

## Chapter 4

# *Activity of the Banking Supervision Department*

In its 2008 activities, the Department focused on maintaining the stability of the banking system, adopting and assimilating the Basel II directives in the banking system and at the Department, enhancing competitiveness and efficiency in the banking system, improving relations with supervisory authorities abroad, assuring greater fairness toward customers, and developing its human resources.

More generally, one may express these activities as three goals of banking supervision—the “three S’s”: stability, safety, and structure.<sup>1</sup> In 2008, these goals were reflected in keeping the banking system stable and resilient in a changing economic environment under crisis and emergency conditions (stability), safeguarding depositors’ money and enhancing banks’ fairness toward customers (safety), and striving to make the industry more competitive and efficient (structure).

The Department’s unrelenting occupation with the stability of the banking system—pursuant to the financial and real crisis described at length the previous chapters of this Annual Review—was the focus of special attention and the object of special thought and resources in 2008. This concern was manifested chiefly in mapping and quantifying main domestic risks and exposures to flashpoints of risk abroad, and in taking measures to minimize them.

Concurrently, the Department continued to adopt and assimilate the Basel II directives ahead of the full implementation of the directives in Israel’s banking system by December 31, 2009, and adopted the upward trajectory of capital adequacy that is intended to raise the banks’ capital ratio to 12 percent by that date.

Much has been written about the lack of competition among Israeli banks, especially in the household and SME sectors. The bank-fee reform, implemented in the first half of 2008, was meant to create transparency and consistency in the prices of banking services by reducing the number of fees and standardizing their names. This, in turn, is intended to further the consumer’s ability to comparison-shop, thereby enhancing competition. Indeed, as of the present writing, the number of fees has decreased steeply (as has the share of bank revenues that is derived from the array of banking services). We intend to pursue the trend further.

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<sup>1</sup> For a broader discussion, see Joseph F. Sinkey, Jr. (2002), *Commercial Bank Financial Management in the Financial Services Industry*, 6th Edition, Chapter 16.

This chapter describes at length the Department's work, parsed by the aforementioned goals. In its first section, we describe the actions taken by the Department to keep the banking system stable, with emphasis on the special measures adopted in the review year in response to the financial and real crisis. In Section 2, we describe the Department's actions in regard to bank-customer relations—actions that, as stated, are meant to protect depositors' money and make banks treat their customers more fairly. Finally, we describe what the Department has been doing to make the banking system more competitive and efficient and offer a broader account of actions in 2008 to apply the bank-fee reform.

## 1. STABILITY: MAINTENANCE OF BANKING SYSTEM STABILITY

Maintaining the stability and resilience of the banking system in a changing economic environment is one of the Banking Supervision Department's principal goals. The Department's continual and ongoing actions in pursuit of this goal, such as adopting the Basel II directives, were augmented this year in view of the financial and real crisis that swept the world, not overlooking Israel, in a series of special measures.

### a. Actions by the Department to cope with the financial and real crisis

In 2008, chiefly in the second half of the year, the Department addressed several important issues relating to the ongoing stability of the banking system amid the global and domestic financial and real crisis. It instructed the banks to increase the frequency of some of the reports that they present the Department and to submit new reports on several matters that are prone to the effects of the crisis. Pursuant to this reportage, some of which was done on a one-off basis, the banks were issued with new directives.

#### —Reporting exposure to foreign financial institutions and countries

In September 2008, as the financial crisis in the United States spread to the global economy, the banks in Israel were instructed to report to the Department more frequently about their exposure to foreign financial institutions wherever such exposure exceeded a certain percent of the bank's equity. Thus, the banks were asked to report immediately about exposure to any foreign financial institution that had adverse indications such as bankruptcy, sale to another bank, nationalization, major losses, recourse to government aid, credit downgrading, or severe exposure to "toxic assets" or troubled economies.

The Supervisor of Banks also instructed the banks, on November 2, 2008, to provide—starting with their Q3-2008 financial statements—separate quantitative and qualitative reportage about their credit exposure to foreign financial institutions.

On January 1, 2009, pursuant to these reports, the Supervisor of Banks sent the banks a letter asking them to make separate reference in their credit policies to borrowers who

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conduct their main activity in high-risk countries and to liabilities for which the source of payback is based on assets located in such countries, including quantity constraints on exposure to such credit, the determination of safety coefficients in its availability, and the use of methods for the classification of credit as problematic and for loan-loss provisions. These coefficients are to be highly conservative.

### **—Reporting large exposures that are affected by the global crisis**

The banks were instructed to review, map, and estimate their exposures to entities, other than foreign financial institutions, that are directly or indirectly exposed to the crisis. The list of such entities includes, but is not limited to, financial institutions in Israel, businesses that are sensitive to changes in the stability of foreign markets and changes in capital markets, and the sort that provided guarantees or collateral against their liabilities to the bank that are themselves exposed to markets in crisis.

### **—Reporting large customers' exposures to nonbanking entities**

The banks were asked to provide special reports on large borrowers' exposures to nonbanking entities. This special reports (performed on a group basis) includes outstanding bonds issued to the public and the extent of liabilities to other entities, differentiating between short terms to maturity (during the coming year) and long terms, and noting the payback sources.

### **—Reporting large customers that show adverse indications**

The banks were instructed to report to the Supervisor of Banks about any borrower with at least one bond series trading at a yield to maturity of more than 15 percent, and whose net indebtedness exceeds a certain percent of the bank's capital base or a certain sum. The report specifies the customer's indebtedness, credit rating and classification at the time of the review, and details and results of an examination of the borrower that relates to the effects of its nonbanking debts on its ability to settle its debts to the bank, by means of a detailed analysis of its payback ability.

- **Reporting on capital-market exposures**

The banks were asked to advise the Supervisor of Banks of all exposures originating in capital-market activity, including credit exposures that surpass a certain percent of the bank's capital base. Capital-market activity includes lending for activity in securities (including derivatives) that are traded on domestic and foreign exchanges, short transactions, and transactions in OTC derivatives, among others. The banks were also instructed to report on every borrower who is active in the capital market and who overdrew its approved facility or extent of exposure (net of collateral) by a certain sum or more on seven business days among the thirty business days preceding the date of the report.

- **Assessment of the quality of credit given for the financing of acquisition of controlling interest**

In view of the considerable disparities that have recently come to light between the value of collateral in terms of securities prices on the exchange and the credit that the banks have given some borrowers for the acquisition of controlling interest, the Department believes it necessary to apply much greater caution in weighing the classification of such credit as impaired debt or making provisions in regard to it.

Accordingly, the Department asked the banks to perform a comprehensive check, by means of their credit-auditing unit (or other independent unit), of all borrowers who borrowed to finance the acquisition of a controlling interest whose balances exceed a certain sum, including credit for the acquisition of a controlling interest in non-traded companies.

The examination report must include, among other things, a detailed analysis of the borrower's payback capacity. If this capacity is based mainly on shares in the acquired company, the bank must analyze the latest valuation of said company's shares and evaluate the ability to rely on it as a source for payback. In any case, the bank must perform its own analysis of the discounting of cash flows in order to test the validity of the "company worth" as derived from proxy measures such as multipliers of cash flows, earnings, or sales. The banks must also perform stress tests on the borrower and relate to its ability to service its debt under the constraints that the test scenarios impose.

