

The Committee to Examine Reducing the Use of Cash in Israel's Economy

Final Report (Translation of main sections)

17 July 2014



Table of Contents

	Preface	
I.	Executive summary and main points of the recommendations	
II.	Establishing the Committee, its guiding principles, and its recommendations A. Establishing the Committee B. Guiding principles C. The Committee’s recommendations	
III.	The shadow economy	
IV.	The business perspective—means of payment	
a.	Cash	
b.	Checks	
c.	Payment cards	
V.	Appendices	
a.	Questions and answers	
b.	Issues raised with the Committee during hearings	
c.	Committee members	

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Paul Landes, Head of Israel Money Laundering and Terror Financing Prohibition Authority, Member

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July 17, 2014

Preface

I am honored to submit herewith the report of the Committee to Examine Reducing the Use of Cash in Israel's Economy.

Based on Israel Tax Authority estimates, about one-fifth of economic activity in Israel is unreported—that is, the shadow economy!

The implication of the shadow economy in Israel is loss of tax revenues of about NIS 40–50 billion per year, an amount equal to nearly the entire shekel budget of Israel's Ministry of Defense, Ministry of Health, or Ministry of Education. With this amount, the VAT rate could be dramatically reduced, thus reducing the cost of living, or alternatively the rate of tax on labor income could be reduced. As another illustration, income tax receipts from employees in the economy total around NIS 40 billion—an amount similar to the tax revenues lost due to the shadow economy. That is, for every shekel of income tax collected from an employee, another citizen is evading a shekel in taxes to the state's coffers.

However, the damage to Israel's economy and society from a shadow economy of such major size does not end with the economic loss. The shadow economy negatively impacts social cohesion and national resilience and calls into question the legitimacy of the rule of law and government administration. It negatively impacts equality in general, and in equal sharing of the civic burden in particular. Bearing of the responsibilities of citizenship, by each individual, is critical to the existence of a civil system. A state like Israel cannot accept these negative impacts. Therefore, the battle against the shadow economy is a strategic goal.

Additionally, besides the issues noted above, the world is moving toward a cashless society. In a digital age, cash will have no significance. It is appropriate that in this issue as well, the State of Israel lead the process and enter the new age in a prepared and innovative manner.

The Committee's mandate, as established in Government Decision 749, on September 17, 2013, was to examine the problems stemming from the use of cash, what is done in this area in other countries, and the unique characteristics of Israel's economy.

On the basis of this examination, the team formulated a work outline and ways to implement a policy to limit the use of cash as a means of payment for goods and services in the Israeli economy. This was with the goal of reducing the phenomenon of the shadow economy in Israel, combatting crime and money laundering, and making the use of advanced and efficient means of payment possible.

The team also focused on promoting alternatives to the use of cash for all segments of the population. This includes preparing a framework for implementing the use of (immediate) debit cards in Israel's economy, and providing a solution for various population segments that do not have bank accounts.

Likewise, it was suggested to implement the Committee's proposals gradually, to allow the economy and the public to get used to the changes. During the months in which the Committee operated, there was a process of public participation and the interim report presented herein will be brought out to the public for comment before being brought to the government for approval.

We believe that the implementation of the Committee's recommendations will provide an appropriate infrastructure for reducing the size of the shadow economy and money laundering, reducing crime, strengthening the sense of equal sharing of the burden, reducing the cost of living, and improving the public welfare.

At this point, I would like to thank all the people who met with the Committee and contributed from their experience. This includes the Director General of the Israel Antitrust Authority and his staff. I extend a special thanks to my colleagues on the Committee, from the Israel Tax Authority, the State Revenues Administration, the Bank of Israel, the Israel Money Laundering and Terror Financing Prohibition Authority, the Israel Police, the Ministry of Justice, and the Ministry of Finance, who invested considerable time and great effort in order to formulate this report.

Sincerely,

Harel Locker

I. Executive summary and main points of the recommendations

The term “shadow economy” denotes the share of economic activity which does not appear in GDP data. The shadow economy is generally defined as economic activity which is conducted outside a country’s legal framework. Thus, most of it is not reported to tax and other authorities. The shadow economy includes activity and revenues which are deliberately hidden from public authorities with the goal of avoiding the fulfillment of the obligations imposed on every citizen and business. Two types of activity are generally referred to when classifying the sources of unreported revenue—legal economic activity and illegal activity. It is difficult to obtain precise data on the scope of the shadow economy—and all data about it are defined as estimates—since by nature, it is conducted far from public view, as its participants are not interested in exposing it or themselves, and because various technological means allow tax evasion by sophisticated methods. Researchers therefore developed models, some of which are controversial, to estimate the value of the shadow economy; however, all the models view their data as only an estimate. One of the estimates for Israel appears in a World Bank research paper.¹ According to that research, which compares 151 advanced and developing countries, between 1999 and 2007, the average size of the shadow economy in Israel was 22 percent of GDP.

The team’s work is the most extensive government effort on this issue to date, and the team’s recommendations include a series of complementary actions to reduce the shadow economy. The foundations of the proposed reform are reduced use of cash, reduced use of endorsed checks, and increased use of electronic means of payment.

Recommendations regarding the use of cash:

The use of cash has been recognized in Israel and abroad as a significant factor affecting the shadow economy, and serves as the “fuel” powering the shadow economy.

Cash makes it easier to evade taxes, launder money, and finance terrorism because it is anonymous and easy to hide from authorities, and because it is easy to use for commercial and financial activities. Use of cash even permits avoiding the financial system which serves as a gatekeeper for preventing, and combatting, money laundering and terrorism financing by imposing various obligations (such as identification and “know your customer”, and reporting to the Israel Money Laundering and Terror Financing Prohibition Authority). Finally, cash constantly needs to be handled by businesses—counting, maintenance, transport, security, storage, etc. With that, cash is a major means of payment in Israel, and over the years cash’s share of GDP has been

¹ Schneider, Friedrich, et al. (2010), “Shadow Economies All over the World”, the World Bank. The research examines 151 countries, both developed and developing.

moderately rising, similar to the situation in many countries. Average circulation per capita (the ratio between average currency circulation² and the average monthly population) is increasing each year against the background of an increase in nominal GDP per capita³, and in recent years it has increased against the background of the decline in the interest rate due to the global crisis.⁴ In real terms, the increase in currency circulation has been around 10 percent, on average, in the past decade.

With that, the Committee recognizes that cash is a basic means of payment in the economy and serves as a widespread and accepted means by the law-abiding population, which is an overwhelming proportion of the public. The Committee thus recommends ways to decrease the use of cash, but not to completely eliminate its use:

- a. Limiting the amount of a cash transaction immediately, to NIS 10,000, with the stipulation that all the conditions set in Sections 6.1, 6.2, 6.3, 6.4, 6.5 (regarding the publication of the guideline), 6.11 and 6.12 in the recommendations below, are fulfilled, and to NIS 5,000 afterward.**
The opinion of the Deputy Attorney General (Criminal) regarding the amount of the restriction in the first stage will be noted at the end of the section on the main points of the recommendations.
- b. Limiting the amount of a transaction between private parties to up to NIS 15,000.**
- c. Likewise, to establish that a violation of the prohibition on conducting cash transactions above the defined threshold will be established as a criminal offense, in respect of which an administrative fine or sanction, as detailed below, will be imposed. In this regard, transactions spread out over several payments will be considered as one transaction, in contrast to extended services which will be considered as separate transactions.**

Recommendations regarding the use of checks:

The use of checks, in general, in Israel is large compared with the rest of the world, and in particular, the use of endorsed checks. The considerable use of endorsed checks supports the shadow economy.

In Israel, checks can be endorsed and passed on without limitations on the amount or the number of endorsements and without documentation of endorser and endorsee. The

² The circulation value includes, besides cash held by the public, cash held by banking corporations in their vaults. It also includes cash held by nonresidents (a phenomenon more of the US and Eurozone, since their currencies are used beyond their borders as well).

³ Generally, circulation also increased as a result of population growth and of inflation. In 2012, population growth was 1.8 percent, and inflation in Israel was 1.6 percent.

⁴ Against the background of the low interest rate environment in Israel and worldwide, as well as the moderation of growth in the economy (to 3.1 percent) and the global slowdown, the public apparently prefers to keep more cash on hand, rather than invest its funds in interest-bearing deposits.

endorsement thus allows the transfer of checks from one person to another without reporting. Checks which can be endorsed are called “negotiable”. Negotiable checks serve as a substitute for cash from various perspectives, such as anonymity, the ability to make payments without a bank account, and the ease and accessibility for the payer and payee—and thus negotiable checks support the shadow economy. Furthermore, use of checks exposes the customer (beneficiary), the business, the bank, and the overall system to risks including operational risks, liquidity risks, and credit risks. There are other risks with negotiable checks: in certain cases the endorsee can demand payment without the drawer being able to make defensive claims about the original transaction—for example, if a check drawer does not receive the goods that were paid for. Risks of money laundering and of terrorism financing are inherent in the use of a negotiable check, and a negotiable check is liable to reach criminal elements. Despite this, there is widespread use of checks in Israel, among other reasons because they provide a solution for commercial needs, including deferred payments outside the customer’s credit framework, spreading charges over several unequal payments and over unequal periods of time, providing guarantees against credit, and check discounting. The total value of transactions which were cleared through the Paper-based (Checks) Clearing House in 2012 was NIS 964 billion (an increase of about 2 percent from the previous year), while the volume of transactions declined by about 1 percent, from 149 million transactions in 2011 to about 147 million in 2012. The average value of a check increased in recent years, and in 2012 it reached NIS 6,537, an increase of about 3 percent compared with the previous year. Furthermore, the share of negotiable checks printed (that is, those without “pay to beneficiary alone” printed on them) recently declined, due to a 2011 amendment to the Banking (Service to the Customer) Law, 5741–1981. This amendment establishes that checks issued by banking corporations must be crossed, with words prohibiting their negotiability, such as “to the beneficiary alone”, printed on them, unless the customer specifically asks otherwise.

The Committee therefore recommends limiting the use of endorsed checks and implementing changes which reduce the existing risks in the use of checks.

- a. Limiting the ability to redeem checks which were endorsed more than once, to NIS 10,000 in a first stage, with the stipulation that all the conditions set in Sections 6.1, 6.2, 6.3, 6.4, 6.5 (regarding the publication of the guideline), 6.11 and 6.12 in the recommendations above, are fulfilled, and to NIS 5,000 in a second stage. Likewise, the Committee recommends prohibiting, at some future stage, trading checks at any value.
The opinion of the Deputy Attorney General (Criminal) regarding the amount of the restriction in the first stage will be noted at the end of the section on the main points of the recommendations.**
- b. A prohibition on paying with and receiving a check without a beneficiary listed on it (blank check).**
- c. Limiting the amount of a check-based transaction to an amount to be determined—but no less than NIS 1,000,000.**

It should be emphasized that there is no intention of eliminating check use.

Promoting the use of electronic means of payment:

The Committee recommends limiting the use of cash and negotiable checks by promoting the use of advanced electronic means of payment (characterized by low fees in accordance with the type of means of payment).

Various electronic means of payment are already in use in Israel, and in recent years their use has increased. In July 2007, the Zahav (the Hebrew acronym for Real Time Gross Settlements) system came into use in Israel, a system which allows the transfer of generally large sums of money in real time and with finality of the payment (that is, irrevocable payment). The Bank of Israel has adopted several processes over time in order to expand the use of the system. Likewise, the use of payment cards (credit cards and debit cards) became entrenched in Israel. The cards are accepted in all large and medium-sized businesses, and in most small businesses. Businesses find it convenient to use cards since the payment is with a high level of security; handling the payment is simple relative to the use of cash or checks, since it does not involve counting, depositing, security, mistakes, and the like; it is also easy to integrate the mechanism which allows the acceptance of card payments. In recent years there has been an increase in the number of active prepaid cards, and in 2012 there were 6.3 million, an increase of 6 percent from the previous year. Several developments contributed to the increase, including an increase in the variety of cards issued (which today includes nonbank payment cards, which are generally related to customer clubs), an expansion of the range of services provided by financing and credit companies, the expansion of e-commerce and an increase in the number of points of sale⁵ (117,000 in 2012, an increase of about 5 percent from the previous year). About 880 million transactions were conducted via payment cards in 2012 (compared with 122 million transactions via checks and 120 million transactions via electronic instructions), an increase of 10 percent compared with the previous year.

