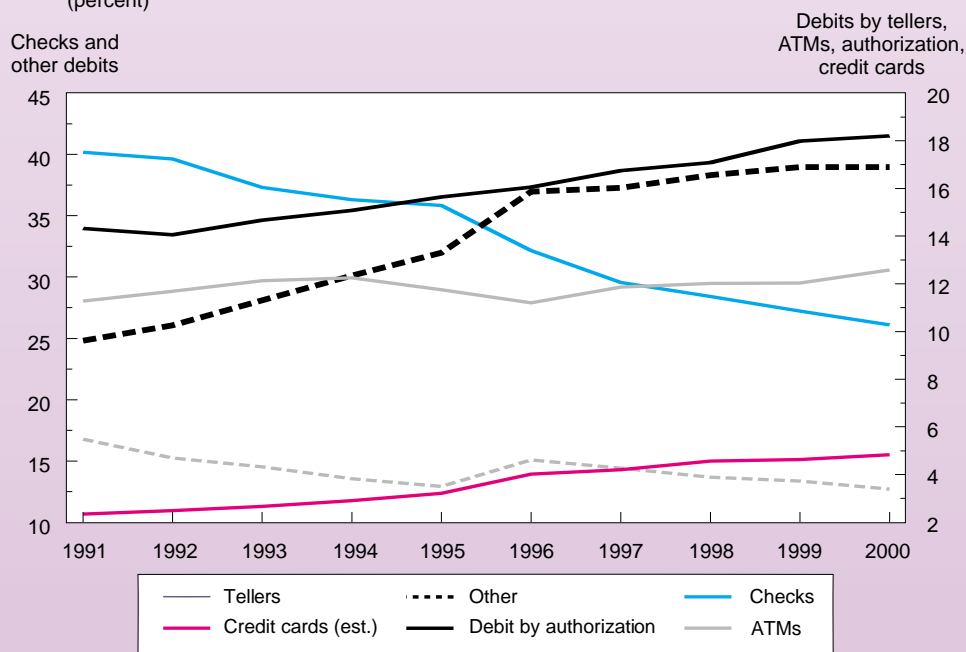
Israel's banking system currently provides customers with a range of banking services via the internet. Their expansion this year was towards securities transactions on the TASE (Tel Aviv Stock Exchange) and stock exchanges abroad, particularly in the US. This expansion came in the context of the permit granted by the Supervisor of Banks to implement transactions in a customer's account (including securities transactions) by means of the internet and activity in capital markets in Israel and abroad.

In 2000 the Banking Supervision Department granted permission to banks to use the internet for financial transfers to a third party. To date this permit has been utilized only by some banks.

Resort to ATMs, which enable the banks to offer financial services to the public at all hours and over a wide geographical area, rose in 2000, as did direct banking, through which customers can implement banking transactions via a computer or telephone without being physically present in a branch (and at times when the bank is closed). Sample figures<sup>14</sup> to the end of 2000 submitted to the Banking Supervision Department, and which should be regarded as an estimate, show that each month there are on average 13.4 million electronic requests for information, 20 percent of them made via the internet. Use of the internet and IVR (interactive voice response system) in order to obtain information has soared. There was no substantial change in the use of ATMs, computer-to-computer services, or information machines. An average of two cash withdrawals were made per month via ATMs per checking account in 2000—similar to the 1999 average.

<sup>14</sup> The data are for a sample of banking institutions in 1999 and 2000, as the reporting requirement went into effect only in 1998:IV. Some of the figures are estimates made by the reporting banks.

**Figure 6.5**  
**Number and Composition of Debits in Current Accounts, 1991–2000**  
 (percent)



SOURCE: Returns to Supervisor of Banks.

The effect of technology on the way banking activities are implemented, as well as on their extent and the degree to which these innovations are adopted by customers, are also reflected in the data reported to the Supervisor of Banks regarding the number and composition of debits from checking accounts. The declining trend in the share of debits by non-automatic means (checks and over the counter) persisted in 2000, too. This trend is marked with regard to checks: their share of total debits has declined consistently, from 40 percent in the early 1990s to 26 percent in 2000. Concurrently, the average amount per check has risen gradually, to stand at NIS 4,600 at the end of the year. There was a similar reduction in transactions conducted over the counter, and they accounted for only 3.4 percent of total debits made through checking accounts (compared with 5.5 percent in 1991). The average cash transaction conducted over the counter has also risen over time, and reached NIS 3,150 in 2000. The decline in non-automatic banking transactions (use of checks and at bank counters) translates into a moderate increase in transactions requiring minimal manual intervention from customers and banks, as was the case in 2000 (Table 6.7 and Figure 6.5).

## **Sale of controlling interest and change of ownership**

In the wake of the Bank Shares Arrangement, the process of privatizing the banks by selling them to identified and stable controlling interests is currently under way. The Arrangement banks are sold by the Ministry of Finance via M.I. Holdings Ltd., and the role of the Bank of Israel under the Banking (Licensing) Law, 5741–1981 is to examine potential purchasers of a bank's controlling interest and grant a permit to those deemed suitable. The criteria guiding the Bank of Israel in approving candidates for a permit include inter alia individual probity, business experience, and financial soundness. The effects of a change in ownership on competition in the banking system, and the existence of conflicts of interest between the business activities of potential buyers and the management of the banking corporation, are also examined.

In 2000 a joint professional committee of the Ministry of Finance and the Bank of Israel examined alternatives to selling the controlling interest of Bank Leumi. Several recommendations were made, the main one being to sell the control core either to a strategic investor or via the stock exchange.