In addition to making the banks meet tougher quantitative and qualitative standards of compulsory reportage, the Department expanded its analysis of the various risks that the banks face, with emphasis on the nostro portfolio, liquidity, and credit. The banks' preparedness for the changes in their business that the financial crisis will bring about, as reflected in their strategies and policies, was also subjected to broader analysis. Checks of the impact of the financial crisis on the banks' capital-adequacy plans and their compliance with targets set by their boards of directors were performed. The Department directed the banks to increase the involvement of their boards of directors and to strengthen the board's relations with the Department. The Supervisor of Banks even made several appearances before boards of directors.

The Department stepped up its presence at the banks. It also counseled prudence in all matters relating to nostro activity and the need to maintain adequate liquidity ratios in regular operations.

The Department's International Relations Unit worked in the shadow of the global financial crisis. Its activities included, but were not limited to, the monitoring and dissemination of information to the Department's professionals about adverse developments abroad, including foreign financial institutions to which the domestic banking system is exposed. The unit also closely monitored the international attitude toward changes in individual regulation and supervision of stability as a result of the crisis and kept the Department's professionals up to date about bailout plans and protectionist policies that various countries adopted to alleviate their financial woes.

In addition to these activities, the Department established dedicated teams for the financial crisis. Some of them co-opted representatives of other Bank of Israel divisions while others were inter-office teams—including a team for the evaluation of the financial crisis and the banks' exposure to it, a team for the discovery of information from nonbanking financial institutions in emergency situations, and a team for the issue of state-guaranteed Upper Tier 2 Capital.

**b. Regular activity**

Maintaining the stability of the banking system is part of the Department's regular activity. It takes place at several levels:

Gathering and production of periodic assessments of the banks' stability and resilience (including auxiliary companies, banking subsidiaries, and branches abroad). This activity includes surveillance of the banks and changes in their mix of activities, their exposure to banking risks, and profit-and-loss factors. This level of activity also includes attention to licensing and dealing with applications that require licensing by the Governor of the Bank of Israel or the Supervisor of Banks (vetting candidates for control or the holding of a controlling interest in banks, formation of subsidiaries, branch policy, activity of foreign banks in Israel, etc.).

Another area of regular activity is the performance of inspections to assure sound banking management. The issues inspected include compliance with the Supervisor's directives in the audited fields and with provisions of law relating to areas of banking activity. The inspection reports warn about deficiencies discovered and set objectives and deadlines for their correction. An important activity in the field of inspection is credit inspection, comprised of three main domains: inspection of credit at the banking-system and individual-bank levels, the writing of position papers on specific issues related to the management of credit risks, and the implementation of Proper Conduct of Banking Business Directives that pertain to credit and the issue of instructions to the banks accordingly.

In 2008, the Department and representatives of the Israeli Money Laundering and Terror Financing Prohibition Authority discussed with representatives of MONEYVAL the findings of the report on MONEYVAL's audit in November 2007 of how Israel generally, and the Bank of Israel and the banking system specifically, deployed for the prevention of money laundering and terror financing.<sup>2</sup> Generally speaking, the evaluators stated that Israel and, especially, its banking system have installed an efficient system for the enforcement of the ban on money laundering and terror financing.

During the review year, the Department continued its regular inspection of banks in regard to money laundering and terror financing. The purpose of these inspections is to evaluate the banks' compliance with the provisions of the law, the Money Laundering and Terror Financing Prohibition Order, Proper Conduct of Banking Business Directive 411,<sup>3</sup> and their ability to prevent and detect money-laundering and terror-financing transactions. Within this framework, the inspection probes the importance that the bank attributes to everything it does, at all executive and control echelons, for the prevention of money laundering and terror financing—via training, detection, record-keeping, reporting of irregular events, and Know Your Customer practices.

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<sup>2</sup> See the 2007 Annual Review of the Supervisor of Banks.

<sup>3</sup> For the full text of the directives, see the appropriate section of [http://www.bankisrael.gov.il/deptdata/pikuah/nihul\\_takin/eng/main.htm](http://www.bankisrael.gov.il/deptdata/pikuah/nihul_takin/eng/main.htm)

As actions to correct deficiencies discovered in the inspections are taken, the inspection findings are forwarded, in cases of noncompliance with legislative requirements relating to money laundering, to the Banking Corporations Sanctions Committee. In 2008, several inspections in regard to money laundering and terror financing prompted the Sanctions Committee to convene for discussion of three banks: Israel Discount Bank, Ltd., First International Bank of Israel, Ltd., and Poalei Agudath Israel Bank, Ltd. NIS 9.2 million in financial sanctions were imposed on these banks—at NIS 3.7 million, NIS 3.5 million, and NIS 2 million, respectively.

The main violations and deficiencies uncovered in these inspections originated in faulty deployment for compliance with the provisions of the Money Laundering and Terror Financing Prohibition Order. The principal inspection findings included failure to record, or to record in entirety, beneficiaries' and controlling principals' identifying particulars and non-reportage or belated reportage of irregular transactions to the Money Laundering and Terror Financing Prohibition Authority.

The Supervisor of Banks intends to initiate several amendments to the Money Laundering and Terror Financing Prohibition Order and expects them to be gazetted in 2009.

Concurrently and as a complement to inspection activity in the specified areas, the Department inspects the banks' IT technology systems and their management in matters that carry potential risk. The purpose of these inspections is to examine how the banks manage their IT risks, including those pertaining to data security. Appropriate management of IT risks helps the bank to protect its assets and the integrity and confidentiality of its customers' financial assets. In 2008, these inspections emphasized potential risks arising from the interconnectivity of banks' systems with outside networks for various purposes—enabling customers to obtain information about their accounts and perform transactions online, transferring data to third parties, etc. Another aspect of IT inspection concerns the handling of queries from banks in regard to Proper Conduct of Banking Business Directive 357 ("IT Management"). Additionally, the Department focused on enhancing banks' awareness of the importance of dealing with cyber crime. Irregular IT events and material malfunctions in the banking system were also dealt with.

Another area of Department activity is the regulation of banking activity, an important tool in the facilitation of banking institutions. The regulatory directives are meant to assure sound and prudent bank management, regulate the activities of the banks' boards of directors and administrations, reinforce the banks' risk-management and internal-audit systems, and improve the banks' internal and public reporting systems. The regulatory work is based on the processing and analysis of information that reaches the Department from various sources, with emphasis on the banking system and regulatory developments abroad, and is translated into guidelines and rules of conduct that the banks must obey. These guidelines and rules are collected in three files: Proper Conduct of Banking Business Directives,<sup>4</sup> Reporting to the Public Directives, and Reporting to

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<sup>4</sup> See n. 3 above.

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the Banking Supervision Department Directives. The directives issued to the banks in 2008 are shown, by date of dissemination, in Appendix 1 at the end of this chapter.

The main regulatory directive issued in 2008 was provisional directive—"Working Framework for Measurement and Capital Adequacy in Accordance with Basel II Directives".

In 2008, the Department continued to adopt and assimilate the Basel II directives ahead of their full implementation by the domestic banking system by December 31, 2009.<sup>5</sup>

The aforementioned Working Framework directive, issued by the Supervisor of Banks on December 31, 2008, is based on the recommendations of the Basel Committee on Banking Supervision in regard to international standards for the measurement of capital and international capital standards, gazetted in June 2006 (hereinafter: Basel II). The Framework includes an international standard for capital adequacy and additional standards relating to risk management and corporate governance.

The provisional directive reflects the Supervisor's position on every matter in which he has discretion. To determine his position, the Supervisor examined the attitude of foreign supervisory authorities toward the topic and how the provisions should be adjusted to the directives, laws, and particulars of the Israeli economy, where necessary.