The committee thus recommends promoting the use of advanced electronic means of payment, through, among other things, the following means:

- a. Expanding the use of debit cards and of identified prepaid cards.** The Committee formulated a framework for expanding the use of immediate credit cards and identified prepaid cards, and for reducing the fees involved in their use. This includes setting a maximum period of 3 days for credit card companies to credit the merchant and agreement on legislation by the Director General of the Antitrust Authority to immediately set separate interchange fees for transactions conducted via a debit card;
- b. Acceleration of the banking system switch to using “smart cards” by using the EMV advanced security standard;**

⁵ Point of sale—POS—is an independent device or a terminal in a system, used to sell goods or services in exchange for payment via a payment card.

- c. **The Committee recommends to move forward with the smart virtual wallet, which will serve as storage for funds from various sources and will allow the use of existing and future means of payment, and to promote digital checks as well;**
- d. **Immediately move forward with on the Electronic Check Clearing Law⁶, which will allow the promotion of the use of advanced electronic means of payment and make the check clearing process more efficient;**
- e. **Acceleration of government use of electronic means of payment in payment systems vis-à-vis the public;**
- f. **Moving forward with the process of financial education for the general public.**

Debit cards and identified prepaid cards: The most common type of payment card in Israel today is a deferred debit card, which serves as a partial substitute for cash, because (a) businesses finance the credit days until they are credited (in the month following the actual transaction), and (b) the card is only accessible to customers who have a credit framework in a bank account. Worldwide, debit cards and prepaid cards serve as a more suitable substitute for cash, because the merchant is generally credited within three days. It should be noted that a prepaid card also serves as a cash substitute for customers without a bank account and is accessible to customers who do not have a credit framework. In Israel, in contrast, such cards do not serve as a suitable substitute for cash because the merchants are credited for such cards on the exact same dates that they are credited for transactions using deferred debit cards, and also because there aren't identified prepaid cards with large amounts in new shekels (such transactions are carried out in cash in large sums and without limits).

In conclusion, the importance of the reform, which is intended to reduce the shadow economy, necessitates wide-ranging, structural, steps, which require a change in commercial, legal, and technological infrastructures. This requires that the implementation stages of the measures, in each area, are carried out gradually and are well thought out, with attention paid to the effect on every sector of the population, including population segments that have less access to advanced electronic means or to bank accounts. It should again be emphasized that the intention is to decrease the use of cash and checks (with an emphasis on multiple endorsements) and not to eliminate their use.

The Committee will continue its work and will be established as a permanent committee that will monitor the implementation of the report's recommendations.

⁶ Also known as the "check Truncation Law".

II. Establishing the Committee, its guiding principles, and its recommendations

A. Establishing the Committee

On September 17, 2013, the Government unanimously decided to establish a Committee to examine reducing the shadow economy and money laundering by limiting and decreasing the use of cash and other means of payment. The goal was to broaden the tax base (the Government decision is attached in Appendix A). The Committee was set up at the instruction of Prime Minister Benjamin Netanyahu, and the Director General of the Prime Minister's Office was appointed to head it. The Committee includes representatives from various regulatory and enforcement agencies in the economy, such as the Prime Minister's Office, the Ministry of Finance, the Israel Tax Authority, the State Attorney, the Attorney General's office, the Israel Money Laundering and Terror Financing Prohibition Authority, the Bank of Israel, and the Israel Police.

The Committee was empowered to formulate a policy path to gradually reduce the use of cash and other paper-based means of payment, including limiting the negotiability of checks, and to make recommendations about providing incentives and removing obstacles in order to encourage the use of advanced electronic means of payment. More precisely, the Committee was charged with formulating a proposal for a gradual process with two complementary components: Reduce the worthwhileness of using cash and other paper-based means of payment, and at the same time increase the worthwhileness of using advanced electronic means of payment by providing incentives and removing obstacles.

Within the framework of the Committee, two subcommittees were established. One was a subcommittee to establish norms of cash payment, led by the head of the Israel Tax Authority and the head of the Israel Money Laundering and Terror Financing Prohibition Authority, and the second subcommittee was a team to formulate a gradual reduction in the use of cash, headed by the Bank of Israel representative.

B. Guiding principles

One of the starting points for the Committee was that most of the population are law-abiding citizens and it is thus appropriate to minimize the negative impact on the usual course of business, and to limit itself to the aspects which are crucial to achieving its goal. Furthermore, the Committee examined the topics from the points of view of consumers and businesses and considered the difficulties that alternative means of payment pose to the range of population segments, including people without a bank account, owners of restricted bank accounts, and business owners; accordingly, it proposed to those groups means of payment that solve those difficulties while still serving the Committee's objective, which is to reduce the shadow economy.

In addition to those principles, the Committee worked according to the following principles:

1. The reform should be formulated through the understanding that it is designated first and foremost to decrease the size of the shadow economy.
2. There needs to be a change in the approach to means of payment, and increased awareness among the public to the link between anonymous means of payment and the shadow economy.
3. It is important to formulate the reform from a systemic perspective: to include all means of payment in the economy, and to include all sectors—business, public, and government. The Committee recommends that the changes that are implemented with regard to cash are also implemented with regard to its substitutes: checks which can be endorsed multiple times, foreign currency, and anonymous prepaid cards.
4. The recommendations should be implemented while paying attention to their effect on all population segments, including people without adequate access to advanced electronic means of payment.
5. It is appropriate to integrate the reform in a gradual manner, because the reform incorporates major steps and the public should be given time to get used to them, and also to allow time to develop additional advanced electronic means of payment. It is appropriate to formulate simple and uniform recommendations in order to facilitate the implementation of the change.

C. The Committee's recommendations

The Committee recommends preparing for an effective date of June 1, 2015 for the implementation of the immediate-term recommendations. This is subject to anchoring the arrangements in law where required, and in any connection to the prohibition on using cash and the restriction on the use of negotiable checks, to the stipulation that all conditions set out in Sections 6.1, 6.2, 6.3, 6.4, 6.5 (regarding the publication of the guideline noted in that section), 6.11, and 6.12 in the main points of the recommendations are met.

With regard to the implementation of the recommendations, the Committee distinguished between recommendations for immediate implementation (from the date of government approval, through Knesset approval of the legislation, where required, to the effective date), recommendations for medium-term implementation (1 year from the date that the prohibitions and restrictions go into effect), and recommendations for future targets (up to 3 years from the date that the prohibitions and restrictions go into effect). The Minister of Finance, with the agreement of the Minister of Justice and the Governor of the Bank of Israel, will be authorized to approve the switch between the stages, for anything regarding to restrictions on the use of cash and negotiable checks, in line with an assessment of the situation and with the recommendation of the permanent committee (the continued work of the existing committee for monitoring the implementation of its recommendations). The situation assessment will take into account the availability of alternative means of payment, the extent to which the reform is progressing in accordance with the original plan, and the effect on the public and the economy.

1. **The Committee recommends limiting the use of cash (NIS and foreign currency), but not eliminating its use.** In Israel and worldwide, it has been recognized that cash is among the factors which facilitate tax evasion, because it is anonymous and easy to hide from authorities, and because it is easy to conduct commercial and financial activities with it. Furthermore, use of cash allows the evasion of the battle against money laundering and financing of terrorism, because it permits the circumvention of the financial system. The financial system serves as a gatekeeper for any activity in the battle against money laundering and financing of terrorism because it complies with various obligations (customer identification, reporting to the Israel Money Laundering and Terror Financing Prohibition Authority, and others). In addition to these two claims against cash, there is the fact that it requires significant resources, since it constantly needs to be dealt with by companies—counting, storing, transporting, security and storage. With that, the Committee recognizes that cash serves as a basic means of payment in the economy, and serves the law-abiding population, which makes up the vast majority of the public. Therefore, the Committee recommends to apply the changes on cash alternatives substitutes as well—a check which allows multiple endorsements, cash in foreign currency, and anonymous prepaid cards.
 - a. The Committee recommends an amount for the limitation on a cash transaction, in the immediate term, of NIS 10,000.⁷
 - b. The Committee recommends an amount for the limitation on a cash transaction, in the medium term, of NIS 5,000.⁸ Transactions at amounts greater than the limitation will only be conducted through means of payment which can be identified and attributed to the parties to the transaction. When setting the appropriate level, the Committee examined the amounts generally used by various countries worldwide with a similar proportion of a shadow economy, and it was aided as well by the setting of a VAT law regarding the requirement to list, as part of the detailed VAT report, invoices for amounts greater than NIS 5,000⁹. In addition, Israel Tax Authority data indicate that in 2012, there were 3 million unidentified transactions for amounts greater than NIS 5,000, with a total value of NIS 273 billion. In that same period, there were 11 million unidentified transactions of amounts less than NIS 5,000, with a total value of NIS 6 billion. The Committee recommends authorizing the Minister of Finance, the Minister responsible for the Israel Tax Authority, to ease, through an Order, this limitation in certain circumstances.
 - c. Transactions between individuals: Since transactions between individuals are characterized by a limited ability to pay with electronic means, as well as the need for the seller to ensure receipt of the payment, the Committee found room for easing in such transactions: the Committee recommends permitting

⁷ As noted, an immediate term recommendation will be implemented as of June 1, 2015, or from the date of Knesset approval of legislation, where required.

⁸ As noted, a medium-term recommendation will be implemented up to 1 year from the date of Knesset approval of legislation.

⁹ Section 69A(c) in the VAT law.

cash transactions, involving only private parties, of amounts up to NIS 15,000. In order to ease the transition, the Committee recommends permitting, for a period of 1 year from the date of Knesset approval of the legislation, a limitation of NIS 50,000 for individuals.

- d. Purchasing used cars: Whereas used-car transactions between individuals are characterized by a limited ability to pay with electronic means of payment, the need for the seller to ensure receipt of the payment, and since in many cases these are transactions that occur when there is no regular activity at banking institutions, the Committee found room for even further easing in such transactions. Thus, the Committee recommends permitting cash payments in a used-car sale between private parties, up to an amount of NIS 50,000.
- e. Owners of restricted accounts will be able to carry out cash transactions of up to NIS 20,000, with the customer bearing the responsibility to keep the receipt for a period of at least 3 years. The receipt is to record that the use of cash was because the customer declares he or she is the owner of a restricted account, and the details (based on an identifying certificate) are to be recorded on the receipt. This easing will be valid until the coming into effect of the debit card as detailed in Sections 6.1, 6.2, 6.3, 6.4, 6.5 (regarding the publication of the guideline noted in this section), 6.11, and 6.12 in the principle recommendations.
- f. Violating the prohibition on conducting cash transactions above the maximum amount defined will be established as a criminal offense for which an administrative fine (on private parties) or a financial sanction (for businesses)—of 25 percent of the transaction value on the buyer and 35 percent of the transaction value on the seller—will be levied. These rates will be imposed on every buyer and seller, whether a business or a private person.
Furthermore, the Committee recommends setting a criminal offense of fraud related to an attempt to avoid the prohibition on paying with cash above the maximum amount set, and to establish that the fraud offense will be considered a source offense in line with the First Addendum to the Prohibition on Money Laundering Law. This will be a temporary order for two years.
The prohibitions and sanctions listed will come into effect with the stipulation that all conditions set out in Sections 6.1, 6.2, 6.3, 6.4, 6.5 (regarding the publication of the guideline noted in this section), 6.11, and 6.12 in the main points of the recommendations above are met.
- g. The Committee recommends that transactions spread out over several payments be considered as one transaction, and that prolonged

services be considered as separate transactions. The Minister of Finance has the authority to determine how special transactions, such as rent payments, are to be considered.