The process of selling the controlling interest in Discount Bank also continued during 2000. The candidates did not propose a group considered worthy of receiving a permit for its purchase from the Governor of the Bank of Israel, and the sale process was stopped. At the beginning of 2001 Otzar Hashilton Hamkomi Ltd. was sold to the Daxia group from France

### **Box 6.1 Preventing Money Laundering in Israel**

#### *Background*

The purpose of money laundering is to obscure the source of money that originates from criminal activities—generally those associated with organized crime or other capital-intensive felonies, such as drugs trafficking, illegal arms trade, prostitution, gambling, theft, etc.—by severing the link between the money and criminal activity. Money laundering has the potential to increase crime, because of the large profits involved, and also hampers the collection of evidence of the original crime. In the long run, it is accompanied by the endemic corruption which can ultimately undermine the stability of the democratic regime.

The war against money laundering has recently been given prominence on the public agenda of western countries. In June 2000 the FATF organization<sup>1</sup> published a 'black list' of 15 countries which are not cooperating in the war

<sup>1</sup> Financial Action Task Force, the international body heading the war against money laundering.

on money laundering. Since Israel has been slow in introducing the relevant legislation it appears on that list.<sup>2</sup>

In 2000 Israel took significant steps to combat money laundering—steps which are essential in order to be considered one of the countries fighting this phenomenon and to be removed from the FATF’s black list. The most prominent steps were the passage of a law against money laundering and the order issued by the Governor of the Bank of Israel obliging banking institutions to institute procedures regarding the identification of customers, reporting of transactions, and management of records. As a result, FATF noted (in February 2001) that Israel is one of the countries fighting money laundering by legislation, but added that legislation alone is not enough to ensure removal from the black list, and that the test will be in its implementation.

*Prohibition of Money Laundering Law, 5761–2000*

The law prohibiting money laundering was passed by the Knesset in August 2000, and will be fully effective no later than February 2002. As well as defining money laundering as a criminal offense and determining the penalty for it (imprisonment for up to ten years and a fine of up to NIS 3 million), the law addresses issues which concern the financial and banking world, among them the obligation to obtain identification, undertakes reporting and keep records of entities providing financial services.<sup>3</sup> Other aspects covered include the following: the appointment of a compliance officer for fulfilling these obligations and supervising their implementation; the reporting requirement on the import into Israel or export from it of amounts of NIS 80,000 or more (NIS 1,000,000 or more for immigrants on their first entry into Israel), and sanctions for infringing these reporting requirements; and the establishment of an authority in the Ministry of Justice that is empowered to prohibit money laundering, receives information from financial services providers, manages a database, and transfers relevant information to the law-enforcement authorities in Israel (the police and the secret service) and to equivalent authorities abroad.

*Prohibition of Money Laundering Order (The Banking Corporations’ Requirement Regarding Identification, Reporting, and Record-Keeping)*

The Prohibition of Money Laundering Law, 5761–2000 empowers the Governor of the Bank of Israel and the ministers responsible for nonbanking reporting entities to issue orders applicable to these entities that determine

<sup>2</sup> Together with Russia, Lebanon, Panama, Lichtenstein, the Philippines, Bahamas, Cayman Islands, Dominican Republic, and others.

<sup>3</sup> A banking corporation, a member of the stock exchange, a portfolio manager, an insurer or insurance agent, a provident fund, a moneychanger, or a post office bank.

their obligations regarding the identification of customers, reporting (to the competent authority), and keeping and verifying records. The order issued by the Governor to the banking corporations on 25.1.2001 was the first to be issued and hence paved the way for others, which are currently at different stages of implementation.

The order determines *inter alia* the obligation to identify (record and verify identification particulars) recipients of services from a banking corporation, including identifying and verifying the account holder and authorized signatory, as well as recording the particulars of beneficiaries of a trust account and holders of a controlling interest in the account of a corporation, in accordance with the customers' declaration. The order also states that after an account has been closed, the identification particulars used when opening it should be kept for seven years, and that the documents regarding a transaction of NIS 50,000 or more should be kept for seven years from the day the instruction was given. In this framework, the banks are required to maintain a computerized database of account numbers, the identification particulars of account holders, authorized signatories, beneficiaries, and holders of controlling interests; service recipients must also be identified on a face-to-face basis, and an objective report submitted to the Authority for the Prohibition of Money Laundering in the Ministry of Justice<sup>4</sup> (according to the nature and amount of the transaction), as well as a subjective report (as is seen fit) on transactions that appear to be unusual.

The order requires the banking corporations to make preparations in the areas of computerization (ensuring the security of data, expanding lists, guaranteeing the interface between reporting and other software), training, and the preparation of forms and procedures. It will therefore go into effect not later than one year from the date of its publication in *Reshumot*, i.e., at the beginning of 2002.

<sup>4</sup> Such as the exchange or conversion of cash exceeding NIS 50,000; the deposit or withdrawal of cash via an account, or the transfer or receipt of cash from abroad, etc. of NIS 200,000 or more; the deposit of foreign-currency checks or international transfers of NIS 1,000,000 or more.

### 3. ACTIVITIES OF THE BANKING SUPERVISION DEPARTMENT

The main functions of the Banking Supervision Department are to maintain the stability and soundness of the banking system, an appropriate level of competition, and proper bank-customer relations; this involves ensuring that the banking corporations are properly managed so that they can meet their obligations to depositors.

The day-to-day work of the Banking Supervision Department consists of monitoring banks with respect to changes in the extent and mix of their activities, their skill in risk

management, and their ability to adapt to macroeconomic and other economic changes. This aspect of the department's activity includes gathering, analyzing and drawing conclusions from different types of banking data. There are two kinds of information: 1) quantitative, measurable data, such as income, expenditure, interest rates, fees, credit, and margins; 2) qualitative data, such as the quality of management, protection of data, adherence to procedures, completeness of the information provided to customers. Some information is gathered in the form of fixed computerized reports, and some is obtained from discussions between Banking Supervision staff and banks' managements. In the course of inspection valuable qualitative data is gathered. Complaints of the public sent to the Banking Supervision Department sometimes reflect problems encountered by many customers in banking corporations, and constitute another important source of information regarding problems in the banking system. The department keeps abreast of new international approaches to banking supervision, banking research from around the world, and the practical conclusions to be drawn from them all.

