

THE BANKING SYSTEM IN ISRAEL

1. DEVELOPMENT OF THE BANKING SYSTEM

Israel possesses a well-developed banking system, evidenced by the fact that bank deposits constitute some 60 per cent of the money supply. Apart from one or two banks founded in the period of the Ottoman Empire (such as, for example, the Bank Leumi Le-Israel B.M., formerly the Anglo-Palestine Bank Ltd.), most of the banks now functioning in Israel were established during the British Mandate. During this period, some dozens of banks were founded; but the economic crises which hit Palestine during the Abyssinian War and again at the outbreak of World War II, resulted in the liquidation of many of the smaller, and the strengthening of the more solid, institutions.

The Banking Ordinance, 1921, which fixed the legal basis of bank operations, was amended several times and the changes were eventually consolidated in the Banking Ordinance, 1941, which is still in force to-day. The Ordinance provided, *inter alia*, that no banking business might be conducted without a permit from the High Commissioner, that the minimum approved nominal capital of a bank be £P.50,000, the minimum paid-up capital be £P.25,000; and that all banks submit a monthly report to the Financial Secretary on their assets and liabilities. The Ordinance also imposed on all banks the obligation to publish an annual balance sheet and a profit and loss account. The High Commissioner appointed a Controller of Banks and an Advisory Committee for Banking.

With the creation of the State of Israel, the powers exercised by the High Commissioner under the Banking Ordinance were transferred to the Minister of Finance, and the control over banking activities was vested in the Department of Bank Control, a part of the Ministry of Finance. A new Advisory Committee for Banking was appointed by the Minister of Finance; its function was to consider problems relating to the activities of the banking system and to submit its recommendations to the Minister. Although the law did not give this Committee any clearly defined power of control over the volume of bank credit or its distribution, the Government issued regulations on these matters from time to time, after consultation with the Committee, and these regulations were usually implemented by the banks.

Side by side with the banks, there developed a network of credit co-operative societies. These co-operatives, created for the purpose of encouraging savings and supplying loans on a mutual benefit basis, now have hundreds of thousands of members. Some co-operatives have developed to such an extent that the volume of their activities exceeds that of several banks; they also grant loans to borrowers who are not members, including large institutions.

The legal basis for the activities of the credit co-operative societies was laid down in the Credit Co-operative Societies' Ordinance, 1933. Until the foundation of the Bank of Israel, the control over these co-operatives was exercised by the Registrar of Co-operative Societies within the Ministry of Labour. An Advisory Committee for Credit Co-operative Societies was created, on lines similar to the Advisory Committee for Banking, to deal with matters affecting the co-operative societies' credit policy. Government regulations relating to credit apply both to banks and to credit co-operative societies.

Towards the end of 1955, there were twenty-five commercial banks in Israel, of which three were registered abroad. In addition, four mortgage banks and the Post Office Bank, as well as ninety-four credit co-operative societies, were operating in the country.

Table 123 shows the development over the years in the number of banks, credit co-operative societies and their branches.

TABLE 123
NUMBER OF BANKING INSTITUTIONS AND THEIR BRANCHES, 1948 TO 1955

	End of 1948	End of 1954	End of 1955
Banks	23	24	25
Branches of Banks, exclusive of Head Offices	46	135	153
<i>Total Bank Offices</i>	69	159	178
Credit Co-operative Societies	70	92	94
Branches of Credit Co-operative Societies	16	56	61
<i>Total Credit Co-operative Offices</i>	86	148	155
<i>Total Offices of Banking Institutions</i>	155	307	333

SOURCE: *Bank of Israel*.

As Table 123 shows, very few new banks have been established since Israel achieved independence, but the number of bank branches has almost tripled. The number of credit co-operative societies has grown considerably since the establishment of the State and the network of their branches has also expanded. In 1955 alone, 26 new branches of banks and credit co-operative societies were opened.

The opening of new branches of banking institutions is linked with the rapid growth of the population due to immigration. However, a high proportion of the immigrants came from countries where the monetary system is undeveloped and they were therefore unaccustomed to using banking facilities. By opening branches of banking institutions in new settlement areas, the use of banking facilities was extended. This helped to increase the volume of time deposits and investments in securities.

During the Mandate, banknotes were issued to banking institutions by the Palestine Currency Board. In 1948, the Issue Department of the Bank Leumi Le-Israel B.M. was set up, in accordance with the terms of an agreement between the Government and the Bank (at that time still the Anglo-Palestine Bank Ltd.). However, the

functions and activities of this Department were restricted to the supply of currency only. The Bank Leumi Le-Israel B.M., then acting both as banker to the Government and the largest commercial bank, was, in fact, performing certain technical functions of a central bank. Nevertheless, until the foundation of the Bank of Israel, no central institution equipped with the necessary powers for directing monetary policy existed.