The provisional directive marks the culmination of a procedure that began in the middle of 2007, when drafts on various topics were distributed to the banks and were discussed in regular meetings with representatives of the banking system and, for specific matters, by joint work teams.

The provisional directive is divided into four sections,

- Section 1—Incidence—specifies how the banking group shall implement the capital requirements.
- Section 2—relating to the first pillar of Basel II (minimum capital requirements)—specifies the method that shall be used to calculate the requisite capital for credit risk (on the basis of two alternative approaches—standardized and internal-ratings-based), operational risk (calculated in accordance with the basic-indicator approach, standardized approaches, or the internal-models and market-risk approach).
- Section 3—relating to the second pillar of Basel II—outlines what the Department expects to attain in its supervisory surveillance of banks. The supervisory surveillance process is meant not only to make sure that the banks allocate enough capital to support all implicit risks in their business but also to encourage them to develop and employ better risk-management techniques for the monitoring and management of their risks. This section deals with the risks that were discussed in the first pillar of Basel II but were not fully treated by the process established in that setting (e.g., concentration-of-credit risk), factors not taken into account in the process set forth in the first pillar (e.g., portfolio interest risk, business risk, and strategic risk), and factors external to the bank (e.g., business-cycle effects).

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<sup>5</sup> For expanded discussion and survey of additional matters related to Basel II, see Israel's Banking System—Annual Survey 2007, Chapter 4.

- Section 4—relating to the third pillar of Basel II—outlines the Department's expectations in regard to market discipline.

The Department will strive to integrate this provisional directive into its existing directives from 2009 onward.

The Supervisor instructed the banks to act in a way that will assure their compliance with the requirements of the standardized approaches of Pillars 1–3 of the Basel II recommendations by the end of 2009. However, the Department is encouraging the banks to deploy in a way that will allow them to adopt, at some appropriate future time, the approaches based on the internal rating of credit risks. These approaches are the last word in the international treatment of this field, and the phased effort to apply them is important for the quality of credit-risk management in Israel.

The implementation of the Basel II recommendations will make a very meaningful contribution to the stability of Israel's banking system.

- The directive will spur the adoption of improved risk-management methods, allowing the capital requirements to be more sensitive to each Bank's risk profile.
  - The directive will improve the correspondence between the profile of the credit portfolio and the composition, rating, and nature of customers, on the one hand, and the capital that should be set aside for them, on the other.
  - The directive includes, for the first time, compulsory allocation of capital against the bank's operational risks.
  - The directive requires the banks to maintain internal processes for capital allocation on account of other risks, including concentration risk and portfolio interest risk.
- In addition to all of these, the Basel II instructions improve the framework of the Banking Supervision Department's work in several ways:
- The risk-focused operating framework is meant to introduce a comprehensive and forward-looking structural method for the evaluation of a bank's risk profile, so that the banking supervision function may focus on the areas of the greatest risk to the bank.
  - The method is based on detailed evaluation of the structural risks that the bank faces, the quality and efficacy of the bank's corporate-governance processes and systems, and the bank's risk management and internal controls.

The OECD principles define corporate governance as the set of relations among the corporation's management, board of directors, shareholders, and additional principals. Corporate governance also provides a structure within which the company sets its targets and the means to attain them and monitor their performance. Strong corporate governance gives the board of directors and the management an incentive to demand the attainment of objectives that reflect the wellbeing of the firm and its shareholders, and should facilitate effective monitoring. The presence of an effective corporate-governance system, at a specific company and in the economy as large, helps to attain the level of safety that a market economy needs for sound performance.



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In terms of the banking system, corporate governance relates to the method of management that a bank's board of directors and senior executive echelons apply. Specifically, it means:

1. setting the bank's objectives;
2. daily operation of the bank's business;
3. satisfying the requirements of accountability to shareholders;
4. aligning the bank's activity and behavior with the expectation that the bank will act safely, appropriately, and in compliance with laws and regulations;
5. protecting depositors.

The Banking Supervision Department has an interest in strong corporate governance because it is a crucial basis for sound and appropriate functioning of the bank and because, unless it operates efficiently, it may degrade the bank's risk profile.

International convergence to standards in measuring and maintaining capital is a steady and protracted process. The Basel Committee reviews and occasionally issues, especially in view of the current economic crisis, clarifications about risk management and the way capital should be measured. The Banking Supervision Department will monitor developments and trends abroad and update its directives where necessary.

Another area of Department activity is the writing of an annual survey of the Israeli banking system and studies on matters directly related to banking, which it publishes as discussion papers or as articles in domestic and foreign journals. In 2008, the Department published the *Annual Survey* for 2007, describing main developments in the banking system from a long-term perspective, and distributed it in Israel and abroad. The Department also published the results of several studies in Israel and abroad: "Characteristics of Business Firms Indebted to Banks that Issued Bonds on the Tel Aviv Stock Exchange in Recent Years," by Professor David Ruthenberg and Michal Zilberberg (in Hebrew) in *Bank of Israel – Banking Supervision Department – Research Unit – Working paper 08.01*; "Loan Pricing under Basel II in an Imperfectly Competitive Banking Market," by Professors David Ruthenberg and Yoram Landskroner in *Journal of Banking and Finance* 32 (2008); and "Competitiveness in the Banking Industry: Theoretical Aspects and Empirical Evidence from Israel and Abroad," by Prof. David Ruthenberg, published (in Hebrew) in *Economic Quarterly* 55.02 (June 2008).

In 2008, the Department produced position papers at the request of the Governor and the Supervisor of Banks in order to provide a theoretical basis—combining the experience amassed in Israel and abroad—for current matters on the Department's agenda. In addition, it prepared material about the Israeli banking system for presentation to international officials.

The Department interacts with foreign supervisory authorities on a regular basis as necessitated by globalization, the upturn in Israeli banks' international activities, the increase in foreign investors' interest in the Israeli banking system, and the recommendations of the Basel Committee, which stress the importance of cooperation and information exchange among supervisory authorities around the world. The

international relations activity focuses on monitoring, at the Department's initiative, of the policies and regulation applied by important foreign supervisory authorities and on helping the licensing function in matters that entail specialization in matters related to foreign countries, analysis of foreign banking trends and developments that have implications for Israeli banking, and maintenance of ongoing relations with foreign supervisory authorities and international agencies in order to develop channels of information.

*(1) Examining Israel's OECD accession*

Since the beginning of 2008, Israel has been going through the OECD accession process, a project coordinated by the Ministry of Finance.

To join the OECD, Israel established twelve committees, in some of which the Bank of Israel is involved. A representative of the Banking Supervision Department chairs the Financial Markets Committee, which is composed of officials from the Bank of Israel, the Ministry of Finance, and the Securities Authority. Representatives of the committee filled in a questionnaire relating to all aspects of the financial markets. The Department's International Relations Unit gathered the material, prepared answers to the questionnaire items, and filled in answers pertaining to the Banking Supervision Department. After the questionnaire was administered, a representative of the OECD visited Israel and wrote an initial report. In November 2008, a discussion was held on various issues related to banking in Israel and the capital market. The work is expected to continue in 2009 and until the accession process is complete.

*(2) Participation in EuroMed*

The Euro-Mediterranean Partnership Program (EuroMed or MEDA) is a regional-cooperation program that promotes the instrumentalities and mechanisms of the EuroMed market (a market that will comprise representatives of the EU and the Mediterranean Basin countries for the purpose of establishing an FTA by 2010). The program is conducted under the auspices of the European Commission and coordinated by EIPA-ECR, the European Institute of Public Administration / European Centre for the Regions.