A review of the activities of the Banking Supervision Department in 2000 follows.

### **Regulating banking activity**

The regulation of banking activity, together with primary and secondary legislation, is a central tool in banking supervision, guiding banking institutions with regard to the Supervisor of Banks' directives on various banking topics. Most directives are intended to regulate the activity of banks' directors and managements, improve internal and external reporting systems, strengthen internal auditing, and ensure that banks' managements act responsibly, properly, and prudently in running their corporations. Regulation is based on processing and analyzing data received by the Banking Supervision Department from various sources, is then translated into directives and rules of conduct for banks, and is issued as: *The Proper Conduct of Banking Business Regulations; Guidelines for Preparing Reports to the Public; and Guidelines for Preparing Reports to the Supervisor of Banks*. The main regulatory directives published in 2000 in the spheres of reporting to the public, risk management, bank-customer relations, etc. appear in the appendix to this chapter.

The principal item secondary legislation formulated in 2000 (and published in January 2001) was the Prohibition of Money Laundering (the Banking Corporations' Requirement Regarding Identification, Reporting, and Record-Keeping) Order, which is an important preliminary stage of the Prohibition of Money Laundering Law, 5761-2000 (see Box 6.1). Its main aim is to prevent the use of the banking system as a tool for money laundering.

### **Evaluation**

The Evaluation Unit consists of seven teams, five of which are responsible for evaluating the banking groups; the other two evaluate the small independent banks, one of them combining evaluation with examination, the other dealing with evaluation and licensing.

The units monitor each banking corporation and prepare current assessment reports of their financial situation, management, and risks (including their subsidiaries and branches abroad), as well as special assessments of specific subjects. The analysis of the banking corporations' situation is based on data taken from various sources—primarily banks' reports to the public and the Bank of Israel, examiners' reports prepared by the Banking Supervision Department's supervision units, information received during the course of discussions with the senior management of the banking corporations, irregularities indicated by complaints from the public, and even information obtained from the written and electronic mass media.

In addition to undertaking monitoring and evaluation, the economists of the Institutional Evaluation Unit deal with various requests from banks (to open overseas offices, implement activities in new fields, issue capital notes, etc.). In 2000 the unit dealt *inter alia* with the following topics:

- Assessing banks' risk management: their ability to meet the Banking Supervision Department's requirements regarding risk management (a regulation dealing primarily with managing market risk was issued);
- The banking corporations' exposure to foreign-currency credit;
- Approving the issuance of capital notes by banks and monitoring the development of capital ratios, particularly in banks that are close to the minimum;
- Dealing with the regulation of banks' holdings in corporations abroad and licenses to establish them; this topic received special attention in view of the banks' preparations to establish financial holding corporations in the US following the change in the law there;
- Reviewing the effect of possible interbank mergers on competition in the banking system, on activity, and on margins (in cooperation with other units);
- The banks' compliance with the requirements of the Banking Supervision Department regarding transactions with parties at interest;
- Changes in the area of ownership of credit card companies and the issue of licenses for this;
- Monitoring the entry into Israel of branches of foreign banks, and preparing to establish a supervisory framework for these branches.

## **Inspection**

The Inspection Unit consists of six teams which deal with specific aspects of banking activity: credit and collateral; internal audit and management; risk management; bank-customer relations and the capital market; information systems; the sixth team inspects all these areas in the independent banks.

The work of the inspection teams involves gleaning information directly from the banks' books and documents. The process of examination is intended to ensure the proper conduct of banking business, including *inter alia* adherence to the Supervisor of Banks' regulations on this subject as well as to the provisions of the relevant laws. The unit's reports warn of deficiencies found and define goals and timetables for amending them.



The activity of the Inspection Unit is set out in periodical work programs, supported by cyclical targets for covering the specific subjects examined. About one third of the unit's inputs are devoted to subjects and risk-related issues that are clarified on an ad hoc basis during the year.

In the area of credit, in 2000 emphasis was placed on the infrastructure for controlling and monitoring credit activities. The credit-rating mechanisms developed in the banks themselves were examined, and the procedures for identifying and classifying problem debts were evaluated. From the industry standpoint, the main focus was on the construction and real-estate industry, which is currently in difficulties, and a review of transactions involving the acquisition of a controlling interest using bank finance was begun.

In the area of management, monitoring and internal audit, emphasis was placed this year on separating day-to-day management duties, for which the executive echelon is responsible, from those of supervising and monitoring the activities of the executive echelon, for which the board of directors is responsible. In addition, special attention was paid to compliance with procedures regarding identification and restrictions on transactions with interested parties.

Under the rubric of risk management, the examination of the systems for managing market risks continued, and considerable resources were allocated for inspecting the management of the exposure arising from the activities of a bank and its customers in the money and capital markets.

In the area of bank-customer relations and the capital market, the banks' adherence to the provisions of the law regarding advice on investment in mutual funds was examined, in the context of the views expressed on this subject by the Securities Authority. The inspection of the activity of banks and the corporations they control in the capital market continued in order to prevent conflicts of interest. Various aspects of the developing competition in the credit card market were examined. The adequacy of activities in the areas of managing variable-interest loans, early-repayment fees, interest calculations, and proper disclosure were also reviewed.

In the sphere of electronic data processing and information systems, emphasis was placed on the online banking services, especially via the internet, that have been developed in the last two years. The processes of computerized systems conversion were also examined, as were aspects of the outsourcing of computer services.

### **International relations**

In the wake of globalization, the expansion of Israeli banks' international activities, and the growing interest of foreign investors in Israel's banking system, a special unit has been set up for international relations. Cooperation and the exchange of information between international supervisory authorities has become an integral part of the work in this unit, in accordance with the recommendations of the Basle Committee on Banking Supervision, which determined standards and norms for banking supervision in countries where foreign banks are present.