The Bank of Israel Law, 5714—1954, invested the Bank of Israel with wide powers for organising the activities of the banking system and for directing credit. The following are the most important of these powers:

(a) *Determining the Ratio and Composition of Liquid Assets*

The Bank of Israel is empowered to fix the ratio of liquid assets which banking institutions are required to hold, both in proportion to deposits and to assets, as well as to decide the composition of these liquid assets. The Bank of Israel is further empowered to take action against banking institutions which have not retained liquid assets in the proportions fixed. Banking institutions are also obliged by the Law to submit to the Bank of Israel a report on their liquid assets at any time and for any period demanded (Sections 49—51 of the Bank of Israel Law).

(b) *Accepting Deposits from Banking Institutions*

The Bank of Israel is empowered to accept deposits from banking institutions and to pay interest on such deposits (Sections 49 and 52).

(c) *Granting of Loans to Banking Institutions on Conditions Determined by the Bank of Israel.*

The Bank of Israel is empowered to grant credit to banking institutions, both by re-discounting and in other ways, and to determine the conditions on which such credit is granted (Sections 42 and 43).

(d) *Stabilising the Volume of Credit or Types of Credit*

The Bank of Israel is empowered to order banking institutions not to expand the total volume of credits granted or investments made by them. It may likewise forbid the expansion of a certain type of credit or investment (Section 53).

(e) *Granting of Advances to the Government*

The Bank of Israel is entitled to give temporary advances to the Government, up to the limit of 20 per cent of the Government's total Ordinary Budget for the current year (Section 45).

(f) *Determining the Maximum Rate of Interest*

The Bank of Israel is empowered to determine the maximum rate of interest which banking institutions may pay on their deposits or receive on loans granted by them (Section 56).

(g) *Activities in the Open Market*

The Bank of Israel is entitled to purchase or sell securities in the open market, and also to issue securities of its own (Sections 46 and 47).

(h) Fixing of the Capital Ratio in Relation to Assets

The Bank of Israel is empowered to fix the minimum permissible limit of paid-up capital and undistributed net profits in banking institutions, as well as the percentage of total assets or of a particular type of asset which these items have to constitute (Section 54).

(i) Minimum Cash Deposits Required on Letters of Credit

The Bank of Israel is empowered to determine the minimum amount of cash which customers are obliged to deposit in connection with the issue of letters of credit by banking institutions. This minimum can be of general application, or can vary for the different types of transactions financed through letters of credit (Section 55).

All these powers of the Bank of Israel are applicable both to banks and to credit co-operative societies, in accordance with the definitions in Section 1 of the Bank of Israel Law. These powers, together with the transferred powers under the Banking Ordinance, 1941, give to the Bank of Israel the wide authority to determine the volume of credit and its qualitative distribution, as well as to ensure the liquidity and stability of the banking institutions.

The activities of the Bank of Israel in the sphere of bank credit distribution are described in detail in Chapter XVIII.

2: STRUCTURE OF THE ASSETS AND LIABILITIES OF THE BANKING INSTITUTIONS

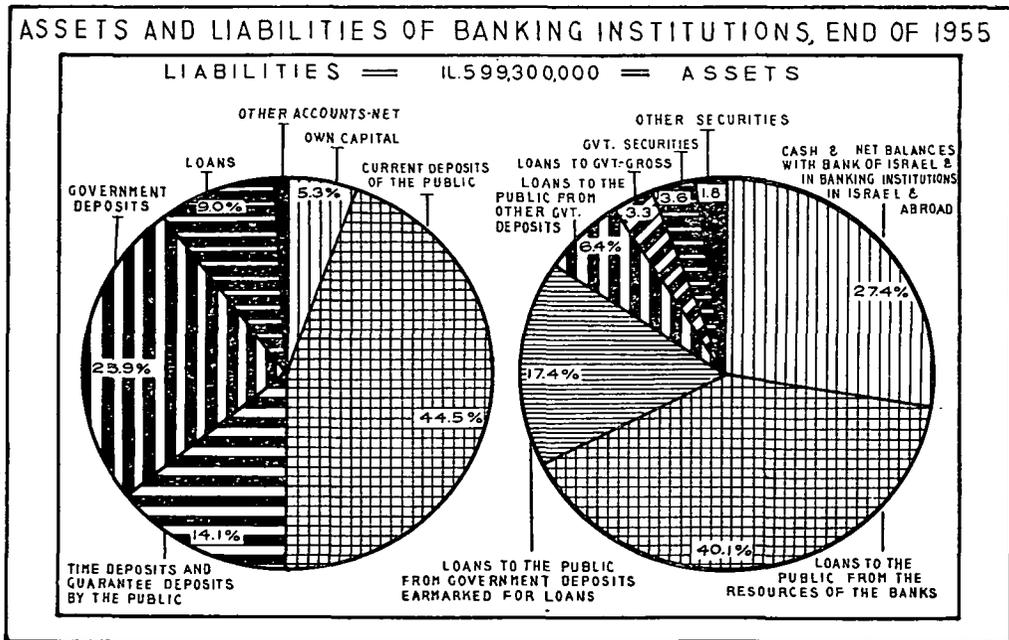
In Table 124, a summary is given of the assets and liabilities of banking institutions in Israel at the end of 1954 and 1955. The total volume of assets and liabilities of banking institutions balanced at the end of 1955 at about IL.844 millions, but some 30 per cent of this amount is represented by mutually offsetting items appearing on both sides of the balance sheet. The proportion of such items is high, owing to the large volume of imports into Israel financed by local banks through guarantees and acceptances.