EuroMed, known as the Barcelona program when launched in 2002, has gone through five phases. The fifth phase began in 2008 and was kicked off at a conference in January 2008 in Brussels. Permanent work teams were put together and a member of the Department's International Relations Unit served as Israel's permanent representative in the field of banking. Phase 5 has ended and the entire project will be closed down in 2009; until then, our work in this matter will continue.

In 2008, the Banking Supervision Department took many forms of action in regard to emergency deployment. The main actions follow.

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### *(3) Implementation of the Financial Authority Emergency Deployment Plan*

The Department applied a deployment plan drawn up in conjunction with an outside consulting firm. The plan applies, among other things, the lessons of Second Lebanon War. An important part of the plan was the demarcation of the Financial Authority's responsibilities and, within this generality, the attainment of coordination with the Ministry of Finance, the Securities Authority, and the Postal Bank.

#### (a) Cooperation with the banking system

The principal activity in regard to emergency deployment in 2008 took place vis-à-vis the banking system. Periodic meetings were held with representatives of the banking system in conjunction with other relevant entities such as the IDF Home Front Command, the emergency system, and the Ministry of Industry, Trade, and Labor. The policy issues discussed at the meetings included:

- determining the levels of service to be offered;
- making policy on passive protection and opening of branches;
- working procedures between commercial banks and the Bank of Israel;
- the decision-making hierarchy;
- establishing a reporting system from banks to the Banking Supervision Department.
- information technology and backup sites;
- relief measures for the population during an emergency;
- remain-at-work injunctions for employees;
- money-transfer systems.

#### (b) The Department's internal deployment

In the review year, the Bank of Israel continued to make progress in its internal deployment, including aspects of legislation, regulation, and operations. The main activities were the following:

1. passage of an amendment to the Checks without Cover Law, 5741-1981, allowing the Supervisor of Banks, under certain conditions, to issue an order not to restrict customers or accounts of customers whose checks were returned;
2. preparations relating to the banking business day;
3. procedures—drafting and updating internal procedures on emergency deployment;
4. updating the Bank of Israel Web site, including the preparation of a file of FAQ on emergencies.

#### (c) Activity during "Operation Cast Lead"

As "Operation Cast Lead" took place, the Banking Supervision Department took far-reaching actions in conjunction with the banking system: meeting with the banks, issuing

systematic guidelines, issuing regular daily updates, and coordinating operations with other entities, including the IDF Home Front Command, the emergency system, the Ministry of Industry, Trade, and Labor, and local authorities.

Coordination among these entities was good and the banking system continued to function in an almost-ordinary manner. The Department issued special dispensations for the public in regard to checks without cover—precluding the restriction of bank accounts, relief in regard to credit facilities (Directive 325), dissemination of a FAQ file to the public, and authorizing the banks to activate mobile branches.

(d) Participation in internal Bank of Israel drills and in a drill with the emergency system

In 2009, the Department is expected to continue making preparations and to issue instructions for emergency situations, including reference to various states of emergency.

## 2. SAFETY: SAFEGUARDING DEPOSITORS' MONEY AND ASSURING FAIR TREATMENT OF CUSTOMERS

Apart from its efforts to keep the banking system stable, the Banking Supervision Department has goals related to bank–customer relations: assuring a fair and efficient banking system, cementing public trust in the system, consolidating the Department's status as an agency that defends banking consumers' rights, financial education, and making the banking system more competitive.

To attain these goals, the Bank–Customer Relations Unit acts at several levels: handling complaints and queries from the public, including detection and correction of banking-system deficiencies; treatment of customers who draw checks without cover; legislation and regulation; and consumer information for the public.

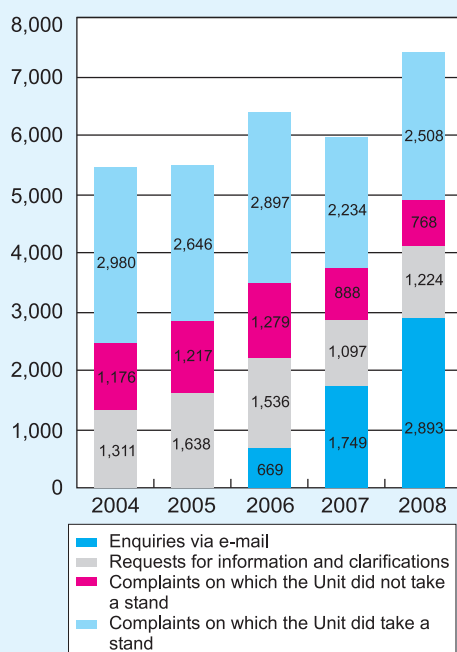
### **a. Treatment of queries from the public**

In 2008, the Department dealt with 4,156 complaints and 4,378 requests for information and miscellaneous requests that were answered in writing. These numbers include 1,140 queries about Heftsiba, Ltd., that were treated in 2008. The Department also provided bank customers with initial responses by telephone to queries relating to their banking business (Figure 4.2 and Table 4.1). The increase in the number of queries handled in 2008 relative to previous years originated, among other factors, in queries relating to Heftsiba and the bank-fee reform and an upturn in the number of miscellaneous queries received by e-mail.

The following data, exclusive of queries about Heftsiba that were dealt with in 2008, show the following:

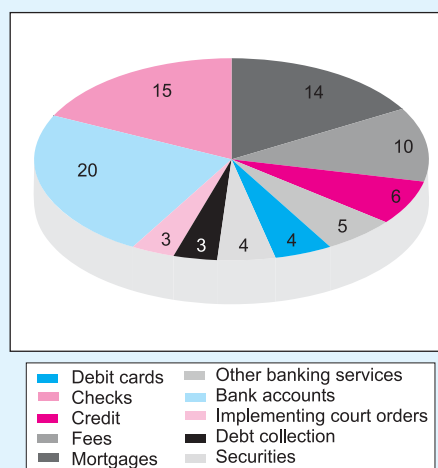
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**Figure 4.1**  
Number of Complaints and Enquiries from the Public Handled by the Public Enquiries Unit, 2004-08



SOURCE: Bank of Israel.

**Figure 4.2**  
Public Enquiries by Subject, 2008 (percent)



SOURCE: Bank of Israel.

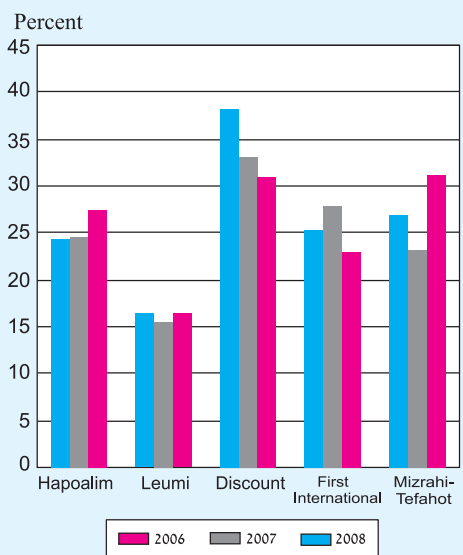
Some 25.6 percent of all complaints on which the Department took a position in 2008 were found justified or partly justified (Table 4.2). The main topics of the queries were bank accounts, checks, mortgages, fees, and credit (Figure 4.2).