The main subjects in this area are:

- Gleaning data on the regulatory policy of supervisory authorities and international entities abroad from various sources and transferring it to the relevant units in the Banking Supervision Department;
- Pro-active follow-up of subjects that are important to the Banking Supervision Department, and assisting in the licensing process, where specialized knowledge of aspects of banking abroad is required;
- Analysis of trends and developments in banking abroad which have implications for banking in Israel;
- Maintaining contact with supervisory authorities abroad and international bodies in order to create an infrastructure of information channels—*inter alia* in order to exchange information as required under the core principles of the Basle Committee;

In the last months of 2000 the international relations unit dealt with some of the topics listed above. A large part of its work involved dealing with the IMF delegation that visited Israel in September and examined *inter alia* the standards of the Banking Supervision Department and the exchange of information with international supervisory authorities.

### **Research**

The research unit serves the Banking Supervision Department as a task force for the examination and analysis of the effects of macroeconomic and other factors on the performance of the banking system and the risks it faces, i.e., its financial stability. The unit monitors developments in banking throughout the world, and keeps abreast of new approaches to such subjects as the management of assets and liabilities, risk management, assessments and methods of hedging, capital adequacy, etc.

Information gained from the professional literature and research projects provides a basis for position papers and research on supervision topics, for developing new tools for assessing the performance of banking institutions, formulating banking regulations, and for adopting other measures intended to advance Israel's banking system.

The following are some of the subjects studied by the unit in 2000:

- Estimating credit risk in banking on the basis of the credit-rating model;
- The optimum structure of the banking system;
- An examination of risk-adjusted return and the optimum asset structure in Israel's banking system;
- Competition in the banking industry, using indices of 'market power.'

These studies appeared in the department's research publication *Banking Review* (in Hebrew).

### **Banker-customer relations**

Protecting the rights of banks' customers and ensuring fairness in bank-customer relations are important both *per se* and for maintaining the stability of the banking system.

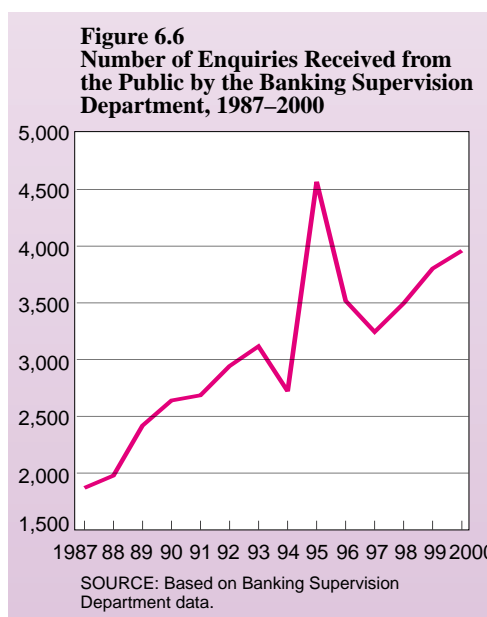
In order to ensure that banks comply with the legal and regulatory requirements in this regard, the Banking Supervision Department operates by means of the Public Enquiries Unit, in addition to the Inspection team operating in the same area. As well as clarifying complaints from the public, the Public Enquiries Unit serves to reveal weak spots in the system by deploying an incognito inspection team. A team also monitors the fees and prices charged by the banks, and checks standard bank-customer contracts in order to ensure that they do not contain any discriminatory clauses. The team that is engaged in this work publishes six-monthly comparative tables of the banks in specific areas.<sup>15</sup> The object of these comparisons—especially of the fee index—is to help the public obtain information about the cost of the services offered by the different banks.

Within the framework of the examination of standard contracts, the Banking Supervision Department is acting to cancel discriminatory clauses in contracts with respect to current accounts.<sup>16</sup> Contracts of association between the banking corporations and customers regarding activities on the internet and by means of credit cards were also examined in 2000.

#### *Public enquiries*

Under the Banking (Service to Customer) Law, 5741–1981,<sup>17</sup> the Supervisor of Banks is responsible for the protection of bank customers’ rights, and the Public Enquiries Unit operates by virtue of this law. Enquiries received include complaints on various subjects—misleading information, the provision of one service being made conditional on another, exaggerated or unjustified fees, discriminatory clauses in contracts, unacceptable service, problems associated with credit cards, checks, savings schemes, etc.

In 2000 the Public Enquiries Unit received 3,959 written enquiries; 4,260 investigations—some of them from previous years—were completed.



<sup>15</sup> The cost of holding a current account or a securities account, and comparative tables of fees in the five major banks.

<sup>16</sup> Arguments were recently placed before the Court for Standard Contracts in connection with the request to abolish discriminatory clauses in Bank Leumi’s current account contract.

<sup>17</sup> The law states that “The Supervisor shall investigate complaints by members of the public concerning their business with banking corporations as far as they appear to him to be of some substance, and shall exercise his powers under the Banking Ordinance, 1941, for this purpose.”

Of the 2,111 complaints on which the unit adopted a position (i.e., justified, partially justified, or unjustified), 741 (35.1 percent) were found to be justified or partially justified. The unit did not take a position on 765 enquiries,<sup>18</sup> and 176 of these were transferred to the relevant bodies to be dealt with after it had been decided that they did not fall under the jurisdiction of the unit. 1,384 approaches were classified as requests for clarification or information arising mainly from ignorance of banking procedures and regulations or from the need for additional information (Table 6.8).

The resolution of about 205 queries had implications either for an individual bank or for the whole of the banking system, and resulted in the publication of regulations requiring that some procedures be amended, employees' adherence to them revised, bank documents amended, etc.