- h. The Committee recommends allowing the use of information transferred by the Israel Money Laundering and Terror Financing Prohibition Authority for the purpose of enforcing the prohibition on using cash by the buyer and/or seller at an amount of NIS 50,000 and more. To that end, the necessary legislative amendments will be added.
 - i. The Committee recommends defining the Israel Tax Authority as the regulator for all issues related to the prohibition on using cash, subject to providing the appropriate resources in terms of budget and human resources.
 - j. The Committee recommends amending Section 47a of the VAT Law, which deals with the prohibition on paying in cash between businesses, pursuant to the recommendations below.
2. **The Committee recommends restricting the possibility of cashing checks which have been transferred more than once.** Negotiable checks—checks which can be endorsed over to another person an unlimited number of times and without documentation of the endorser or endorsee—serve as a cash substitute in various perspectives (for example, anonymity and the possibility to pay without a bank account). This increases the risk of their being used for money laundering or terrorism financing, and it could create fertile ground for economic activity by participants who do not report it to the tax authorities. In addition, they are liable to represent a risk to the drawer of the check (the payer), because they may reach unwanted parties—criminal elements or other endorsees, whom the payer does not know, but whom nevertheless may be, under certain circumstances, the legitimate holder of the check and thus hold the direct right to redeem the check vis-à-vis the drawer.

In order to deal with these problems, the Committee recommends establishing, in legislation, restrictions on banking corporations receiving, for payment or collection from another banking corporation, checks which ostensibly were endorsed more than once. (Receiving a check which was endorsed by the beneficiary and presented by the endorsee will be allowed.) This will come into effect gradually and in parallel with the restrictions placed on the use of cash:

Immediate term:¹⁰ To establish the limitation related to checks with a face value of greater than NIS 10,000. It is recommended to permit redeeming a check at an amount greater than the limitation, which has been endorsed only once, under the stipulation that the endorsee writes on the back of the check his or her name and identification number;

Medium term:¹¹ To establish the limitation related to checks with a face value of greater than NIS 5,000. Nonetheless, it is important that companies will be able to receive credit against checks, so it is recommended to permit redeeming a check at an amount greater than the limitation, which has been endorsed only once to a supervised financial institution (based on a decision to be formulated by the Committee), and only for the purpose of receiving credit, and subject to arranging the regulation of currency service providers, including credit service providers. Until such regulation is established, it is recommended to allow the redeeming of a check at an amount greater than the limitation, which has been endorsed only once, under the stipulation that the endorsee writes on the back of the check his or her name and identification number;

Future:¹² To extend the limitation to checks of any amount. It is also recommended to allow redeeming a check at an amount greater than the limitation, which has been endorsed only once to a supervised financial institution (based on a decision to be formulated by the Committee), and only for the purpose of receiving credit, and subject to arranging the regulation of currency service providers, including credit service providers.

In addition to the above, negotiable checks with a face value lower than the limitation amount may be traded one or more times, provided that the following details are recorded on the back of the check, for every endorsement: "I hereby endorse this check to (name)_____, ID number-_____, Signed, (name)_____, date_____, signature_____." Endorsing a check without filling in these details will constitute a criminal offense.

Below please find a table which concentrates the recommendations regarding restrictions on checks:

Timeframe	Type of check	Permitted amount on check	Endorsements
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¹⁰ As noted, an immediate term recommendation will be implemented as of June 1, 2015, or from the date of Knesset approval of legislation, where required.

¹¹ As noted, a medium-term recommendation will be implemented up to 1 year from the date of Knesset approval of legislation.

¹² As noted, up to 3 years from the date that the prohibitions and restrictions go into effect

Immediate (From the date of Knesset approval of legislation.)	Open check	Prohibited	---
	Pay to beneficiary only	Any amount	Cannot be endorsed
	Negotiable check	Up to NIS 10,000	May be endorsed, under stipulation that details are recorded on back of check
		Greater than NIS 10,000	One endorsement permitted, under stipulation that endorsee records name and ID number on back of check*.
Medium (Up to 1 year from the date of Knesset approval of legislation.)	Open check	Prohibited	---
	Pay to beneficiary only	Up to an amount to be determined and no less than NIS 1 million	Cannot be endorsed
	Negotiable check	Up to NIS 5,000	May be endorsed, under stipulation that details are recorded on back of check.
		Greater than NIS 5,000, up to NIS 1 million	One endorsement to a financial institution permitted, (based on decision to be formulated by the Committee), and only for receiving credit*.
Future (Up to 3 years from the date of Knesset approval of legislation.)	Open check	Prohibited	---
	Pay to beneficiary only	Up to an amount to be determined and no less than NIS 1 million	Cannot be endorsed
	Negotiable check	Prohibited	One endorsement to a financial institution permitted, (based on decision to be formulated by the Committee), and only for receiving credit.

* Subject to currency services providers regulations going into effect.

3. The Committee recommends establishing a prohibition on paying with and receiving checks on which the name of the beneficiary is not written (blank check). Violating this (by the check issuer or receiver) is a criminal offense which will entail an administrative fine (on private parties) of 25 percent of the amount on the check or a financial sanction (on businesses) of 35 percent of the face value of the check.

4. The Committee recommends restricting a check transaction amount to an amount to be determined—but no less than NIS 1 million. Use of checks involves numerous risks, including (1) operational risks: the check clearing process includes several stages, and a failure of any one of them, due to a technical problem, human error, etc. will disrupt it; (2) liquidity risks: the beneficiary cannot be certain that the check will in fact be redeemed; (3) credit risks: the beneficiary cannot be certain that the check will be paid on time; (4) risks resulting from crimes: the check can be stolen, forged, or used to commit fraud; and (5) money laundering risk: checks can be deposited and the source of the income hidden. Limiting the amount of a check transaction will reduce the risks which originate from such transactions and affect various entities in the economy, including the broad public, businesses, and banks. Setting a maximum amount supports the use of safer and more efficient systems, such as Zahav.¹³

5. The Committee recommends emphasizing the public aspect. It is not simple to integrate advanced means of payment among the broader public, because various sectors of the population have different needs. The Committee therefore recommends to deal with the public perspective: to progress with a process of financial education for the broad public, to include the public in the planned changes, to increase awareness of risks inherent in use of open and negotiable checks, to present the advantages inherent in alternative electronic means of payment (characterized by low fees in accordance with the type of means of payment), and to conduct a periodic survey in order to examine what means of payment are used by various population sectors. In order to clarify the recommendations to the public, a question and answer file will be distributed, which will present the recommendations through real-life examples (see Appendix B). The Israel Tax Authority and the Bank of Israel together, and based on the policies to be outlined by the permanent Committee, have the responsibility for explaining and implementing the changes among the general public.

¹³ The Zahav system is Israel's RTGS—real time gross settlement—system, which allows irrevocable payments to be made safely and immediately.

6. The Committee recommends promoting the use of debit cards and identified prepaid cards. In order to provide a suitable alternative to cash, and thus serve the objectives of the Committee, means of payment which have both the advantages of cash—available to the general population and providing the beneficiary with immediate and irrevocable remuneration—and the advantages of payment cards—identified, secure, and documented—should be promoted. In effect, debit cards feature most of the advantages noted (accessible to bank account holders and through the Postal Bank), and prepaid cards are also accessible.

The current situation: Today, the debit cards and identified prepaid cards available in Israel do not serve as a cash substitute for business owners, because the cards do not provide immediate and irrevocable remuneration—merchants in Israel are credited only once a month, in the month following the payment month, so that the business does not have an incentive to request payment through them.

Cards available in Israel today have other shortcomings: (1) they bear high fees (there will be fees in the future as well, but lower), for both the customer and business; (2) they are issued separately, physically, from all other cards; (3) the debit card is generally issued only to customers who do not have a credit framework; (4) the unidentified prepaid card, in New Shekels, is limited to a small amount of NIS 1,000, and is an anonymous means of payment and thus has the same shortcomings as cash, and the limitations on cash will apply to it as well; (5) the identified prepaid card is currently only issued in foreign currency. Due to the risks inherent in an individual card loaded with a large amount of money, the maximum loading amount of this type of card is the equivalent of around NIS 10,000.

Committee recommendations for an outline: In accordance with what has been noted above, the Committee formulated an outline for expanding the use of debit cards and identified prepaid cards and to reduce the fees that come with them, through the following means:

1. Ensure that the merchant will be credited no more than 3 days after the transaction is conducted, by regulating the manner in which funds are transferred from the issuer to the acquirer and from the acquirer to the merchant.
2. Authorize by law the Director General of the Israel Antitrust Authority to establish, immediately, separate interchange fees for transactions carried out by debit card, which reflect the risks and costs to the issuer, with the goal of ensuring that these fees will reflect the reduced risks in such cards.

- These fees will apply to identified prepaid cards as well. The Committee is of the opinion that fees for using such cards should be reduced.
3. To establish that a customer-initiated transaction fee should not be charged for any immediate debit transaction on its own; only monthly usage fees should be permitted to be charged (guidelines on this issue will be issued by the Supervisor of Banks).
 4. To issue guidelines to the banking system that a debit card combining a cash withdrawal function should be a shelf product to be offered by the bank to its customers as a means of conducting transactions in their accounts, at a supervised price (guidelines on this issue will be issued by the Supervisor of Banks).
 5. To increase the availability of the option of carrying out transactions by immediate debit through setting up one of two options: (1) providing a guideline through which it will be possible to carry out all types of debits (cash withdrawal, immediate debit, deferred debit, and charge for credit) on one payment card (new and existing), gradually, over a 2-year period; (2) providing a guideline to immediately issue a debit card, with no cost, as a shadow card for every payment card that is issued. It should be emphasized that there is no intention to prevent issuers from issuing a card for cash withdrawals only, to the extent customers request it (this will be promoted by the Bank of Israel).
 6. To regulate the full disclosure to merchants and debit card holders of transactions carried out with a debit card.
 7. To request that the Director General of the Israel Antitrust Authority examine imposing a prohibition on creating contractual limitations on dealings between an acquirer and a business which would prevent the development of immediate debit transactions.
 8. To regulate the access to the credit card switch, even to the acquirer as defined in Section 36i of the Banking (Licensing) Law, 5741–1981.
 9. To progress, vis-à-vis the Postal Bank as well as additional entities, with the option of issuing an identified prepaid card in NIS, in amounts up to NIS 10,000. The Bank of Israel will examine the possibility that financial institutes will put into use and offer the general public, without an exception, identified prepaid card in NIS, up to NIS 10,000 per card.
 10. To continue to promote competition in the area of payment card and prepaid card activity: the Bank of Israel already works to regulate the activity of entities clearing payment card transactions, in accordance with the supervisory framework for clearers set by the Supervisor. This activity will encourage clearers that are not auxiliary banking corporations to enter the market. In addition, the need to advance setting up an additional

switch for carrying out payment card transactions will be considered. The need to regulate the payment card transaction clearing process, and the activity of the various entities involved in the process (issuers, acquirers, etc.) will also be considered.

11. To determine that the Postal Bank will put into use a debit card to all postal bank's clearing accounts holders. As for the banking corporations—to advance the possibility of issuing a directive that will require them to issue a debit card, subject to certain conditions, to anyone who requests it, and to permit opening a suitable bank account to that end.
12. To ensure that the limitations currently in place regarding use of a debit card for a debtor who is able to pay his charges but refuses and for a debtor of limited means, in accordance with the Execution Office Law, 5767–1967, and in accordance with the Collection of Fines, Fees and Expenses Law, will not apply to debit cards.

7. **The Committee recommends the promotion of implementing the EMV advanced security standard.**¹⁴ In 2013, the Bank of Israel found that it is important that the banking system in Israel switch to using smart cards. Smart cards enable customers to carry out all types of transactions that the previous payment card allowed—immediate debit, deferred debit, credit transactions, and cash withdrawal—but it also grants them new advantages. First, in order to use a smart card a code needs to be entered in a terminal at the business, which reduces the use of lost or stolen cards. The switch will thus reduce the potential for fraud and will increase customer and card company trust. Second, the switch brings the economy in line with the world, which in turn allows broader use of credit cards abroad.