Among the five large banks, Israel Discount Bank had the highest share of justified complaints in total complaints presented—38.2 percent (as against 33 percent in 2007), followed by Mizrahi-Tefahot Bank (27 percent as against 23.1 percent in 2007), First International Bank (25.4 percent and 27.9 percent, respectively), and Bank Hapoalim (24.3 percent and 24.6 percent, respectively). Bank Leumi had the lowest proportion of justified complaints (16.3 percent in 2008 as against 15.5 percent in 2007—Figure 4.3). When the five large banks were compared in terms of percent of justified queries weighted by various criteria of size, we found that the best ratio was attained by Bank Leumi and the worst belonged to Israel Discount Bank. Checking the distribution of the banking groups in terms of their share in justified complaints, weighted by group size (in terms of total assets), we obtained a similar ranking, with Leumi as the best group and the Israel Discount group as the worst (Figure 4.4).

Checking the number of queries about the bank by various criteria of bank size, we found the best ratio at Leumi and First International and the worst at Mizrahi-Tefahot (Table 4.3).

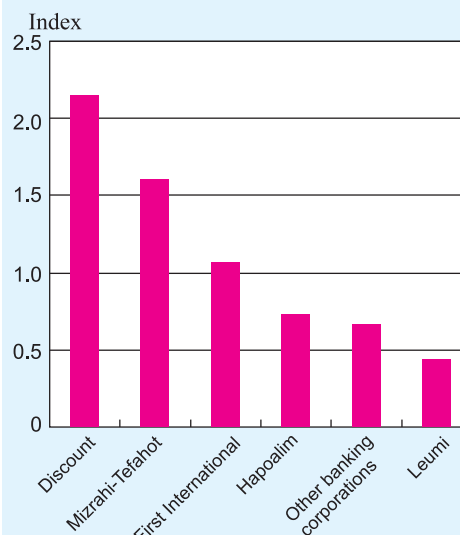
Among credit-card companies, Isracard had the highest share of justified complaints in 2008 (7.7 percent as against 16.7 percent in 2007), follow closely by Leumi Card (7 percent and 6.9 percent, respectively). The lowest share of justified complaints was

**Figure 4.3**  
Proportion of Justified Complaints in Total Complaints, the Five Major Banking Groups, 2006-08



SOURCE: The Public Enquiries Unit of the Supervisor of Banks.

**Figure 4.4**  
Proportion of Justified Complaints in the Banking Groups, Relative to Group Size,<sup>a</sup> 2008



<sup>a</sup> Calculated as follows: the number of justified complaints against a banking group divided by the total number of justified complaints against all banks; this ratio is then divided by the share of that banking group's assets in the total assets of the banking system. Example: a bank had 50 justified complaints, out of a total of 100 justified complaints against all banks. Its total assets were valued at 1,000, and the total assets of the banking system were valued at 3,000. The relative proportion shown in the figure would be  $(50/100)/(1000/3000) = 1.5$ . Hence an index of less than one is considered "good," and an index of more than 1 is considered "less good." SOURCE: Bank of Israel.

that of ICC (2.9 percent as against 3.4 percent in the respective years).

As for the mortgage industry, 36.2 percent of complaints on which the Department took a position in 2008 were found to be justified or partly justified. Among the mortgage banks, Discount Mortgage Bank had the highest share of justified complaints, at 56.1 percent (as against 73.4 percent in 2007), followed by Bank Hapoalim (44.2 percent as against 47.7 percent in the respective years) and First International Bank (35.7 percent and 28 percent, respectively). The lowest share of justified complaints about mortgages was found at Leumi Mortgage Bank (8.5 percent as against 20.7 percent in the respective years—Table 4.4).

As part of the Department's treatment of complaints from the public and the remedies that it provides for complainants, the banks were instructed to make cash refunds to those whose complaints were found justified. The total compensation paid out by banks to customers on these grounds was NIS 3 million, not including remedies for casualties of Heftsiba, as described below.

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**Table 4.1**  
**Investigation of Complaints and Enquiries from the Public, 2008<sup>a</sup>**

|  | Number       | Percent of total |
|--|--------------|------------------|
| <b>Complaints on which a decision was made</b> |              |                  |
| Unjustified                                    | 1,866        | 25               |
| Justified                                      | 526          | 7                |
| Partly justified                               | 116          | 2                |
| <b>Total</b>                                   | <b>2,508</b> | <b>34</b>        |
| <b>Complaints on which no stand was taken</b>  |              |                  |
| Treatment stopped due to legal proceedings     | 145          | 3                |
| Treatment stopped for other reasons            | 238          | 2                |
| Not within the Unit's jurisdiction             | 178          | 2                |
| Unable to take a stand                         | 202          | 3                |
| Not appropriate to be dealt with by the Unit   | 5            | 0                |
| <b>Total</b>                                   | <b>768</b>   | <b>10</b>        |
| <b>Other enquiries</b>                         |              |                  |
| Requests                                       | 286          | 4                |
| Clarifications                                 | 938          | 13               |
| Enquiries via e-mail                           | 2,893        | 39               |
| <b>Total</b>                                   | <b>4,117</b> | <b>56</b>        |
| <b>Total enquiries dealt with by the Unit</b>  | <b>7,393</b> | <b>100</b>       |

<sup>a</sup> Not including 1,140 enquiries relating to the collapse of the Heftsiba construction company.

**Table 4.2**  
**Distribution of Justified Complaints, by Bank, 2008**

|                            | Number of complaints on which a decision was made <sup>a</sup> | Number of justified and partly justified complaints | Justified and partly justified complaints as percentage of those on which a decision was made |
|----------------------------|--|---|---|
| Hapoalim                   | 543  | 132   | 24.3  |
| Leumi                      | 398  | 65  | 16.3  |
| Discount                   | 364  | 139   | 38.2  |
| Mizrahi-Tefahot            | 330  | 89  | 27.0  |
| First International        | 142  | 36  | 25.4  |
| Discount Mortgage          | 134  | 74  | 55.2  |
| Leumi Mortgage             | 113  | 13  | 11.5  |
| Otsar Hahayal              | 82   | 15  | 18.3  |
| Union                      | 63   | 7   | 11.1  |
| Yahav                      | 58   | 18  | 31.0  |
| Mercantile Discount        | 52   | 15  | 28.8  |
| Isracard                   | 52   | 4   | 7.7   |
| Leumi Card                 | 43   | 3   | 7.0   |
| CAL                        | 35   | 1   | 2.9   |
| Massad                     | 28   | 11  | 39.3  |
| Jerusalem                  | 26   | 8   | 30.8  |
| Other banking corporations | 45   | 12  | 26.7  |
| <b>Total</b>               | <b>2,508</b>   | <b>642</b>  | <b>25.6</b>   |

<sup>a</sup> Justified, partly justified, or unjustified.

**Table 4.3**  
**Distribution of Complaints Between the Five Major Banks, and Different Parameters of Bank Size,<sup>a</sup> 2008** (percent)

|                     | Complaints <sup>b</sup> | Justified and partly justified complaints | Total assets <sup>c</sup> | Number of branches | Deposits of the public <sup>c</sup> |
|---------------------|-------------------------|---|---------------------------|--------------------|-------------------------------------|
| Hapoalim            | 30.6                    | 30.2                                      | 33.8                      | 31.5               | 33.7                                |
| Leumi               | 22.4                    | 14.1                                      | 31.6                      | 26.8               | 31.9                                |
| Discount            | 20.5                    | 28.6                                      | 14.3                      | 16.1               | 14.2                                |
| First International | 8.0                     | 7.8                                       | 8.6                       | 11.0               | 11.7                                |
| Mizrahi-Tefahot     | 18.6                    | 19.3                                      | 11.7                      | 14.5               | 8.5                                 |
| Total               | 100                     | 100                                       | 100                       | 100                | 100                                 |

<sup>a</sup> Not including subsidiaries.