**Table 6.8**  
**Results of Enquiries, Treatment of Which was Concluded, 1999–2000**

	1999		2000	
	Number of enquiries	Percent of total enquiries	Number of enquiries	Percent of total enquiries
<b>Number on which stand was taken</b>				
Number found wholly or partly justified	837	19.6	741	17.4
Number found unjustified	1,202	28.2	1,370	32.2
<b>Total</b>	<b>2,039</b>	<b>47.9</b>	<b>2,111</b>	<b>49.6</b>
<b>Number on which no stand was taken</b>				
1. Treatment stopped due to legal action	173	4.1	154	3.6
2. Treatment stopped for other reasons	181	4.2	236	5.5
3. Not within unit's jurisdiction	148	3.5	176	4.1
4. Unable to take a stand	232	5.4	199	4.7
<b>Total</b>	<b>734</b>	<b>17.2</b>	<b>765</b>	<b>18.0</b>
<b>Requests and clarifications</b>				
Requests	422	9.9	637	15.0
Clarifications	756	17.7	747	17.5
<b>Total</b>	<b>1,178</b>	<b>27.7</b>	<b>1,384</b>	<b>32.5</b>
<b>Total number of enquiries treatment of which was concluded</b>	<b>3,951</b>	<b>92.7</b>	<b>4,260</b>	<b>100.0</b>

SOURCE: Banking Supervision Department.

<sup>18</sup> Because they were withdrawn, there were conflicting accounts, the subject was *sub judice*, a settlement was reached between the customer and the bank, or for other reasons.

- *Abolition of management fees for savers in financial institutions:* following complaints from savers, the terms of association between them and the fund were examined. It was found that these terms do not permit fees to be charged; consequently the Bank of Israel ordered that the fees that had been charged be repaid to the savers.
- *Benefits for pensioners:* the examination of complaints regarding fees charged for a magnetic card issued to a group of pensioners by one of the banks was expanded to ascertain whether these pensioners had received all the benefits due to them under the bank's own internal circular. In the wake of the examination, the bank was instructed to repay the customers the fee it had charged them for credit allocation over several years even though the bank had stated in its own circular that they would be exempt from this fee. The fees were repaid with interest and CPI-indexation from the date they were first charged.
- *Exposing clients to risk:* the examination of a complaint revealed that at a branch of one of the banks some customers had been encouraged to take a dollar loan and invest it in a local-currency, CPI-indexed savings scheme. In the unit's opinion, the branch's action was unacceptable, as it is unreasonable for a bank to expose its customers to risk. We instructed the bank to cancel the loans and savings schemes forthwith and repay all the customers the amount of the monthly payments to that date with interest and indexation.
- *Referring borrowers to committees of the Ministry of Construction and Housing:* the banks act to realize an asset in cases where borrowers cannot meet the terms of their mortgage. In the wake of complaints from new immigrants to a Knesset committee, the Banking Supervision Department told the mortgage banks to publish a notice in the Russian language stating that immigrants who had difficulties in repaying a mortgage could apply to the inter-ministerial committee. When it transpired that this problem was not confined to immigrants, the Banking Supervision Department instructed the banks to publish clear directions on the subject for all borrowers.

In some instances, the implications arising from the investigation of a specific subject required regulation in the field of bank-customer relations. The salient subjects that arose in 2000 were as follows:

- *Procedures for extending a housing loan:* amendments and additions were introduced by the Regulation Unit into the procedures for extending housing loans. These included inter alia offering borrowers one of three alternative repayment dates during the month (the first, tenth or fifteenth of the month),<sup>19</sup>; a uniform system of accounting was determined for cases in which the day in the month on which the loan is repaid is not the same as the one on which it was extended; proper disclosure regarding variable-interest CPI-indexed loans was extended,

<sup>19</sup> The amendment does not apply to directed loans, to loans incorporating directed loans, or to loans extended before 1 July, 2000, when the regulation went into effect.

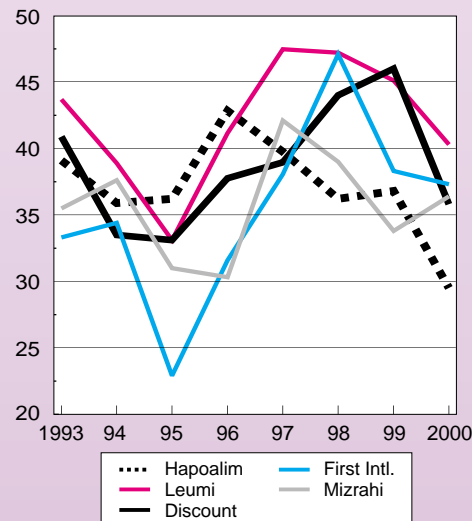
including setting an objective external basis for changing the interest rate. The purpose of other new regulations is to prevent pressure from being exerted on home-buyers to take a mortgage only from a banking corporation associated with a specific contractor or developer (endorsement of guarantee), or to prevent a borrower from taking a loan from a banking corporation if he has already borrowed from another bank (junior lien).

- *Minors' accounts:* it was decided that a minor aged 14 or more should be permitted to withdraw money by means of a debit card only if there was a positive balance in his or her account. This was made possible once it became clear that technological advances enable cash withdrawals to be restricted in this situation. The regulation was amended accordingly.
- *Debit by means of a bi-monthly report on credit-card transactions performed abroad:* since debits for foreign-currency transactions implemented abroad are deducted from a customer's account upon receipt of the debit notice from abroad, the Banking Supervision Department initiated an amendment to the Debit Card Regulations, 5746–1986. Under the amendment, which went into effect on 1 August 2000, credit card companies are obliged to give a customer, at his request, notice of debits against transactions implemented abroad not later than 17 days after the date on which his account was debited for the transaction.