The switch to smart cards (cards that combine deferred debit and immediate debit and that have advanced security technology) requires bringing various systems in line with each other, including Shva and points of sale. According to the plan outlined by the Supervisor of Banks, in collaboration with the Israel Antitrust Authority, the Shva company is expected to complete the preparations in about 2 years, and banks and credit card companies will formulate a plan that will allow all credit cards in Israel, as well as related infrastructures, to switch to smart cards within about 3½ years, no later than December 31, 2016. Within the framework of implementing this recommendation, smart cards (which support EMV) will be issued to customers; a prohibition on connecting new POS terminals which do not meet

¹⁴ EMV (Europay, MasterCard, and Visa) is an international standard for cards with chip technology. This technology increases the level of security of debit cards and of the cardholder's information.

the Shva standard will be examined, as will the possibility of the Bank of Israel creating economic incentives to switch over existing terminals which do not meet the standard, an EMV-supporting system for approving and clearing transactions will be outlined and developed, and the development of the terminals will be implemented through adjustment and work with manufacturers and distributors. Until the transfer to smart cards, the Bank of Israel will require banks to offer a credit card to customers who request it, whether a deferred debit card or debit card. Of course, customers who hold a credit card for deferred debit will be able to request that the bank also issue them a debit card.

8. **The Committee recommends to promote the smart virtual wallet, which serves as storage for money from various sources and will allow the use of existing and future (all or part) means of payment.** These include a credit card, a deferred debit card, a debit card, a prepaid card, Internet account, and mobile payment. The virtual wallet will be advanced by the team to promote advanced means of payment (as noted in Recommendation 14 below), in order to ensure that its development will be accompanied by an effort to reduce the risks inherent in digital payments, especially the risks of money laundering and terrorism financing and the risks of cyber crime. Together with this effort, solutions to consumer issues such as misuse, etc. will also be formulated.
9. **The Committee recommends promoting digital checks.** The digital check will include commercial and legal aspects which are similar to the existing physical checks, and thus will maintain the uses which are unique to checks—it will allow future payments, to carry out a series of payments, and to provide a check as a guarantee. However, at the same time, it will avoid the risks inherent in current checks, because all sides involved in the transaction will be documented. That is, the digital check will deal with one of the major disadvantages of using a check—an undocumented endorsement to another party. In addition, the digital check will contribute to a marked increase in the efficiency of the clearing process. Promoting the digital check will require legal and regulatory preparation.
10. **The Committee recommends to immediately advance the Electronic Check Clearing Law, because it will allow the advancement of using advanced electronic means of payment and the improved efficiency of the check clearing process.** The Check Truncation Law regulates the move

from physical clearing to electronic clearing of checks, as well as the issue of check destruction. The following are the principles expected to be included:

- a. The law is intended to regulate the move from physical clearing of checks to checks clearing electronically through automated communication—automated scanning of the checks and transferring the image file between banks for clearing
- b. Electronic clearing of checks is expected to aid the overall economy, both because it is expected to shorten the period for clearing and to provide certainty about the payment within a relatively short period of time, and because it is expected to reduce costs.

11. The Committee recommends formulating, as soon as possible, regulation for currency services providers. Thus, the currency service provider sector will be regulated. The Committee recognizes the importance of currency service providers' activities, and it does not aim to negatively impact this sector or to place obstacles which will make it immeasurably difficult to operate. With that, facing the risk which exists in their activity, including risks of money laundering, tax evasion, and terrorism financing, the Committee recommends to impose directed regulation which will include various aspects beyond the aspects currently regulated under the Prohibition on Money Laundering Law, 5760–2000. Currency service providers will be required to receive a license (which is different from the current requirement to be registered). Within the framework of the regulation, a new concept in the sector will be defined: credit service provider, which is a currency service provider that deals in activity requiring granting credit, including check discounting, factoring, and nonbank loans.

Credit service providers will be subject to stronger licensing and supervisory requirements than the requirements for currency service providers, based on the understanding that their activity involves a higher risk coefficient in terms of money laundering and terrorism financing and in consumer aspects, which requires increased regulation. Nonetheless, within the framework of imposing a licensing requirement on credit service providers, the need to establish financial demands will be considered. These include obligations to provide initial capital (or bank guarantee), to make an annual capital declaration, to meet professional tests, to take directed training, and to have directed computer software and software to identify known terrorists. In addition, the possibility of imposing restrictions on credit service providers regarding the option of conducting cash transactions, under terms and amounts that will be set within the framework of this report, will be examined. Beyond the amount

that will be set, the credit service provider will be able to pay via a means of payment which can be identified and attributed to the initiator of the transaction. A check issued by a credit service provider will not be able to be endorsed at all. With that, a customer will be able to request to receive the check made out to another party, which will allow, among other things, payment to the customer's suppliers.

Similarly, in light of the fact that financial activity involved providing credit, which bears, as noted, a higher risk coefficient in terms of money laundering routed through currency service providers that are also credit service providers, there will be a need to ensure proper control over their activities. Thus, the possibility will be considered of expanding credit service providers' obligation to report to the Israel Money Laundering and Terror Financing Prohibition Authority beyond the obligations currently set by law, including lowering the reporting threshold in respect of certain activities.

The Committee recommends establishing the identity of the regulator of currency service providers in general, and credit service providers in particular, while ascertaining that an appropriate regulator, with authorities, resources, and manpower that will allow him to conduct suitable supervision.

12. **The Committee recommends examining the issue of nonbank loans within the framework of the permanent committee.** In Israel, the nonbank loans market operates alongside the bank credit market. The nonbank loans market is fundamentally legal and includes legitimate companies and entities. With that, it is often called the "grey market", as alongside the legitimate entities there are criminal elements operating in it as well. Because of this, and in particular as it is a cash intensive sector, it serves as fertile ground for criminal activity, including money laundering and tax crimes. The existing legislation today in this area includes only consumer aspects, and aspects of supervision, regulation, and enforcement are missing. In addition, providing nonbank loans is not among the services which require registration as a currency service provider under the Prohibition on Money Laundering Law, 5760–2000, and therefore the Money Laundering and Terror Financing Prohibition regime does not apply to it. Along with the need to support this market so that it will serve as competition to the banking system and financial institutions that extend loans, there is a need to deal with the risks deriving from such activity, and in particular risks of crime, money laundering, and shadow economy. In light of this, the Committee recommends examining the area of nonbank loans, including examining the existing legal regulations and proposing a comprehensive and detailed arrangement for this area, within the framework of the permanent committee

13. **The Committee recommends requiring every business to have a POS terminal or other means of accepting payment cards.** The expenditure on the POS terminal will be recognized as a current expense. The obligation will not apply to exempt businesses. The Committee recommends that the proposed change be updated in the Bookkeeping Guidelines and that it come into effect with the approval of the Committee's recommendations. This is in order to encourage the business sector to use cash alternatives.
14. **The Committee recommends that the Government act to promote the use of advanced electronic means of payment** by expanding their use in making and receiving payments. That is, government functions which come into contact with the public through either receiving or making payments will promote the use of electronic means of payment. The government will use a prepaid card or electronic transfers to pay individuals who do not own a bank account, and will encourage the public to pay taxes through electronic means rather than paper-based means. Similarly, in order to provide the general public with access to the advanced system, the Committee recommends acting to improve the technological infrastructure which relates to electronic means of payment (Internet, points of sale) in every place in Israel in which it is needed.
15. **The Committee recommends setting up a team—headed by the Bank of Israel, and with the collaboration of the National Cyber Bureau, Digital Israel, and other functions—tasked with promoting advanced electronic means of payment.** It is of utmost importance to develop means of payments and payment and settlement systems in Israel in a manner that will encourage the public to expand the use of efficient and secure advanced electronic means of payment. Thus, it is important to create the advanced electronic infrastructure and at the same time to act to secure it and the means of payment from risks such as data theft, forgery, fraud and cyber attacks. Accordingly, the Committee recommends setting up a team—headed by the Bank of Israel, and with the collaboration of the National Cyber Bureau, Digital Israel headquarters, and other functions—which will act to strengthen the security of the advanced means of payment. The team will establish rules for the security features that will come with the electronic payments.

The following are the Committee's recommendations:

	Main points of the recommendations	Timeframe
	Timeframe: The Committee recommends preparing for the effective date for implementation of the immediate term recommendations to be June 1, 2015 , subject to anchoring the regulations in law where required, and for everything related to prohibiting use of cash and limiting the use of negotiable checks, subject to the stipulation that all the conditions set in Sections 6.1, 6.2, 6.3, 6.4, 6.5 (regarding the publication of the guideline noted in that section), 6.11 and 6.12 in the main points of the recommendations are fulfilled.	
1	To limit the use of cash in NIS and in foreign currency	
1.1	To apply the limitation to transactions of greater than NIS 10,000	Immediate
1.2	To reduce the amount of the limitation so that it applies to transactions of greater than NIS 5,000	Medium
1.3	Transactions which only involve private individuals – the limitation shall apply to transactions of greater than NIS 50,000. After 1 year from when the limitation goes into effect, the amount will be NIS 15,000.	Immediate
1.4	Used car transactions between private individuals – the limitation shall apply to transactions of greater than NIS 50,000	Immediate
1.5	To allow owners of restricted accounts to conduct cash transactions in amounts up to NIS 20,000. It is the customer's obligation to save the receipt for a period of at least 3 years. It must be recorded on the receipt that cash was used based on the customers' declaration that their account is restricted, and identifying details (based on ID documentation) are to be listed on the receipt. This easing will be in effect until the fulfillment of the conditions set in Sections 6.1, 6.2, 6.3, 6.4, 6.5 (regarding the publication of the guideline noted in that section), 6.11 and 6.12.	Immediate
1.6	To establish the following sanctions: 1.6.1—Violation of the prohibition on conducting cash transactions above the defined upper threshold will be set as a criminal offense, in respect of such violation an administrative fine (on private entities) or financial sanction (on businesses) will be imposed, at a rate of 25 percent of the transaction value for the buyer and 35 percent of the transaction value for the seller. 1.6.2—A criminal offense of fraud related to an attempt to evade the prohibition on conducting a transaction in cash above the defined upper threshold. The fraud offense will be considered an origin violation in accordance with the First Addendum to the Prohibition on Money Laundering Law, as a temporary order for 2 years. 1.6.3—The prohibitions and sanctions listed above are conditional on the implementation of the following recommendations: 6.1, 6.2, 6.3, 6.4, 6.5 (regarding the publication of the guideline), 6.11 and 6.12 in the main points of the recommendations.	Immediate

1.7	To establish that transactions spread over payments will be considered as a single transaction, and that extended services will be considered as separate transactions.	Immediate
1.8	To allow making use of information transferred from the Israel Money Laundering and Terror Financing Prohibition Authority for enforcing the prohibition on using cash on the buyer and/or seller at an amount of NIS 50,000 and greater. To that end, required amendments will be enacted.	Immediate
1.9	To establish that the Israel Tax Authority will be the regulator of all issues regarding the prohibition on using cash, subject to being provided the appropriate resources in terms of budget and manpower.	Immediate
1.10	To amend Section 47a of the VAT Law, which deals with the prohibition on cash payments between businesses.	
2	To limit the possibility of redeeming checks that have been endorsed more than once	
2.1	To establish the limitation in regard to a check with a face value of greater than NIS 10,000 (in accordance with the limitation on the use of cash, and with the stipulation that all the conditions listed in Section 1.6.3 in the main points of the recommendations are fulfilled). In the immediate term, it is recommended to allow the redemption of a check at an amount greater than the limitation, which was endorsed one time only, under the condition that the endorsee records his or her name and ID number on the back of the check.	Immediate
2.2	To reduce the amount of the limitation so that it will apply to a check with a face value of greater than NIS 5,000 (in accordance with the limitation on the use of cash). Subject to regulation on currency services providers, including credit service providers, it is recommended to permit the redemption of a check at an amount greater than the limitation, which has been endorsed one time only to a supervised financial institution (based on a decision that will be formulated by the Committee), and only in order to receive credit. Until the application of said regulation, it is recommended to permit the redemption of a check at an amount greater than the limitation which has been endorsed one time only, under the condition that the endorsee records his or her name and ID number on the back of the check. The regulation on currency service providers shall not be legislated within the framework of the Prohibition on Money Laundering and Financing of Terror Law.	Medium
2.3	To set a restriction for banks to redeem a negotiable check at any amount. It is recommended to permit redemption of a check at an amount greater than the limitation, which has been endorsed one time only to a supervised financial institution (based on a decision that will be formulated by the Committee), only in order to receive	Future