<sup>b</sup> On which a decision was made—justified, partly justified, or unjustified.

<sup>c</sup> December 2007 data.

**Table 4.4**  
**Distribution of Justified Complaints about Mortgages, by Bank, 2008**

|                            | Number of complaints on which a decision was made | Number of justified and partly justified complaints | Justified and partly justified complaints as percentage of those on which a decision was made |
|----------------------------|---|---|---|
| Discount Mortgage          | 132   | 74  | 56  |
| Mizrahi-Tefahot            | 117   | 40  | 34  |
| Leumi Mortgage             | 106   | 9   | 8   |
| Hapoalim                   | 77  | 34  | 44  |
| First International        | 28  | 10  | 36  |
| Jerusalem                  | 17  | 5   | 29  |
| Other banking corporations | 17  | 7   | 41  |
| Total                      | 494   | 179   | 36  |

#### **b. Complaints from persons who bought dwellings from Heftsiba**

The treatment of queries from the public in regard to Heftsiba began at approximately the time that this company collapsed in August 2007. For detailed information about the Department's handling of the Heftsiba affair, consult the Department's *Annual Review* for 2007.

The Department continued to treat the matter intensively in 2008 in response to the many complaints that it continued to receive about the company's failure to issue guarantees as required by the Sales Law, checks, mortgage money that did not reach its destination, etc.



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Within the framework of queries that were investigated to completion, casualties of Heftsiba received, in accordance with the stance of the Supervisor of Banks, the total sum of NIS 245 million in remedies (through December 31, 2008):

- For NIS 55.5 million in payments that were deposited in project accounts, guarantees were issued after the Department's intervention.
- For NIS 84 million in payments secured by conditional guarantees, the conditionality was rescinded in accordance with the Department's stance.
- NIS 61 million in payments that were deposited in various Heftsiba accounts were transferred to project accounts pursuant to the Department's intervention.
- NIS 37 million in guarantees was taken out for the payments that were transferred to project accounts after the Department's intervention.
- NIS 7.5 million in payments deposited with various Heftsiba accounts under circumstances of the absence of a construction-loan bank was refunded to homebuyers pursuant to the Department's intervention.

In 2008, as part of the application of the lessons of the Heftsiba affair, the Department issued Proper Conduct of Banking Business Directives relating to construction loans and the phrasing of letters of guarantee as prescribed by the Sales (Apartments) (Assurance of Investments of Persons Acquiring Apartments) Law, 5734–1974:

*Directive 326, relating to construction loans:*<sup>6</sup> the directive concerning construction loans, effective June 1, 2008, is meant to secure the money of homebuyers in projects that are financed by the construction-loan method. The directive establishes a coupon procedure so that persons who buy dwellings from a building contractor may pay the consideration efficiently and safely by depositing the funds directly to the project account with the financing bank, and assures these payments with appropriate collateral.

Banks that finance construction projects in this manner are required to issue a coupon book for each dwelling in the project, by means of which the buyer pays the consideration solely to the project account with the financing bank. Homebuyers' money that is paid in this manner is secured and the bank must provide the homebuyer with a guarantee of the money or make sure that the buyer receives some other form of collateral that the law recognizes.

*Directive 456, relating to the phrasing of the letter of guarantee prescribed by the Sales (Apartments) (Assurance of Investments of Persons Acquiring Apartments) Law, 5734–1974:*<sup>7</sup> this directive establishes a standard phrasing that all banks must use when issuing this guarantee. The guarantee under the Sales Law is the most common form of security allowed by law to assure homebuyers' investments. The standard phrasing set forth in the directive is based, among other things, on a ruling by the Standard Contracts Tribunal on November 25, 2007, validated by a consensual ruling obtained by the Banking Supervision Department and Mizrahi-Tefahot Bank, Ltd., concerning the revocation of one-sided terms in the letter of guarantee that Mizrahi-Tefahot had been issuing. The directive went into effect on June 1, 2008.

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<sup>6</sup> See note 3 above.

<sup>7</sup> See note 3 above

In 2008, the Department played a role in the passage of two amendments to the Sales Law—Amendment 4, 5768-2008, and Amendment 5, 5768-2008—that revised various clauses and added new ones. Noteworthy among the latter are clauses dealing with construction loans, obligations of companies that issue housing loans, the appointment of a supervisory officer and the supervisory powers that he is to enjoy, imposing a financial sanction for breaching the provisions of the law, etc.

### c. Treatment of checks without cover

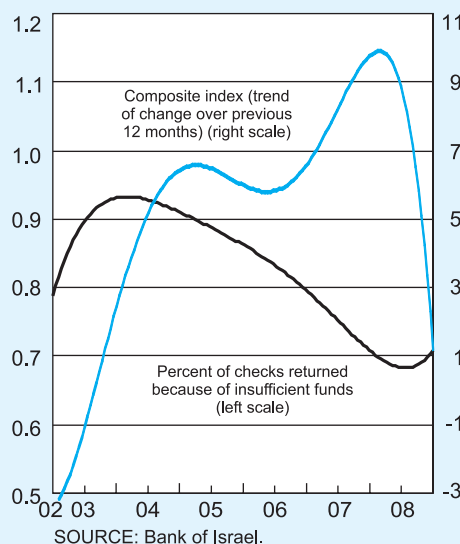
The total sum of checks that banks refused to honor on grounds of “insufficient funds” increased significantly in 2008, attesting to a decline in payment ethics. After holding steady in 2005–2007 at NIS 6.7 billion, 0.7 percent of total charges to the public’s current accounts by means of checks, this amount increased in 2008 to NIS 7.8 billion, 0.85 percent of the total. Most of the upturn (NIS 600 million) occurred in the last quarter of the year. This finding corresponds to findings adduced from other indicators of trends in real economic activity. The composite state-of-the-economy index, for example, also showed that most of the downturn in real activity occurred in the fourth quarter of 2008. Figure 4.5 provides an illustration. (For an expanded analysis of real economic activity in 2008, see Section 1 of Chapter 1 of this Survey.)

In 2008, the Department responded in writing to 1,808 queries, and to additional queries by telephone, on matters related to the restriction of accounts and customers.

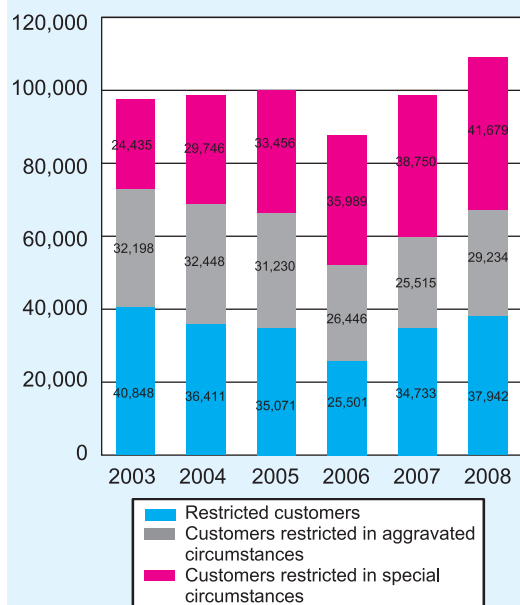
The Department also dealt with restricted customers’ appeals to the courts under the Checks without Cover Law, 5741-1981. In all, 911 new appeal files were opened during 2008 and litigation pertaining to 867 appeal files, including some that had been opened with the courts in previous years, ended during the year. The courts accepted 30 percent of the appeals; in these cases, the restrictions imposed on customers were rescinded.