#### *Incognito inspections*

One of the unit's teams undertakes incognito inspections. Its members visit bank branches without identifying themselves and check the accuracy and comprehensiveness of the information given to potential customers as well as the extent to which banks comply with banking regulations and legislation regarding bank-customer relations. The intensification of the team's activity has led to heightened awareness and the correction of many of the faults revealed. The banking corporations have recently begun to deploy incognito inspection teams of their own in order to examine their branches.

**Figure 6.7**  
Percent of Justified Complaints<sup>a</sup>  
among Total Complaints against the  
Five Major Banks, 1993–2000



<sup>a</sup> On which the unit took a stand (i.e., justified or partially justified/unjustified).  
SOURCE: Based on Banking Supervision Department data.

### *Examination of banks' fees and standard contracts*

An international comparison of fees<sup>20</sup> was undertaken in 2000, and the subject of fees for the annulment of liens was studied. As a result, the Bank of Israel instructed several banks to stop charging this fee and refund money taken for it at its real value. In addition, reports to customers of changes in fee rates and the introduction of new fees by the credit card companies was examined, and as a result companies were required to inform customers of these in their monthly statements. Rules were also issued for the layout of standard contracts with reference to the minimum size of lettering, emphasis of headings and substantive clauses, and the spacing between lines.

Discussions are continuing in the Standard Contracts Court regarding the request to abolish discriminatory clauses in Bank Leumi's current account contract. One of the mortgage banks was also required to cancel discriminatory clauses in its housing loan contract, and it was decided that additional clauses, to whose amendment the bank did not agree, would be brought before the court.

## **Information and financial reporting**

### *Information and reporting unit*

The Information and Reporting Unit assembles the information in the Banking Supervision Department, and manages its databases. As the directives in *The Proper Conduct of Banking Business Regulations* are formulated in the department, this unit translates the regulations and constraints into reporting guidelines, constructs the reporting format, and invests resources in developing sophisticated reporting tools (including *inter alia* logical checks that improve the quality of the data received). After the data are absorbed into the system they are processed and cross-checked with data from other information systems in the unit. Converting the data into usable and available information is an important part of the unit's function.

Backed by this information, the unit monitors banks' compliance with the limitations of the Banking (Licensing) Law, 5741–1981 and *The Proper Conduct of Banking Business Regulations*, and follows up on the steps required to be taken by banks in which irregularities have been discovered. Due to the complexity of the Banking Supervision Department's information systems, the unit also deals with their incorporation by the banks.

The information is passed on to various outside parties, and the banks receive feedback from them. The unit handles more than 600 enquiries every year from various economic entities, and publishes (also on the internet) the maximum and average rates of interest on the 'gray' market, used to calculate the fee for early repayment of mortgages to the mortgage banks.

The unit issues several publications: *Annual Information on the Banking Corporations*, containing information on the banking system in Israel<sup>21</sup> over a five-year period; *Current*

<sup>20</sup> The main findings may be found on the Bank of Israel's Hebrew website, [www.bankisrael.gov.il](http://www.bankisrael.gov.il).

<sup>21</sup> This also appears on the Bank of Israel's website (see previous note), under Information and Data.

*Information on the Banking Corporations*, a loose-leaf binder containing updated information on the banking system in Israel; and *Main Data on the Activity of Each Bank*, a quarterly publication (in Hebrew) comparing the different banks, based on information obtained from their financial statements.

In conjunction with the Financial Statements Unit, the unit examines banks' 'working documents' to check the reliability of the data received. Irregularities discovered in the course of these inspections prove the need to continue the process of assimilating reporting systems in banks.

#### *Financial Statements Unit*

This unit's main function is to initiate changes and improvements in the *Guidelines for Preparing Reports for the Public*, and audits financial reports at the level of the entire banking system and for the individual bank.

In 2000 checks were performed in the accounting area covering issues such as disclosure of the minimum capital ratio in the directors' report and of housing loans in commercial banks, and the weighting of problem housing loans in the minimum capital ratio of the mortgage banks.

The unit also dealt with new directives regarding reporting to the public, including:

- A directive regarding "Accounting in relation to derivatives and hedging activities."<sup>22</sup>
- A provisional directive on "A qualitative report on exposure to market risks and methods of managing them."
- Guidelines were issued regarding the disclosure of housing loan activity by commercial banks, including the method of making provision in accordance with the depth of arrears.

#### **Licensing**

The Licensing Unit deals with all aspects of licensing banking corporations. It reviews requests from banking corporations for permits under the Banking (Licensing) Law, 5741–1981, and when it deems it appropriate it submits a recommendation to the Governor of the Bank of Israel or the Supervisor of Banks to grant a license under the provisions of the law.

The unit also deals with examining the suitability of candidates for purchasing a controlling interest and/or core holding in a banking corporation; in this framework, with the aid of other units in the department it examines, the probity and financial robustness of the applicants, and submits its recommendations.

During 2000 the unit dealt *inter alia* with the following subjects:

- The suitability of the candidates for purchasing the core holding in Discount Bank; this was examined in conjunction with employees from other units in the department;

<sup>22</sup> Circular no. 1992-06 dated 17.01.2000.



- The suitability of the candidates for purchasing the core holding in Otzar Hashilton Hamkomi Ltd., also in cooperation with employees from other units in the department;
- Granting a permit to HSBC to open a branch in Israel;
- Participating in the committee examining alternatives to the continued privatization of Bank Leumi.

### **Payment systems and credit cards**

The activity of the Payment Systems Unit concentrates on all the regulatory and supervisory aspects of the payments system in Israel, including credit cards and the clearing house, as well as subjects related to bank-customer relations.<sup>23</sup>

#### *Credit cards*

The credit card companies are auxiliary corporations inspected and supervised by the Supervisor of Banks. In 2000 the Banking Supervision Department issued directives regulating the activities of these companies, including one dealing with amending the record in a customer's account. Work is currently being done on regulating the activities of these companies and also as regards proper disclosure by them.