	credit, and subject to arranging the regulation of currency service providers, including credit services providers.	
2.4	Negotiable checks with a face value lower than the limitation amount may be traded one or more times, provided that the following details are recorded on the back of the check, for every endorsement: "I hereby endorse this check to (name)_____, ID number_____, Signed, (name)_____, date_____, signature_____." Endorsing a check without filling in these details will constitute a criminal offense.	Immediate
3	To establish a prohibition on issuing and receiving checks on which the name of the beneficiary is not written (blank check).	Immediate
4	To restrict a check (negotiable or nonnegotiable) transaction amount to an amount to be determined and no less than NIS 1 million.	Medium
5	To focus attention on the public aspect and on informing the public, in accordance with the policies to set by the permanent committee. The Israel Tax Authority and the Bank of Israel together bear this responsibility.	
5.1	To progress with a process of financial education for the broad public in general, and for specific population segments in particular.	Immediate
5.2	To conduct a periodic survey to determine what the public's needs are with regard to means of payment.	Medium
6	To promote the use of debit cards and identified prepaid cards.	
6.1	To regulate the manner of transferring funds from issuer to acquirer and from the acquirer to the merchant, so that in immediate debit transactions, the merchant will be credited as soon as possible after the date on which the transaction is conducted, and no more than 3 days after the transaction is conducted.	Immediate
6.2	To authorize through law the Director General of the Israel Antitrust Authority to establish, immediately, separate interchange fees for transactions carried out by debit card and to different types of transactions, which reflect the risks and costs to the issuer, with the goal of ensuring that these fees will reflect the reduced risks in such cards. These fees will apply to identified prepaid cards as well. The Committee formulated a framework for reducing the fees on debit cards and prepaid cards.	Immediate
6.3	To establish that a customer-initiated transaction fee ("line-item fee") should not be charged for any immediate debit transaction on its own; only monthly usage fees should be permitted to be charged.	Immediate
6.4	To issue guidelines to the banking system that an immediate debit card combining a cash withdrawal function should be a shelf	Immediate

	product to be offered by the banking corporation to its customers as a means of conducting transactions in their accounts, at a supervised price.	
6.5	To increase the availability of the option of carrying out transactions by immediate debit through setting up one of two options: (1) providing a guideline through which it will be possible to carry out all types of debits (cash withdrawal, immediate debit, deferred debit, and charge for credit) on one payment card (new and existing), gradually, over a 2-year period; (2) providing a guideline to issue an immediate debit card, with no cost, as a shadow card for every payment card that is issued.	Immediate
6.6	To regulate the full disclosure to merchants and immediate debit card holders of transactions carried out with an immediate debit card.	Immediate
6.7	To request that the Director General of the Israel Antitrust Authority examine imposing a prohibition on creating contractual limitations on dealings between an acquirer and a merchant which would prevent the development of immediate debit transactions.	Immediate
6.8	To work toward regulation providing access to the credit card switch, even to the acquirer as defined in Section 36i of the Banking (Licensing) Law, 5741–1981.	Immediate
6.9	To permit the Postal Bank as well as additional entities, to issue an identified prepaid card in NIS, in amounts up to NIS 10,000, as detailed in the full recommendation on page 18.	Immediate
6.10	To promote competition in the area of payment card and prepaid card clearing activity.	Medium
6.11	To require the Postal Bank to issue a debit card to anyone who requests it, and to permit opening a suitable bank account to that end. As for the banking corporations—to advance the possibility of issuing a directive that will require them to issue a debit card, subject to certain conditions, to anyone who requests it, and to permit opening a suitable bank account to that end.	Immediate
6.12	To ensure that the limitations currently in place regarding use of a debit card for a debtor who is able to pay his charges but refuses and for a debtor of limited means, in accordance with the Execution Office Law, 5767–1967, and in accordance with the Collection of Fines, Fees and Expenses Law, 5755–1995, will not apply to immediate debit cards.	Immediate
7	To promote the implementation of the EMV advanced security standard	
7.1	To examine a prohibition on connecting new POS terminals which do not meet the Shva standard. The Bank of Israel will examine the possibility of creating economic incentives to switch over existing terminals which do not meet said standard.	Immediate
7.2	To integrate the new characterization in terminals through	Future

	coordination and work with manufacturers and distributors.	
7.3	To issue smart (EMV-supporting) cards to customers, in line with the plan outlined by the Supervisor of Banks.	Future
8	To promote the smart virtual wallet, which serves as storage for money from various sources.	Future
9	To promote digital checks which have similar characteristics to those of the existing physical checks, including dealing with legal and regulatory aspects.	Future
10	To advance the Electronic Check Clearing Law in order to advance the use of advanced electronic means of payment.	Immediate
11	To regulate the currency service providers sector.	
11.1	To formulate regulation for currency service providers and to regulate the new activity sector of credit service providers.	Medium
11.2	To assign the appropriate regulator for currency service providers in general, and credit service providers in particular, while ensuring the assigning of an appropriate regulator, with authority, resources, and manpower that will allow appropriate supervision.	Medium
12	Examine the issue of nonbank loans within the framework of the permanent committee.	
13	To require every business to have a POS terminal or other means of accepting payment cards. The expenditure on the POS terminal will be recognized as a current expense. The obligation will not apply to exempt businesses. The Committee recommends that the proposed change be updated in the Bookkeeping Guidelines.	Immediate
14	To increase the role of government ministries in encouraging the switch to electronic means of payment.	
14.1	To provide solutions to communications problems where it is necessary.	Immediate
14.2	To expand the government's use of electronic means for receiving and making payments.	Immediate
14.3	To use identified prepaid cards in lieu of cash.	Immediate
15	To set up a team headed by the Bank of Israel, and with the collaboration of the National Cyber Bureau, the Digital Israel coordinating bureau, and other functions—tasked with:	
15.1	To promote the use of advanced, efficient, and secure electronic means of payment.	Future
15.2	To bolster information security, regulate and set uniform rules related to advanced electronic means of payment.	Future

III. The shadow economy

The term “shadow economy” or “black economy” denotes the share of economic activity which does not appear in GDP data. There is an inherent difficulty in obtaining precise data on the size of the shadow economy. Researchers have therefore developed models, some of which are controversial, to estimate the size of the shadow economy—however, all the models view their data as only an estimate.

One of the estimates appears in a research study—conducted by the World Bank¹⁵—which compared 151 advanced and developing economies. According to that study, in 1999–2007 the average share of the shadow economy in Israel was about 22 percent of GDP. The lowest shares were found in Switzerland, at 8.5 percent, and in the US, with 8.6 percent. The highest shares were found in Peru, at 59 percent, Panama, at 64 percent, and Bolivia, where it was 67 percent. The study also indicated that compared with 25 OECD countries, the size of the shadow economy in Israel is among the highest in the developed world (Figure 1). The size of the shadow economy in Greece, as indicated in the figure, was a major factor in that country reaching a crisis and the inability to repay its debt. The same report notes that the size of organized criminal activity in Israel is estimated in the billions of shekels, and assessed by the OECD to be 3–5 percent of GDP. The report details the very large negative impact on the economy and society in Israel, and explains that crime-sourced unreported capital is not only a source of additional revenues, but also an obstacle to free competition and economic growth. The report notes that the illegal acquisition of wealth contributes to senses of inequality and injustice, and erodes the value of the rule of law.

Reducing the shadow economy will translate into growth in tax revenues, which would allow an increase of government expenditure and/or a reduction of taxes. Such measures will contribute to a sense of equality in the burden as well as improved public welfare.

The research study noted above also examined the factors which serve as incentives for the shadow economy. Its main findings are:

1. Tax rates: A high positive correlation was found between the tax rate and the size of the shadow economy, which leads to a vicious cycle. Large shadow economies increase tax rates, because they reduce the tax base and thereby make it difficult for the government to reduce tax rates.

¹⁵ Schneider, Friedrich, "Shadow Economies all Over the World", The World Bank, 7/2010.

2. Regulation: The size of the shadow economy is derived to a great extent from the weight of prohibitions and restrictions imposed by the government, the quotas it sets, and the licenses it requires in various economic sectors. Reducing regulation decreases the size of the shadow economy in a country.
3. Economic growth (an increase in work opportunities, growth, and welfare): Empirical evidence in Israel and abroad indicates that the extent of unreported activity is negatively correlated with the growth rate.
4. Social norms: The shadow economy thrives when a culture of tax evasion is considered legitimate and acceptable.
5. The risk of getting caught by authorities: The extent of enforcement and strength of the punishment affects citizen's and companies' risk. The smaller the risk of getting caught and punished, the greater the growth of the shadow economy.
6. Ease of joining: The easier it is to join the shadow economy, the higher the share of citizens and companies that participate in it. Anonymous means of payment enable people to join the shadow economy relatively easily.

In accordance with these findings, and the area of its authority, the Locker Committee recommended to decrease the use of anonymous means of payment and to promote a financial education campaign for the broader public to clarify how large shadow economies negatively impact the economy, and how they are connected to anonymous means of payment, with the goal of involving the public in implementing the change.

IV. The business perspective—means of payment

a. Cash

A description of the situation

Currency in circulation and average circulation per capita

Currency in circulation was NIS 55 billion at the end of 2012, compared with NIS 49 billion at the end of 2011 (an increase of 12 percent, compared with growth of 9 percent in the previous year).¹⁶ In real terms, the increase in 2012

¹⁶ The value of circulation includes, in addition to cash held by the public, also cash held by banking corporations in their vaults. Cash in circulation also includes cash held by nonresidents (a phenomenon more characteristic of the eurozone and the US, because their currencies are used outside of their borders as well).

was 10 percent, and in 2011 it was 7 percent. During the past decade the average annual increase of currency in circulation was 10 percent, excluding 2008–09, during which the global economic crisis reached a peak and the increase was greater.¹⁷ In 2012, the average circulation per capita (the ratio between average currency circulation and the average monthly population) was NIS 6,711.¹⁸ The average circulation per capita increases each year, both in current terms and in real terms, against the background of an increase in per capita nominal GDP, a product which is made up of the change in prices and in real per capita GDP. However, in recent years, increased demand for cash also contributed (as well as an increase in M1, the monetary aggregate which includes the public's current account deposits) , as well as the decline in interest rates due to the global crisis.

Cash held by the public as a share of GDP

Cash continues to be a major means of payment in Israel, and over the years its share in GDP has been increasing moderately, similar to the situation in many countries (such as Australia, the Eurozone, and others). In 2012, the ratio of cash held by the public to GDP was 5.2 percent, compared with 4.9 percent in 2011. The increase in the quantity of cash held by the public in recent years may also be attributed to the low interest rates on financial assets since the beginning of the crisis in 2008. This increase came along with an increase in demand for total means of payment—M1—which also includes the public's current accounts. With that, this share is still low compared with the average share in EU countries of 6.8 percent in 2011.

Cash withdrawals in Israel

Bank of Israel data indicate that in recent years there has been a trend of decline in the number of cash withdrawals (from 140 million transactions in 2007 to 130 million transactions in 2012), while the value of the withdrawals increased consistently. In 2007, NIS 158 billion were withdrawn, and in 2012 NIS 205 billion were withdrawn.¹⁹ In 2012, the total value of withdrawals per

¹⁷ Against the background of economic growth data (3.1 percent), the global slowdown, and the low interest rate environment in Israel and abroad, it appears that the public preferred to hold more cash in its hands instead of investing the funds in interest-bearing deposits. In addition, the growth of the population (1.8 percent) and the inflation rate (1.6 percent) also led to the increase in circulation.

¹⁸ It should be noted that with that, in actuality, the value of per capita circulation in Israel is lower, because the shekel serves as means of payment in the Palestinian Authority area as well, but the calculation is only based on Israel's population.

¹⁹ Source of data: Bank of Israel, Annual data on banking corporations, Table 11.5—Debits to the Public's Current Accounts. Financial data are nominal.

resident averaged NIS 9,305, and the average number of withdrawals was 14 per year.

Although the amount of cash held by the public has been increasing consistently (from NIS 25 billion in 2007 to NIS 49 billion in 2012), the share of cash held by the public out of total money supply (total cash held by the public and the public's deposits in current accounts in banks) has been in a trend of decline (Figure 3).