The number of restricted customers and restricted accounts increased in 2008 relative to 2007. There were 37,942 ordinary restricted customers at year’s end as against 34,733 customers at the end of 2007, up 9.2 percent. The

**Figure 4.5**  
Checks Returned Because of Insufficient Funds (By sum), and the Composite State-of-the-Economy Index, 2002-08



**Figure 4.6**  
**Number of Restricted Customers, 2003-08**



SOURCE: Bank of Israel.

number of restricted customers under aggravated circumstances was 29,234 at the end of 2008 as against 25,515 year earlier, up 14.6 percent. The number of restricted customers has been growing steadily in recent years with the exception of 2006, when the restriction of 11,000 customers was rescinded in December due to the Second Lebanon War (Figure 4.6).

Amending legislation: in 2008, the Department played a role in amending the Checks without Cover Law, 5741-1981: Amendment 7, 5768-2008, added two grounds for appeal in Section 10 of the law. According to the amendment, an account holder may, in a state of emergency, petition the court to exclude a check from the count of refused checks if he was rendered unable to take care of his affairs due to personal injury or property damage by

enemy action, for which reason the check was refused, and also if he lives in a part of the country where a state of emergency was declared and his income was significantly impaired thereby, for which reason the check was refused. Furthermore, the Supervisor of Banks was empowered to suspend, after the Government declares a "special situation" in the rear, the imposition of restrictions on an account and an account holder due to the return of checks without cover, in respect of a certain part of the country or the entire country. During "Operation Cast Lead," the Supervisor of Banks invoked this authority and instructed the banks to refrain from restricting the accounts of customers at their branches in Sderot and Ashkelon.

### 3. STRUCTURE: ENHANCING COMPETITIVENESS AND EFFICIENCY IN THE BANKING INDUSTRY

One of the Department's goals, as stated,<sup>8</sup> is to enhance competitiveness and efficiency in the banking industry. This section of the Review describes what the Department did in 2008 in pursuit of this goal.

<sup>8</sup> See the first page of this chapter.

**a. Implementation of the bank-fee reform**

On July 1, 2008, the bank-fee reform, originating in the provisions of the Banking (Customer Service) Law (Amendment 12), 5767-2007, went into full effect. The purpose of the reform is to create transparency in the prices of banking services by cutting down on the number of fees and standardizing the names of fees and the mechanism used to collect them. The underlying view is that customers' awareness of the prices of banking services, their growing involvement by negotiating with banks to improve the terms, and their rational decisions may combine to lower prices in the long-term and, to some extent, in the near term as well, as has indeed happened. To enhance the public's awareness and involvement, the Department was also empowered to publish periodic comparisons of the prices of banking services that customers actually pay, which are much lower than the prices appearing in the banks' schedules of fees. Furthermore, the Department was empowered to control the prices of certain services that meet the definition in the law, if it considers this kind of intervention justified.

*(1) Preparations for the reform*

The Department spent the first half of 2008 preparing itself and the banking system for the implementation of the reform. Within the framework of its preparations, the Department took the following actions, among others:

(a) Creation of legislative infrastructure

— The Banking (Customer Service) (Fees) Rules, 5768-2008, were issued, establishing two kinds of fee schedules—full and short-list<sup>9</sup>—and rules for informing customers about the prices of banking services. Furthermore, the Banking (Customer Service) (Fees) Rules (Amendment), 5768-2008, were issued to regulate several matters that were determined after the banks asked for clarifications.

— The Banking (Customer Service) (Proper Disclosure and Presentation of Documents) Rules, 5752-1992, were amended to align them with the reform.

— On May 1, 2008, a list of services controllable under Section 7 of the Banking (Customer Service) Law (Amendment 12), 5767-2007, was published. On May 21, 2008, the Banking (Customer Service) (Decontrol of Certain Banking Services and Revision of Control in Other Cases) Order, 5768-2008, was published, updating the list of services that may be placed under price control and establishing maximum prices for several services, all of which to prepare the ground for the application of the reform.

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<sup>9</sup> The full schedule of fees is the full and standard list of services for which banks are allowed to charge fees. Incidental to the creation of this list, the number of fees was reduced to about one-third. The short-list schedules are brief lists of common fees in three core consumer domains—current accounts, mortgages, and credit cards—that are derived from the full schedule of fees.

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### (b) Supporting the banking system's preparations

— The Banking Supervision Department supported the banking system's preparations by issuing clarifications on the many questions that the banks asked as they deployed for the fee reform, relating to the correct interpretation of the schedule of fees and how to inform customers about the imminent change in the fee schedule. Clarifications that were relevant to the banks at large were aggregated in three circulars that the Department sent to the banks.

— The banks set fees for banking services that appeared in both the full schedule and the short-list schedules and reported them to the Department. Pursuant to several actions that the Department took as it received the schedules, various banks informed it that they were cutting the prices of common banking services: ATM cards, warning letter from attorney, collection fees, rollover of interim grants and guarantees/deposits, etc. The Department also informed the banks that it was considering placing the following services under price control: opening a housing-loan account, generating or printing documents from the digital database, locating documents, and locating accounts. In response to the Department's notice, the banks reduced the prices of these services.

### (c) Release of information to the public

— As the reform was about to go into effect, the Department released copious information about it—a Guide to the Customer, FAQ, useful advice on savings, fees, and so on—by means of its Web site. The site also provided the public with useful tools for the comparison of different banks' prices: comparison tables on main issues, calculators permitting comparison in accordance with each customer's specific consumption profile, links to the banks' fee schedules, etc.

— For those who do not have access to the Internet, the Department placed a notice in the media and invited the public to address questions and requests for clarifications to its Public Enquiries Unit. The unit gave customers information and explanations and even sent many inquirers informational material by "snail mail."

## *(2) Implementation of the reform and monitoring of its results*

Since the reform went into full effect (July 1, 2008), the Department has been closely monitoring its implementation and has taken the actions described below, among others:

### (a) Information campaign for the public

The Department conducted an information campaign via the media (television, radio, Internet, press) to apprise the public of the fee reform, enhance its awareness of the prices of banking services, and make it aware of the vast amount of information at the Bank of Israel Web site about banking consumerism generally and the fee reform specifically.

(b) Fine-tuning the reform in response to information received when it first went into effect

The Department made adjustments in the reform as soon as information from customers, among other sources, showed it that such adjustments were necessary. The adjustments were reflected in the Banking (Customer Service) (Fees) Rules (Amendment 2), 5768-2008. The main ones were the following:

- lowering the prices of deposit-box transactions by defining them as direct-channel transactions.
- lowering the prices of teller services for weak population groups: senior citizens, customers with disabilities, and customers who have neither credit cards nor ATM cards. These customers may carry out four teller transactions for the price of one direct-channel transaction;
- lowering management fees for building committees. Since the adjustment, committees have been charged according to the personal schedule as opposed to the small-business schedule.

The adjustments went into effect on September 1, 2008.

(c) Reporting to the public about the results of the fee reform

The Department gathered data on the prices of banking services. After analyzing them, it published its findings on the effect of the reform on the household sector at the five large banks, issued a comparison of the fees that customers actually paid, and reported its actions and findings to the Knesset Economics Committee.