#### *The clearing house*

There is an ongoing process of clearing local currency that does not derive from checks via the interbank clearing house. In October 2000 the Clearing House Committee decided that one-off credits would also be cleared in this way.

#### *Large payments system*

The globalization of the money and capital markets has led many countries to construct systems for clearing large amounts in real time, in order to significantly reduce credit risks during the clearing process. Systems that clear in real time have become the standard, and one of the conditions for joining the euro zone is the existence of such a system. The Banking Supervision Department expects the banks to begin managing the credit risks due to the process of clearing local currency, and approached them in this connection in 2000:IV as a step towards establishing a large payments system.

### **Special activities**

#### *Checks without cover*

This section, in cooperation with the commercial banks, operates a complex computerized system for dealing with checks without cover. The system is based on the provisions of the Checks Without Cover Law, 5741–1981, which was last amended in 1992. In 1994

<sup>23</sup> Various subjects connected with the relations between the payers (the customers) and the clearers (the banking corporations).

and 1995 the authority to restrict banks' customers was extended in a series of new laws which also apply to customers with files against them in the Execution Office, who refuse to grant their spouses divorces despite court orders to do so, and with bankruptcies. Most of the restricted customers (77,000 at the end of 2000, the same as at the end of 1999) were issuers of checks without cover. At the end of 2000 the number included about 9,600 with files against them in the Execution Office or who had refused to divorce their spouse.

Each month an average of 5,000 new customers who have been reported to the Bank of Israel are added to the restricted customer database in connection with about 6,000 checking accounts<sup>24</sup> that have been restricted because checks have been returned.

**Table 6.9**  
**Restricted Customers and Accounts, 1996–2000**

	1996	1997	1998	1999	2000	(end-of-year) Rate of change in 2000 (%)
Restricted accounts	160,258	162,486	150,447	138,754	135,500	–2.3
<i>of which</i> For checks returned	96,805	113,533	106,389	97,390	93,797	
Restricted customers	81,668	87,510	82,621	77,365	76,860	–0.6
<i>of which</i> Restricted in aggravated circumstances	38,625	44,285	40,862	36,470	33,632	–7.8
Special restrictions	1,588	2,725	4,177	6,765	9,628	
Percent of those restricted in aggravated circumstances	49	54	55	56	44	

The downward trend in the number of restricted customers and accounts evident since 1998 continued in 2000. In annual terms the reduction is about 2.3 percent (Table 6.9). The tightening of control systems by the Bank of Israel and the banks, through the stricter enforcement of credit limits, provides a partial explanation for this trend. This may be the banks' response to the rise in credit risks due to the economic slowdown.

An analysis of restricted customers by restriction characteristics indicates conflicting trends: while the number of new restricted customers and customers restricted in aggravated circumstances contributes to the overall decline in the number of restricted customers, the rapid increase in the number of customers with 'special restrictions' (in the Ministry of Justice database) is continuing.

The computerized systems dealing with restricted customers are highly sophisticated. Most of the section's work-load therefore consists of guiding the banking system in dealing with processes and handling excursions and complaints. Some 3,000 written requests for clarifications or other action were received from the public and other entities

<sup>24</sup> Some customers have several restricted accounts.

in 2000, of which 1,500 were appeals lodged in the courts (1,300 in 1999). This figure does not include telephone requests (about 10,000) for clarification and information. An IVR (interactive voice response system) deals with the most common approaches from restricted customers. Approximately 500 of the phone enquiries they make each month (about half the total number of such enquiries) are dealt with via the IVR.

The Bank of Israel makes the information about restricted accounts available to the public in various ways: up-to-date circulars are sent to large firms, and there are also recorded messages and a page on the Bank of Israel's website.

#### *Readiness for emergencies*

In the framework of the domestic state of emergency system, the Supervisor of Banks is responsible for the management of banking activity. The banking system is part of the general economy, but due to the industry's relatively large size, special arrangements relating to banking have been formulated. In 2000 attention was focused on establishing and operating temporary bank branches in concentrations of evacuated population.

#### *Arab banks in Judea and Samaria*

The banking system in Judea and Samaria is supervised solely (since the end of 1995) by the Palestine Monetary Authority. This system comprises 22 banks: 6 domestic banks, two British banks, two Egyptian banks, and 12 Jordanian banks. All of these together have about 100 branches, with total assets of some \$ 2 billion. Almost all these banks operate in close cooperation with the Israeli banks, and for all of them an Israeli bank serves as the connecting link with the Israeli system. Thus, the Banking Supervision Department does not supervise the Arab banks in Judea and Samaria, and merely provides technical assistance to the Palestine Monetary Authority in coordination with the Israeli banking system.

After the transfer of authority there was only one branch of an Israeli bank (Mercantile Discount in Bethlehem) in the area controlled by the Palestinian Authority, and towards the end of 2000 it ceased operations following differences of opinion between the bank's management and the Palestine Monetary Authority. The remaining branches in Judea and Samaria are located in Jewish settlements, and remain part of the Israeli banking system.

The Supervisor of Banks was also responsible for administering the assets of the closed Arab banks. In the past, the Supervisor of Banks was given custody of 42 branches of those banks in Judea and Samaria, the Gaza Region, north Sinai, and east Jerusalem. Over the years the Banking Supervision Department dealt with levying thousands of mortgages extended in the past to the local residents, as well as with other aspects of the property of these banks. This activity has gradually diminished, because branches were restored to the reopened banks. In 2000 this was implemented in only a few branches in east Jerusalem. In the first half of 2001 the Banking Supervision Department's treatment of this subject concluded, and it came under the responsibility of the Custodian of Absentee Property.