Automated Teller Machines (ATM)

At the end of 2012, there were 1,863 ATMs in Israel (including machines owned by Shva). This is an increase of 3 percent from 2011, and is similar to the year over year increase in 2011. In addition to those machines, there were 1,430 cash distribution devices at the end of 2012. These machines, all of which were privately owned, entered the market in 2005, and the businesses in which they are located operate them via the banknotes that cycle through their turnover, as is commonly done abroad. Despite the large number of such devices, the value of withdrawals and transactions through them is very small compared with those through bank ATMs, because their service fees are high and because the business owners limit the maximum withdrawal amount to several hundred shekels, while limitations on withdrawals from bank ATMs are based on the customer's card type.

The number of total machines per million residents (that is, the number of bank ATMs and the private devices per million residents) was around 400 in 2012. This figure is low compared with the figures in EU countries (966 in 2011).

In 2012, the trend of growth in the amount of average withdrawal from bank ATMs continued. It increased by 6 percent to reach NIS 650 (with average annual growth in the past decade of 8 percent). The value of cumulative withdrawals per resident was NIS 9,305 in 2012, and the number per resident in 2012 was 14, similar to 2011.

Risks of money laundering using cash

Many crimes generate cash, including drug dealing, human trafficking, gambling, extortion, and bribery. The use of cash is a convenient basis for laundering money from criminal sources because of, among other things, its anonymity and its ease of transport, the ease of concealing cash from the authorities, and the ease of inserting these funds into the legitimate financial system and using them for private and/or commercial activities.

There are various operating methods used by criminals and professional money launderers in order to insert funds from criminal origin into the legitimate financial system as part of the money laundering process. The following are the main modes of operation used for laundering cash gained illegitimately.

1. **Laundering money by acquiring assets with cash:**²⁰ Laundering money using cash can occur by, among other things, purchasing assets such as real estate, automobiles (including luxury cars), and yachts, and paying for them with cash of illegal origin. In contrast, the receipt from the subsequent sale of that asset can be presented as a legitimate source of money. Sometimes, as part of the laundering process, ownership of the asset is transferred numerous times before the asset is sold. For example, money laundering by purchasing real estate takes place in the following manner: cash generated from crime is transferred to a straw man, who is the ostensible purchaser, and who deposits the funds into the seller's account. Ownership of the building is then transferred to entities related to the criminal (the ownership of the building may be transferred at markedly lower price than the value of the building), who then sell the building to an unrelated third party, and the remuneration is transferred to their account, which is managed for the criminal. In other cases, the building is purchased with cash of illegal origin, by a straw man, who holds the building for the criminal. In the automobile industry, there are known methods of laundering money in which criminal elements manage car lots, and use their cash-rich operations as a means to deposit cash of illegal origin, while presenting the transaction as the purchase of a car by a customer of the lot.
2. **Laundering money through purchasing services with cash:** In a similar manner, money which has its origin in cash can be laundered by purchasing services (for example, consulting or lawyer/accountant fees). The risk of money laundering through services is that in many cases it is difficult to assess the value of the services provided. In such a case, criminal elements can pay for services with significant sums of cash of

²⁰ In January 2007, the FATF issued a typology report on money laundering and terrorism financing through the real estate sector: <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20through%20the%20Real%20Estate%20Sector.pdf>
The report notes, in the section dealing with means of payment used for purchasing real estate, that "The use of monetary instruments in real estate transactions has traditionally dealt primarily with the use of cash. Although methods of payment continue to evolve, cash continues to be one of the main ways of obtaining and handling funds at the early stages of the process in many of the cases that ultimately involve funds of illegal origin."

illegal origin, when the consultant is working for the criminal, and in such manner the cash which is transferred to the service provider is presented as fee for the service provided.

3. **Smuggling cash:** Criminal and terrorist organizations smuggle cash in order to launder money generated illegally and to finance their activities. Cash smuggling across a border or to another jurisdiction often uses dollars, and the fund deposit or another transaction (such as cashing a check) is carried out on the other side of the border, with the collaboration of a financial entity. Likewise, a place with a deficient AML and CFT regime is a preferred destination for smuggling. It is not necessary for the smuggling to be carried out through physical transfer of cash. Cash of illegal origin can be converted into other means of payment or assets, such as bank checks, diamonds, precious metals, antiques, or works of art, as well as relatively new means such as anonymous prepaid cards, and converted back into cash on the other side of the border. Accordingly, funds generated abroad illegally can be smuggled into Israel and integrated into the business and/or financial system, as part of the money laundering process.
4. **Currency services providers:** Currency services providers, whether or not they are registered as such with the Ministry of Finance, are by their nature involved in carrying out many cash transactions. The volume of their activities, including the large amount of cash transactions, together with relatively low regulation, increases the risk of this sector being used for money laundering and/or terrorism financing. Many criminal organizations “hold” businesses such as money changing or check discounting, and grey market lending, for, among other reasons, money laundering. The manner in which currency services providers are used as part of the money laundering process include:
 - a. Converting cash from one currency to a different currency which can be used to move away the funds with illegal origins.
 - b. Conducting various activities in exchange for the cash, in order to sever the chain of laundering from the source of the money, by turning the funds into anonymous means of payment in the form of cash, so that the funds’ trail can no longer be followed. Cutting off the fund trail through activities which are paid for with cash also helps to make it more difficult to locate assets which were paid for with cash, and thus reduces the ability to confiscate assets.
 - c. An additional method of separating illegal funds from their source is to exchange, at a currency services provider, small bills which may originate from, for example, drug dealing, for large bills.

5. **Currency services providers that deal in activity which is involved in granting credit:** Known modes of laundering money indicate that in effect check clearing is used frequently, in order to hide the source of funds of illegal origin. Thus, for example, checks received from gambling, or in payment for fictitious invoices, are cashed by the criminal in remuneration for cash or a check drawn on a currency services provider's account (with or without the cooperation of the currency services provider), in order to hide and obscure the source of the funds.

The factoring market allows criminal elements to present a legitimate source for the funds which were of illegal origin, in the form of the funding put up by the factoring company, while the debt acquired by the factoring company in actuality is illegitimate property which was generated through crime. The more the factoring company will allow the payment on the debt to be made through means of payment with higher risk of money laundering (cash, transfer from abroad, third-party payment, etc.), the greater the risk of this payment method being used by criminal elements. The lack of sufficient supervision for money laundering and terrorism financing on the factoring market also increases the risk of money laundering and terrorism financing by criminal elements.
6. **Cash intensive businesses:** One of the most common methods of laundering money of illegal origin is mixing funds from illegal origin with a legitimate business, in order to obfuscate the source of the money and to create for them a legitimate source of business activity. This method of laundering is also applicable to cash of illegal origin, which is laundered by depositing it into bank accounts of cash intensive businesses, and which is presented as part of the business's routine turnover. Therefore, cash intensive businesses pose a higher risk from the money laundering perspective. Criminal organizations establish ostensibly legitimate businesses (such as parking lots, kiosks, restaurants, grocery stores, car lots, and currency service providers) which have a high cash turnover, and serve as a business infrastructure which allows the insertion of cash of illegal origin into the legitimate business system. The greater the business's turnover, the easier it is to launder money of illegal origin, since their deposit in an account will not raise bank employees' suspicions.
7. **Structuring:** Another way to avoid reporting cash activities is dispersing cash deposits or withdrawals in various financial institutions, and at low amounts (structuring). In this manner, only a small part of the activity takes place in any one financial institution, and without the overall picture available to the financial institution, so that it is difficult to assess that it is part of money laundering activity.

8. **The risks of money laundering in the nonbank loans market:** The risks of money laundering in the nonbank loans market can be divided into two types: (a) the risks of the borrower laundering money, (b) the risk of the lender laundering money. In the first case, the borrower can repay the loan with property of illegal origin. In the second case, the lender can lend funds of illegal origin or create a fake situation in which the lender ostensibly provides the loan, when in actuality the activity is fictitious and is only carried out for the purpose of registering and creating an (ostensibly) legitimate source for the funds.

In general, the nonbank loans market is a cash-intensive business. Cash-intensive businesses provide fertile ground for laundering cash of illegal origin. Likewise, in many cases the financial asset given for the loan is a check²¹—including negotiable checks when the remuneration is provided in cash. In this manner, the lending entity is able to continue to roll forward the check that was provided as payment or as repayment of the loan, without recording particulars. Likewise, the proceeds given in cash raise the risk of laundering criminal proceeds in cash form, while at the same time enabling the borrowing entity to receive cash and sever the laundering chain, when dealing with checks of illegal origin.

The issues related to the Committee's work

Advantages of cash

Cash is a common means of payment in Israel, for several main reasons:

1. Cash is an available and widely accepted means of payment, due to the number and dispersion of bank branches and ATMs.²²
2. Payment with cash is convenient, rapid, and inexpensive in the sense that it does not depend on technological aids or computer, electrical, or communications systems
3. As opposed to electronic means of payment, cash does not involve identification of the payer. This anonymity becomes more important when payers want to hide the activity, whether legitimate or illegitimate
4. Cash payment is relatively assured of not being counterfeit

²¹ Sometimes several checks are given together, according to the terms of the loan and the number of repayments set.

²² Below there is detailed information on the number of ATMs in Israel and abroad.

5. Cash payment is final and immediate, so it enables businesses to maintain a high level of liquidity

Disadvantages of cash

1. Exposure to risks of tax evasion, money laundering, and financing of terrorism
2. Use of cash involves high cost as a result of the current handling of banknotes and coins: secure transport of the money, its deposit in a bank account, securing the cash at the business, and dealing with making change (holding and counting small change)
3. There are costs derived from errors and fraud
4. Use of cash is exposed to risks of loss, wear and tear, and theft (it cannot be insured)
5. Use of cash involves documentation errors by businesses
6. Cost to the consumer—involves accessibility to ATMs or bank branches, interest and withdrawal fees

b. Checks

Trends

During 2012, about 147 million checks were drawn in Israel, a decline of about 1 percent compared with the previous year. The trend of decline began in 2004, and through 2012 the decline reached 11.4 percent. In contrast, there is a rising trend in the value of checks—from NIS 787 billion in 2004 to about NIS 964 billion in 2012, a nominal increase of 22.5 percent. However, it is important to note that the change in real terms is a decline of 0.6 percent. The average value of a check in 2004 was NIS 4,740, and in 2012 it was NIS 6,558—a nominal increase of 38 percent, and an increase of 12.3 percent in real terms.

The high average value of check transactions indicates that it is generally accepted in the business sector in Israel to use this means of payment in order to pay taxes and conduct high-value transactions. To support this conclusion, the correlation between the annual value of checks and total tax payments in Israel is examined (Figure 8). The figure presents GDP against tax revenues and total value of checks drawn. The findings indicate that first, there is a high positive correlation between the change in GDP and both tax payments and total check value. Second, it indicates

that there is a high positive correlation between tax revenues and the use of checks, which points to the conclusion that a notable part of taxes in Israel is paid via checks.

Households in Israel have reduced their use of checks for two main reasons. First, they increased their use of electronic means of payment, primarily debit cards and electronic transfers. The electronic payments sector has developed rapidly and consistently since the 1990s, and its developments can be seen in the increase in availability of ATMs and points of sale which allow transactions to be conducted via debit cards. As a result, electronic means of payment became more efficient and user-friendly alternatives. Second, an increasing number of businesses do not accept checks, in order to avoid the risks involved.

Check fees: There is a fee for printing checkbooks. This is subject to the supervision of the Supervisor of Banks and is set at a maximum of NIS 0.36 per check. Depositing a check involves either a teller-executed or customer-executed transaction fee, depending on how the customer deposited the check. This applies to deposits ranging from a single check to a group of 20 checks.

Issues related to the Committee's work

1. Paying for goods with a check exposes the seller to liquidity risk and to credit risk, since the goods and the payment for them are not transferred simultaneously.²³ While the item is provided at the time the check is received, the payment is not received on that day, since the check is deposited in the beneficiary's account "conditionally" for 3 days, during which it is liable to be returned.²⁴
2. The use of checks exposes the bank as well to liquidity risk and credit risk. The liquidity risk derives from, among other things, the fact that banks credit customers on day T, while interbank settlement takes place on day T+1. The credit risk derives from, among other things, the use of checks making it harder for the bank to have complete control on the extent to which customers meet their credit limits: a customer may dispense checks without limit and without the bank being able to monitor it. Checks presented for collection after a customer has fully

²³ DVP (delivery versus payment) is the process in which goods and the corresponding payment for them are exchanged simultaneously.