The assets and liabilities of the banking institutions, apart from the mutually offsetting items, totalled some IL.600 millions at the end of 1955. On that date, current deposits constituted some 45 per cent of the total liabilities of banking institutions. The share of time deposits and other liabilities then amounted to 14 per cent of total liabilities. In view of the fact that, apart from the Post Office Bank, no special banking institutions for savings exist in Israel, the savings of the public in the form of time deposits are concentrated in the commercial banks and in credit co-operative societies. A further 9 per cent of the liabilities of banking institutions consisted of loans from other financial institutions, for the most part from foreign banks. Their own capital, including paid-up capital and reserve funds, constituted at the end of 1955 some 5 per cent of the total liabilities of banking institutions and was equal in value to 9 per cent of the deposits made by the public.

At the end of 1955, some 64 per cent of the total assets of banking institutions consisted of loans to the public, of which some two-thirds were granted from the

banks' own resources and the remainder from Government deposits. On the other hand, Government securities accounted for less than 4 per cent of total assets at the end of 1955: of this, the major part consisted of certificates of the Financial Institution Loans in which banks and credit co-operative societies are legally obliged to invest 9 per cent of the deposits in local currency against which they have to hold liquid assets. Since World War II, Government securities have occupied a most important place among the assets of banking institutions in countries where the banking system is well developed, their share of total assets being a third or more, and in countries such as Great Britain and the Netherlands as much as two-thirds. The extremely small amount of Government securities held by banking institutions in Israel is due to the lack of a large and active market for such securities and to the comparatively low rate of interest paid on them. The share of non-governmental securities in the assets of banking institutions is likewise low and amounted to only 1.8 per cent at the end of 1955. On the other hand, cash and balances in other banking institutions constituted on that date some 27 per cent of the assets of banking institutions.

During the first year of Bank of Israel operations, considerable changes occurred in the structure of the assets and liabilities of banking institutions, as shown in Table 124. There was a considerable rise in the proportion of liquid assets: this was caused by the restrictions imposed by the Bank of Israel, which prevented the expansion of credits in spite of the marked growth in the volume of deposits during 1955, and in the resultant improvement in the liquidity of the banks. Another reason for the increased share of liquid assets in total assets, was provided by the transfer to the Bank of Israel of most loans made to the Government by the banking institutions.



This measure not only brought about a fall in the proportion of credits to the Government and Government deposits in the balance sheets of banking institutions, but also caused the conversion of loans to the Government into balances with the Bank of Israel. The developments which took place in the deposits, credits and liquidity of banking institutions during 1955 are discussed in detail in Chapters XIII and XV.

TABLE 124

ASSETS AND LIABILITIES OF BANKING INSTITUTIONS, 1954 AND 1955

ASSETS

Item	in IL. millions		in per cent	
	End of 1954	End of 1955	End of 1954	End of 1955
Cash and Net Balances with the Bank of Israel and in Banking Institutions in Israel and Abroad	106.6	164.0	21.1	27.4
Loans to the Public:	319.2	382.9	63.1	63.9
a) From Own Resources	227.1	240.1	44.9	40.1
b) From Government Deposits				
Earmarked for Loans	69.3	104.2	13.7	17.4
c) From other Government Deposits	22.8	38.6	4.5	6.4
Loans to the Government * (gross)	44.5	19.8	8.8	3.3
Government Securities	25.4	21.8	5.0	3.6
Other Securities	10.0	10.8	2.0	1.8
<i>Total Assets</i>	505.7	599.3	100.0	100.0
Mutually Offsetting Items	258.7	245.0		
<i>Grand Total</i>	764.4	844.3		

LIABILITIES

Item	in IL. millions		in per cent	
	End of 1954	End of 1955	End of 1954	End of 1955
Own Capital	25.4	31.9	5.0	5.3
Current Deposits of the Public	222.9	266.6	44.1	44.5
Time Deposits and Guarantee				
Deposits of the Public	68.3	84.4	13.5	14.1
Government Deposits including				
Deposits Earmarked for Loans	143.1	155.3	28.3	25.9
Loans	45.9	53.8	9.1	9.0
Other Accounts (net)	0.1	7.3	—	1.2
<i>Total Direct Liabilities</i>	505.7	599.3	100.0	100.0
Mutually Offsetting Items	258.7	245.0		
<i>Grand Total</i>	764.4	844.3		

* Including debt of the Exchange Funds.

SOURCE: Bank of Israel.