**APPENDIX 6.1**  
**Activities of the Banking Supervision Department in 2000**

- 13 January      1. In the framework of the *Guidelines for Preparing Reports to the Public*, a provisional regulation was issued regarding qualitative reporting on exposure to market risks and ways of managing them.  
2. A regulation on the subject of authorized debits set out a procedure for implementing a change in the account of a debtor on the basis of a written authorization from one bank to another, and also for the way the banks—the transferer and the transferee—should act. This refers to instances in which the original written authorization was not found by the transferring banks and/or was not given by the customer to the receiving bank.
- 17 January      In the wake of a rise in the extent of activity in financial derivatives in the banking system, and the publication of an accounting rules standard on the subject in the US, a regulation was issued regarding accounting procedures for derivatives and hedging activities. The regulation determines accounting and reporting rules for transactions in derivatives (including those incorporated in other contracts) and hedging activities, and requires a banking corporation to acknowledge all derivatives as assets or liabilities in its balance sheet, and to measure them according to their ‘fair value.’
- 7 February      With the introduction of the Companies Law, 5749–1999, on February 1, 2000, its implications for the *Guidelines for Preparing Reports to the Public* were examined and the relevant sections amended.
- 28 February    The regulation regarding procedures for extending housing loans was amended as follows:  
1. Three alternative repayment dates during the month were set;  
2. A uniform accounting system was determined for cases in which the monthly date set for repaying the loan is not identical with the date on which it was implemented.
- 19 March      The Banking (Dormant Accounts) Order, 5760–2000 was issued, determining the ways money in dormant accounts should be invested.

- 25 May            1. At the request of Bank Leumi, the license of the Leumi and Co. Investment House Ltd. as a merchant bank was revoked;  
2. A merchant bank license was issued to Bank Leumi Merchant Bank Ltd.
- 15 June            The Supervisor of Banks instructed banking corporations to refrain from repurchasing shares of the banking corporation until the subject had been settled by means of a Proper Conduct of Banking Business Regulation, even though the Companies Law, 5749–1999 permits a company to buy shares as aforesaid in the framework of a ‘distribution,’ and under the conditions determined in the law.
- 5 July             1. In the framework of the *Guidelines for Preparing Reports to the Public* it was decided that starting with the reports to the public of 30 June 2000 banking corporations will be required to report in NIS millions.  
2. In view of the increase in derivatives transactions by banking corporations, it was decided that the disclosure format in reports to the public should be brought up to date to reflect the effect of derivatives transactions on rates of income and expenditure, in the framework of assets and liabilities management.
- 27 July            In the wake of the expansion of activity in derivatives in the banking system, the banking corporations were obliged to submit a report on the indexation balance to the Supervisor of Banks, i.e., a monthly report (on the basis of the individual bank) and a quarterly report (on the basis of the individual bank and on a consolidated basis). The purpose of this is to obtain a comprehensive picture of risk exposure.
- 31 July            1. In the framework of the *Guidelines for Preparing Reports to the Supervisor of Banks*, the date for submitting a mortgage bank’s monthly report on credit extended to the public and deposits received from the public during the month (information on interest) was brought forward to four days after the end of the reported month. The change will enable the Supervisor of Banks to announce and publish the average interest rate sooner, so that the banking corporations will be able to adjust the interest on variable-interest loans on the basis of the published rate.  
2. The Bank of Israel published the *Annual Report of the Supervisor of Banks* for Israel’s banking system in 1999.
- 13 August        A license for a foreign bank was granted to Standard Chartered Bank.
- 4 September     The regulation regarding procedures for extending housing loans was

amended as follows:

1. The definition of a 'housing loan' was extended to include a loan extended upon the mortgaging of a dwelling, in accordance with section 13 of the Banking Ordinance, 1941;

2. A banking corporation is required to set a reasonable period, of not less than ten days, within which a borrower may conclude the procedure for obtaining a loan; in that case the interest on the loan shall be as determined at the beginning of the period;

3. For CPI-indexed loans, where the interest is not fixed throughout the loan's duration, it is determined that the basis for setting the interest rate on the loan at the time it is changed shall be objective and external. The banking corporation must inform the borrower of the adjusted annual interest rate throughout the duration of the loan, with reference to the information known at the time and bearing in mind the basis for determining the interest rate on it. This should be done close to the date at which the procedure for obtaining the loan is begun.

5–19 September An IMF (International Monetary Fund) delegation visited Israel and examined *inter alia* the stability of the financial sector and the standards of the Banking Supervision Department, in accordance with the core principles set by the Basle Committee on Banking Supervision.

19 September At the request of Discount Bank, the license granted to it to establish a merchant bank was cancelled.

20 September In the wake of the Proper Conduct of Banking Business Regulation regarding the allocation of capital against exposure to market risks, the banking corporations are required to submit a quarterly report to the Supervisor of Banks on the allocation of capital against this exposure.

26 September 1. In the light of the banks' assertions that technological advances enable them to limit withdrawals by means of a bank card to a situation in which there is a positive balance in the account, the regulation regarding accounts of minors was amended to enable a minor aged 14 or more to withdraw money by means of a debit card.

2. In the amendment to the regulation regarding the minimum capital ratio, it was established that it is not possible to hold Tier 2 capital against Tier 1 capital allocated for market risks.

6 December Banking corporations are required to give the Supervisor of Banks 45 days' notice of the purchase of control or an interest in a corporation

abroad, and must submit reports on the corporation abroad as determined by the Supervisor. This directive is issued in the context of the expansion of the banks' activities abroad following the relaxation of foreign exchange control in Israel, and the abolition of the need for Israeli banking corporations to obtain a permit to buy or establish subsidiaries abroad. The steps the management of a banking corporation must take in order to ensure the existence of supervision and monitoring of the corporation abroad are issued.

- 28 December A license for a foreign bank was issued to HSBC Bank Plc.
- 31 December A comprehensive revision of the banking supervision regulations in the light of the Companies Law, 5759–1999 was completed, with particular reference to matters connected with the work of the board of directors.

**The Banking Supervision Department: Organizational Structure**