²⁴ Under special circumstances, a check may bounce after more than 3 business days, and in extraordinary cases, after a period of up to 60 days.

utilized the credit limit will be returned due to insufficient cover. In such a case (under specific conditions established by the Supervisor of Banks), the customer is liable to be classified as a “drawer of checks without cover” and the customer’s account may even be restricted.

3. Checks expose the entire system to operational risks. These are liable to create obstacles in the operation of the check settlement procedure.
4. The use of checks is exposed to forgeries and fraud of various types. It has been assessed that the financial damage caused by check fraud was about NIS 2 million in the first half of 2010, and the financial damage that banks succeeded to prevent was about NIS 25 million.²⁵
5. In Israel, checks may be re-endorsed without restriction on the amount or the number of endorsements, and without documentation from the endorser. Endorsing a check thus allows the beneficiary to transfer the check to a third party (endorsee), that is, to transfer the check without any record or report.²⁶ Checks that can be re-endorsed are called “negotiable”.

The use of negotiable checks requires the economy to deal with several difficulties. First, similar to use of cash, they are an anonymous means of payment and thus allow concealing transactions and evading payment of taxes. Second, presentation of artificially large turnover in order to receive credit from banks and “improving” financial statements by reducing payables balances, which leads to credit damages for banks. Third, a negotiable check is liable to reach criminal elements or the grey market without the knowledge of the drawer of the check. Finally, under certain circumstances, the endorsee can demand the payment without the drawer being able to make defensive claims related to the underlying transaction.

In order to reduce the number of endorsements, and thus to reduce the above-noted risks, an amendment was added in 2011 to the Banking (Service to the Customer) Law, 5741–1981. This amendment establishes that checkbooks issued by banking corporations are to be crossed and labeled, limiting their transfer (“to beneficiary alone”), unless the customer requests otherwise.²⁷

²⁵ Data presented here are estimates based on information received from some commercial banks and are updated to 2010.

²⁶ The check is only registered in the account from which the money is withdrawn and in the account in which it is deposited. In between it can pass through many stations.

²⁷ The amendment is clearly based on the assumption that a reduction in the number of negotiable checks will reduce the number of re-endorsements as well. It is important to note that since the endorsements are not documented, there is no way to check the assumption—there is no way to know how many negotiable checks actually were endorsed and how many times each check changed hands.

In order to examine the effects of the amendment, a comparison was made between the number and type of checkbooks in the year preceding the amendment, and their number and type in the year following.²⁸ The comparison indicated that even though the overall quantity of checkbooks declined between the two periods by only 3 percent, the number of restricted checkbooks increased by 50 percent and the number of unrestricted checkbooks declined by a similar rate. The share of restricted checkbooks out of all checkbooks increased from 45 to 70 percent. Among corporations, the rate of change is lower: an increase of 10 percent in restricted checkbooks and a decline of about 19 percent in unrestricted checkbooks.

6. The cost of using a check is higher than the cost of using electronic means of payment. This is primarily a social cost—because negotiable checks are a fertile ground for tax evasion, they lead to reduced government revenues and increased tax for law abiding citizens. It is also an environmental cost: use of checks consumes paper, space (to store the checks) and energy (to print the checks, sort and transport them and to operate the clearing houses). The estimated cost of a check for a bank in Israel is NIS 6–12²⁹, while a transfer via electronic means costs only several agorot. The situation is similar in other countries as well. In Australia, for example, the cost of a check is equivalent to about NIS 6.50, in Portugal around NIS 7, and in Sweden it is around NIS 11³⁰, while transfers via electronic means cost much less.
7. In Israel, there is relatively widespread use of postdated checks, in both the business sector and the public sector. Postdated checks are used to provide guarantees against credit, for periodic tax payments, to make payments that are beyond the customer's credit framework, and to spread out payments into unequal parts and/or over unequal periods of time.

The widespread use of postdated checks brought a surge in check discounting, a service in which the customer receives the financial value of the check immediately, in return for a fee. There are thousands of currency service providers³¹ who deal in check

²⁸ The data is based on information received from a significant sample of commercial banks.

²⁹ The estimated cost to the bank includes variable costs and fixed costs, including the operation of the clearing house, maintenance of computer systems, storage of the checks, and transport.

³⁰ Based on data received from the central bank in those countries.

³¹ As of January 2014, the database "Currency Service Providers" lists about 1,700 corporations and private individuals who are authorized to provide check discounting services. The Currency Service Providers are listed in the database of the Currency Service Providers unit in the Capital Markets, Insurance, and Savings Department at the Ministry of Finance.

discounting, and the activity can be viewed as a nonbank loan—the cash given by the currency service provider is the loan, the face value of the check is the repayment, and the difference between the two is the fee, which includes the risk that on the date of repayment there will not be enough funds to cover the check.

In addition to check discounting, currency service providers began to also offer check redemption services, in which a person deposits with a currency service provider a check on the date written on the check (in check discounting, the check is deposited before the payment date), and in exchange receives the amount of the check in cash, net of a fee. Customers will choose to redeem a check this way when there are some restrictions on the payer's account, but they can also do this in order to evade taxes or to launder money (otherwise, they would deposit the check directly into a bank account, where there is a lower fee).

8. Check clearing is less efficient than clearing of electronic means. It is a paper-based payment instruction that the customer has to deposit in a bank, an activity which cannot be carried out remotely.³²
9. Customers have the right to cancel a check when they don't receive something in exchange for the payment. This is done through a cancellation instruction to the bank. However, the cancellation right is limited when the check receiver endorses it over to a third party. That third party is entitled to redeem the check even if consumers did not receive the goods or services from the original business that they paid.
10. Use is also made of open checks (checks where the name of the payee is left blank) as a means of payment which is an alternative to cash. The disadvantage of an open check is that except for the original account and the target account, the check can pass unreported through numerous hands, and thus is an anonymous means of payment, similar to cash. Therefore, the disadvantages of cash apply to open check as well—theft, loss, the inability to insure, and exposure of both sides of the transaction to risk.

Risks of money laundering using checks

Similar to activity using cash, when there are means of payment with characteristics similar to cash, those means involve money laundering risks. As noted, in Israel checks may be endorsed without restrictions on the amount or on the number of endorsements, as well as without documentation of the endorser. Endorsing a check is an activity that

³² Excluding recent renewals in interbank checks alone, limited in amount.

allows the beneficiary to transfer the check to a third party (endorsee), and thus allows the transfer of checks from one person to another without any record or report. The characteristics of a negotiable check, as an alternative to cash due to the anonymity created with the re-endorsement of the check, and the ability to transfer from one person to another without recording it and without the ability of following the trail of the funds and the entities involved, increase the risk of the use of negotiable checks for money laundering and/or financing terrorism activities.

Inherent in the market for check discounting carried out by currency service providers³³ are significant money laundering risks. In general the use of currency service providers by criminal elements can be divided into two: (a) the use by criminal elements of services provided by legitimate currency service providers without their knowledge and/or involvement, and (b) when the currency service provider is involved in the criminal activity, and at times is under the hidden ownership of the criminal. Several money laundering or terrorism financing risks can be seen in such activity, which leads criminal elements to use currency service providers for check discounting purposes: the amount of regulatory and supervisory demands in this sector under the Prohibition on Money Laundering Law are much lower than the regulation and supervision of the banking industry. The Know Your Customer process at a bank, which includes verifying³⁴ identification particulars provided by the customer who is carrying out an activity, is more involved than at a currency service provider, and that is in light of the relationship between the bank and customers managing their accounts there, as opposed to the relationship between a currency service provider and a customer who in most cases just shows up. A criminal element who requests to redeem a check of illegal origin will prefer to cash the check with a currency service provider rather than deposit the check in a bank which manages his account. When a currency service provider deposits checks of illegal origin in his account, the checks will be deposited together with many other checks which were received from other customers, so that the deposit will not be out of the ordinary for the bank, as opposed to the deposit or cashing of a check directly by the customer into his bank account. The known typologies of money laundering indicate that in actuality frequent use is made of check discounting in order to conceal the source of funds of illegal origin. Thus,

³³ Check discounting can also be carried out through the banking system.

³⁴ In contrast to the banking sector, currency service providers are not subject to a requirement to verify identification documents vis-à-vis the population registry, and thus it is easier to use forged documents in order to carry out the activity by concealing the service recipient.

for example, checks received from gambling, or in exchange for the sale of fictitious invoices, will be cashed by the criminal in exchange for cash or a check drawn on the account of the currency service provider (whether or not the currency service provider is collaborating with the criminal), in order to distort and hide the source of the money. There are currency service providers who operate vis-à-vis other currency service providers in the Palestinian Authority areas (Judea and Samaria). This activity presents risks of money laundering and financing of terrorism, since checks that were drawn on accounts in Israel can be deposited via accounts managed in the PA areas.

c. Payment cards—the existing situation

The most common card in Israel is the deferred debit card, often called a “credit card”. This card enables customers to pay for goods and services, as well as to withdraw funds through ATMs up to the credit limit assigned to them by the card issuer. Customers’ accounts are debited, and merchants’ accounts are credited, once a month, on the following month, and the businesses finance those credit days. This is one reason why the deferred debit card cannot serve as an alternative to cash. Another reason is that it is only accessible to customers with a bank account which has a credit framework.

The most common use of a payment card in Israel is use of a deferred debit card. This card is related directly to the customer’s bank account, and allows the customer to withdraw cash at ATMs, and/or to pay for goods and services at a business, up to the credit framework allocated by the card issuer. The total of the transactions carried out by the customer is calculated once a month, for the month before the payment date, and this amount is charged to the customer’s bank account, in one combined payment. A debit card is similar to a deferred debit card, with one difference: the charge to the customer’s account takes place immediately with the transaction, not combined into one monthly payment, and its characteristics are similar to paying with cash. In contrast to these, the holder of a (revolving) credit card can choose at the end of each month whether to pay the full amount or whether to split it into payments. When the balance is split into several payments, the customer pays interest to the credit card company. A prepaid card is a payment card loaded in advance with a maximum amount, and each payment is subtracted from that value, until the balance reaches zero. This type of card includes gift cards and phone cards. Some of these cards allow reloading and some are made for one-time use.

Today, payment cards are accepted at all large and medium-sized businesses and at most small businesses. Accepting payment through the debit card is easy to implement at a business, is widespread, and serves as a relatively secure form of income for the business. There are very small businesses which do not accept credit card payments and that chose not to link up with a merchant acquirer for various reasons, including the relatively high cost of the service. This means of payment is relatively expensive for the tiny company and the payment is not immediate (it is received in the month following the date set with the merchant acquirer.) In payment transactions carried out via debit cards, businesses submit for discounting the debit card receipts in order to shorten the financing days, in exchange for a fee.

Today, acceptance of debit cards and the prepaid card are easily implemented in all businesses which accept debit cards. From the perspective of the business owner, there is no difference between a deferred debit card and a debit card or prepaid card, since in all those cases the business receives its payment in the following month, despite the fact that in some of those means of payment the customer is charged the day after the transaction. Immediate debit cards are intended mainly for consumers for whom the bank does not authorize a credit framework. Prepaid cards are likely to be used as a substitute for cash for customers who do not have a bank account.

In recent years there has been an increase in the number of active cards in Israel, and in 2012 there was an increase of 6 percent.

In Israel, there are three credit card companies: Isracard Group, Leumi Card, and Cal-Israel Credit Cards. The companies issue and settle domestic brands of debit cards under licenses from the relevant international organizations.

The activity in the sector expanded in recent years at a notable rate, affected by several factors: the issuance of nonbank debit cards (which are generally related to customer clubs); the expansion of the range of services provided by financing and credit companies through instruments which allow the card holder to set the amount and date of the payment in accordance with the customer's needs and ability; and the continued increase in use of cards because using them at businesses is easy and available and because the number of e-commerce sites has increased.