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### APPENDIX 1: ACTIONS OF THE BANKING SUPERVISION DEPARTMENT—EVENTS IN 2008 AND EARLY 2009<sup>10</sup>

#### **Jan. 8**

As part of the bank-fee reform, the Banking (Customer Service) (Fees) Rules, 5768-2008, were published, establishing two kinds of rate schedules—full and short-list—and rules for informing customers about the prices of banking services. The rules were established by force of the Banking (Customer Service) Law (Amendment 12), 5767-2007, which enjoins banks against charging individuals or small businesses fees that do not appear on the full schedule. Consequently, the Proper Conduct of Banking Business Directive that itemized bank fees was canceled, the Proper Conduct of Banking Business Directive that establishes procedures regulating several aspects of fees was updated, and the Banking (Customer Service) (Proper Disclosure and Presentation of Documents) Rules, 5752-1992, were amended to align them with the reform.

#### **Feb. 4**

A Proper Conduct of Banking Business Directive relating to construction loans was issued, establishing an efficient and safe way for persons buying dwellings from a contractor to pay the consideration directly to the project account with the financing bank and assuring the security of these payments by means of appropriate collateral. The “coupon method” established by the Directive requires banks that finance construction projects via the construction-loan method to issue a coupon book for each dwelling in the project, with which homebuyers make payments on account of the consideration solely to the financing bank’s account for the project. Homebuyers’ money paid in this manner is secured from the first sheqel and from the moment the payment is made.

The directive went into effect on June 1, 2008.

#### **Feb. 21**

The Department published a letter to the banks on the topic of asset-backed financial instruments and structured securitization transactions—disclosure, recognition of interest income, degradation of value, and classification for the purpose of capital requirements. Additional letters on these topics were published on Feb. 24 and Dec. 3.

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<sup>10</sup>To read the Proper Conduct of Banking Business Directives that are mentioned below, see note 3.

**March 5**

A circular about adjusting the format of reportage to the public by credit-card companies was issued.

**March 9**

A letter to the banks about the disclosure of activity sectors and of customer-recruitment and/or product marketing campaigns was published.

**March 18**

A directive that substantially broadened the swath of compulsory disclosure in banks' quarterly statements was published.

**April 2**

A directive that standardized the phrasing of letters of guarantee under the Sales (Apartments) (Assurance of Investments of Persons Acquiring Apartments) Law, 5734–1974, obligatory for all banks, was published. The phrasing of the guarantee letter creates a standard framework for all conditions that such a letter includes and determines, among other things, cases in which a bank must pay out the guarantee, the indexation mechanism for the guarantee sum, the date of payment of guarantee after a demand for such action is received, and cases in which the guarantee expires. The directive went into effect on June 1, 2008.

**April 13**

In response to the global and domestic financial turmoil and uncertainty about the extent of its effect on the Israeli economy in the near future, the banks were instructed to review the goals in their long-term strategic plans, reassess the risks to which they were exposed, estimate the extent of capital required in view of this risk profile, and re-examine their risk-management policies and the adequacy of the means and ways of managing their risks. The banks were also instructed to have their boards of directors discuss in plenary format the contours of the requisite deployment with reference to changes in the business environment—all of which no later than July 1, 2008.

**April 27**

The Proper Conduct of Banking Business Directive relating to communication between a bank's CPA-auditor and its overarching audit supervisors was updated. In addition to



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the board of directors' audit committee, the CPA-auditor must determine the identity of additional board members who are in charge of overarching audit and determine with whom among them he must hold discussions.

### **April 27**

After approving an instruction from the Securities Authority, the Department added an provisional directive to its directives on the reporting to the public, establishing the format to be used in disclosing the procedure for approval of the reporting bank's financial statements.

### **May 21**

The Banking (Customer Service) (Decontrol of Certain Banking Services and Revision of Control in Other Cases) Order, 5768-2008, was published, abolishing price control on some banking services and making various adjustments in order to prepare the legal situation for the full implementation of the fee reform.

### **June 25**

In awareness of the fact that the banks face increasingly complex market risks generally and interest risks particularly, a Reporting to the Public Directive requiring banks to make more accurate and explicit disclosure of these risks was issued.

### **Aug. 18**

In view of the changes that occurred in the Israeli banks' activity environment domestically and abroad, the board of directors of each bank was instructed to discuss and approve a policy document relating to the activity of overseas offices. The board was instructed to set exposure limits for the activities of such offices.

### **Aug. 26**

The Banking (Customer Service) (Fees) Rules (Amendment 2), 5768-2008, were issued, making adjustments to the fee reform that lowered the prices of banking services for weak population groups—senior citizens, customers with disabilities, and customers who have neither credit cards nor ATM cards.

**Sept. 28**

A Proper Conduct of Banking Business Directive concerning controls and procedures relating to disclosure and internal control of financial reportage was issued. The directive requires banks' managements to evaluate internal control at the end of each year and to assess changes in internal control that have, or are expected to have, a material effect on the bank's internal control of its financial reportage.

**Sept. 28**

In response to the spreading of the global crisis, the banks were required to report to the Department on a fortnightly basis about their exposure to foreign financial institutions, and to report immediately about any foreign financial institution that is found to have adverse indicators. As for other exposures, the banks were instructed to review, map, and estimate their exposures to entities exposed to the crisis and to report the findings to the Department. Finally, the banks were instructed to present the Department with a list of major borrowers who were materially exposed to the crisis, report the indebtedness of each, and indicate the reason for the exposure.

**Oct. 16**

In view of the crisis in the money and capital markets, the format used by banks and credit-card companies to report to the Department about liquidity risks was updated.

**Nov. 2**

As the adverse trends in the global financial markets worsened and the implications of the crisis for foreign financial institutions evoked concern, the banks were instructed to disclose separately their credit exposure to foreign financial institutions, so that the users of the financial statements might attain a better understanding of the Israeli banks' exposure to these institutions.

**Nov. 9**

Pursuant to publications from the Securities Authority concerning compulsory disclosure in the board of directors statement about the degradation of financial asset value, the banks were required to provide separate quantitative disclosure—in board statements from September 30, 2008, onward—of the total amount of losses not yet realized in securities that are available for sale, using the format that was made obligatory in the Security Authority's explanatory notes.

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### **Dec. 10**

To give users of the banks' financial statements a better understanding of the banks' exposures to risks originating in activity in foreign countries, a Reporting to the Public Directive requiring banks to disclose their exposures to foreign countries was issued.

### **Dec. 18**

Recent global business events demonstrated the need to strengthen the procedures on determining the fair value of financial assets. Accordingly, the banks were given instructions that they are to apply from the 2008 public statements onward. The instructions relate to internal control of the evaluation of fair value, the measurement of fair value, and disclosure of the process in which fair value is determined.

### **Dec. 31**

An provisional directive establishing a framework for measurement and capital adequacy under the Basel II directives was issued. Afterwards, a process of reconciling the Proper Conduct of Banking Business Directives with the new Basel directives began. The reconciliation was performed by a team comprised of members of all Department units. The directives with which the process was launched were the following:

- a. board of directors — Proper Conduct of Banking Business Directive 301;
- b. credit-risk management—Proper Conduct of Banking Business Directives 316, 318, and 319;
- c. financial information in borrowers' files — Proper Conduct of Banking Business Directive 317;
- d. liquidity-risk management —Proper Conduct of Banking Business Directive 342.

### **Jan. 11, 2009**

A circular concerning the disclosure of risks and instruments that lie at the focus of the global crisis was issued.

**Banking Supervision Department—Organizational Structure**