The number of cards increased by 73 percent in the past decade, and at the end of 2012 there were 6.35 million.³⁵ The total value of debit card transactions has increased consistently, and there is a tendency at businesses to implement the use of debit cards for micropayments as well—such as in vending machines and photo booths (Figure 9). In 2012, the total value on debit cards was about NIS 202 billion, the average transaction value was NIS 238, and most of the transactions (70 percent) were for less than NIS 200. This figure likely indicates that this means of payment serves as an alternative to cash in retail goods and services transactions.

In order to carry out a debit card transaction, the issuer and merchant acquirer need to be linked, both contractually and technologically. The contractual link sets the dates on which payment is transferred and each side's responsibility in various situations. The technological interface allows the transaction to be inputted at the business, the electronic transfer of the authorization request to the merchant acquirer and the issuer, and the settlement of the transaction on the agreed upon date.

In Israel, there is an agreement which regulates the contractual relationship between the three credit card companies.³⁶ The technological connection is via the single technological interface in Israel for debit card transactions—an interface which is operated by Shva (the Hebrew acronym for Automated Bank Services) Ltd. As illustrated in the following figures, Shva collects all the debit card transactions conducted in businesses in Israel, transfers them to the relevant merchant acquirer and card issuer, receives transaction acceptance or rejection notices, and carries out the accounting between issuers and merchant acquirers.

V. Appendices

a. Questions and answers

Q: Will the cash restriction also apply to the NIS 13,000 in cash that I have as savings in my home—what to do with cash?

³⁵ Cards with at least 1 transaction during the final quarter of the year.

³⁶ This constitutes a monopolistic agreement as defined in the Antitrust Law, 5748–1988, and is subject to the approval of the Antitrust Authority.

A: The Committee does not recommend imposing a limitation on withdrawing or holding cash. However, in this regard, it should be noted that a person cannot be compensated for loss or theft of coins or banknotes, since they are not identifiable. Electronic means of payment contain various solutions for cases of loss or theft.

Q: How will I give spending money to children?

A: There is no intention of eliminating cash. The amount of the limitation which was set does not prevent us from continuing to use cash to pay amounts which are less than the limitation. In terms of amounts which are greater than the limitation amount, the Committee suggests to use substitutes, as will be detailed below.

Q: Why not reduce taxes to eliminate the incentive to evade taxes?

A: The steps recommended by the Committee are expected to enhance tax collection, since more transactions will be recorded and taxed. Enhanced collection may allow taxes to be reduced, but remember that it will not necessarily lead to that result, since tax policy is based on other considerations as well—budgetary, macroeconomic, and social.

Q: How will I pay for products priced higher than the limitation (such as a car, furniture, or electronic items)?

A: There will be a range of means of payment with which to pay—checks payable only to the beneficiary, prepaid payment cards, debit cards and deferred debit cards, bank transfers via Masav³⁷ or real time transfers via the Zahav system (which allows secure payments that are immediate and irrevocable).

Q: As it is not worthwhile for small businesses to accept payment cards, won't the restrictions on the use of cash be quite costly for them?

A: The Committee recommends several steps that will reduce the cost of using cards, such as debit cards and prepaid cards. The outline formulated by the Committee for using debit cards and prepaid cards will benefit business owners and consumers because it will shorten the number of credit days (the business owner will receive remuneration about 3 days after the transaction is carried out, as opposed to 20 days currently). In addition, remember that there are costs involved in using cash as well...

Q: What limitations will apply to using cash and checks? What are the amounts?

A: The limitation on the use of cash begins at NIS 10,000 and declines to NIS 5,000. For negotiable checks, the limitation begins at NIS 10,000, declines to NIS 5,000, and at the end of the process the possibility of reducing the threshold to zero will be considered (that is, checks will only be able to be endorsed according to rules that will be set, they will not be able to be endorsed endlessly).

³⁷ Masav is Israel's Automated Clearing House.

Q: I gave a postdated check for an amount that is greater than the limitation, what will happen to it?

A: Provisional directives will provide a solution, and a postdated check will be able to be deposited. It should be noted that **the reform does not eliminate cash and checks**, because they play important roles.

Q: Is it possible to spread out a purchase over several payments, and cumulatively to deviate from the limitation?

A: A transaction cannot be artificially divided up in order to pay for it with cash. When the price is greater than the limitation, **payment can be made via the following means:** a check payable only to the beneficiary, a check which may be endorsed only once, per the conditions that will be set, credit card, and standing order.

Q: What is a debit card?

A: **It is a card that is charged immediately upon the transaction** (subject to the balance in the account and the credit framework), not once per month on a set date.

Q: Why is it worthwhile for me to use a debit card rather than a credit card?

A: A debit card allows the close monitoring of private expenditures. Furthermore, **the Committee formulated several steps that will reduce the cost of using debit cards.** Remember that there are costs involved in using cash as well.

Q: How will it be possible to pay suppliers of services in transactions which cannot be carried out by debit card or prepaid card? How will it be possible to pay Internet service providers, electricity, TV services, etc. via standing order?

A: The use of debit cards and prepaid cards will not replace the use of deferred debit cards and credit cards. **The new cards will be able to be used as an alternative to cash and will allow competition and reduced fees in the payment card market**, but nonetheless it will be possible to continue to make payments via credit card or standing order.

Q: How is it possible to get additional information on means of payment in Israel?

A: Additional information on means of payment in Israel is available on **the Bank of Israel website.**

Q: Does the limitation only apply to the purchase of goods and services from a business/merchant or does it also apply to used goods transactions (a purchase from a private individual)?

A: **The limitation on transactions between private individuals, including used goods transactions, is NIS 50,000 and in the future it is expected to be lowered to NIS 15,000.** For the purchase of a used car, cash is limited to NIS 50,000.

Q: I have a small business with 3 employees, and my bank account has been restricted for several months. Until now, I have paid my employees with cash. How will I pay my employees' salary?

A: For sums up to the amount of the limitation, you will be able to continue paying employees with cash. For sums greater than the amount of the limitation, you will be able to use identified prepaid cards (each of which can be loaded with an amount up to NIS 10,000). These cards can be purchased with cash.

Q: I own a grocery store and have always paid suppliers with checks I received from customers. Will I be able to continue doing so?

A: **The restriction on the use of unlimited endorsed checks** will begin at NIS 10,000, will decline to NIS 5,000, and at the end of the process the option of lowering the threshold to zero will be considered. (That is, below the amount of the limitation it will be possible to endorse checks without limit, like today, while for amounts greater than the limitation, it will be possible to endorse checks, in accordance with the rules that will be set.)

Q: What means will the government be able to use in order to enforce the new limitations? What will prevent people from paying with cash for amounts greater than the limitation? Is the Committee proposing any form of sanction?

A: Paying with cash for amounts greater than the limitation will be a criminal offense and will lead to sanctions at an amount to be set. A check that does not meet the limitation requirements will not be redeemed at the drawer's bank.

b. Issues raised with the Committee during hearings

Cash is a major, legitimate, and common means of payment in Israel's economy. It serves law-abiding groups of the population who make up an overwhelming majority of the public. This is because, among other things, cash is accessible, available, and convenient, which assists in close management of household budgets and provides businesses with high liquidity and immediate use of funds.

During the course of the Committee's discussions, it became apparent that there is extensive use of cash to conduct transactions in among certain population groups. In order to assist those population segments (known to date), the Committee recommends making banking services and cash-substitute means of payment more accessible, along with information and financial education campaigns. Following are several examples of population segments that may be especially affected by the implementation of the Committee's recommendations. Some of the issues were raised with the Committee during its hearings.

- a. **Minorities:** According to data submitted for the Committee's inspection by the Authority for the Economic Development of the Minorities Sector at the Prime Minister's Office, cash is the most widely used means of payment among the Arab population. For example, the percentage of credit card holders in the Arab sector is around 30 percent. In contrast, more than 85 percent of the Jewish sector owns a credit card. There are various reasons for this—culture, managing the household and controlling expenses, trade with the Palestinian Authority, etc. The solutions proposed by the Committee for this population are to move forward with information and financial education campaigns and to implement the limitations gradually in order to allow adequate time for preparation.
- b. **Debtors with limited means:** The Execution Office Law, 5767–1967, and the Center for the Collection of Fines, Fees, and Expenses Law, 5755–1995, permit—under certain circumstances—prohibiting debtors with limited means (who number about 300,000) from using checks or payment cards. Without a cash substitute, this group will not have the possibility of carrying out transactions in amounts greater than the limitation threshold. The Committee felt that using cash for amounts up to NIS 20,000 should be allowed for this group, with it being the customer's responsibility to keep the receipt for a period of at least three years. Likewise, the Committee determined that the Postal Bank should be required to issue a debit card to anyone who requests it and to allow opening a suitable account for that. As far as banking corporations, to advance the possibility to issue a directive which will require the issuing, subject to certain conditions, of a debit card to anyone who requests it, and to allow opening a suitable account for that. In addition, the Committee recommends that the restrictions currently in place related to use of a credit card by a debtor who has the means to repay but avoids repaying loans and on a debtor with limited means, in accordance with the Execution Office Law, 5767–1967, and the

Center for the Collection of Fines, Fees, and Expenses Law, 5755–1995, will not apply to debit cards.

- c. **Customers whose account is restricted:** About 500,000 customers whose bank account has been restricted under the Checks Without Cover Law, 5741–1981 (which also include debtors restricted under special circumstances) are not permitted to draw checks, and some of those customers are limited by law or within the framework of banks' credit risk management from using credit cards currently existing in the market. The Committee was of the opinion that customers whose account is restricted, similar to the group of debtors with limited means, should be allowed to make payments with cash, for amounts of up to NIS 20,000, with the customer responsible for keeping the receipt for a period of at least three years. Likewise, the Committee determined that the Postal Bank should be required to issue a debit card to anyone who requests it and to allow opening a suitable account for that. As far as banking corporations, to advance the possibility to issue a directive which will require the issuing, subject to certain conditions, of a debit card to anyone who requests it, and to allow opening a suitable account for that. In addition, the Committee recommends that the restrictions currently in place related to use of a payment card by a debtor who has the means to repay but avoids repaying loans and on a debtor with limited means, in accordance with the Execution Office Law, 5767–1967, and the Center for the Collection of Fines, Fees, and Expenses Law, 5755–1995, will not apply to debit cards.
- d. **People who do not have a bank account:** The number of people who do not have a bank account is not known, though in the course of the Committee meetings it was indicated that there are about 200,000–300,000. These are people who are not interested in opening a bank account, for a range of reasons, or those who until now have had the option of opening an account withheld from them (including people under various restrictions, as noted above, people who have declared bankruptcy in the past, and others). In this regard it should be noted that the limitation on the use of cash will require, *de facto*, opening an account at a commercial bank or at the Postal Bank, for anyone who wants to conduct a transaction at an amount greater than the maximum threshold level set. These customers will also be able to open a debit-only account. In order to assist customers who have been prevented from opening an account, the Committee recommends that the Postal Bank be required to issue a debit card to anyone who requests it and to allow opening a suitable clearing account for that. As far as banking corporations, to advance the possibility to issue a directive which will require the issuing, subject to certain conditions, of a debit card to anyone who requests it, and to allow opening a suitable account for that.
- e. **Businesses:** Using cash give businesses greater liquidity, which is crucial to small and midsized businesses, in particular due to credit difficulties. In addition, the use of cash allows companies some certainty with regard to remuneration, since checks contain some level of uncertainty. Furthermore, the use of credit cards has a high cost for businesses, in light of the commercial conditions currently in place between credit card companies and businesses, which place the cost of credit cards on businesses (the cost of the acquiring system and the cost of the credit assurance

system). It should be noted that the Committee also has recommendations related to endorsed checks that are liable to impact on businesses (such as the team's recommendation to limit paying checks which have been endorsed) and a possible negative impact on the ability to accept suppliers' credit (inventory in exchange for deferred checks which the business received from its customers). In order to provide a solution to this population group, the Committee recommends to advance the use of a debit card and identified prepaid card and to ensure that the merchant will be credited not more than 3 days after the transaction occurs, through the regulation of the manner in which funds are transferred from the issuer to the acquirer and from the acquirer to the merchant. It should be emphasized that the use of a debit card presents a marked easing for merchants, which according to an Israel Antitrust Authority estimate reaches hundreds of millions of shekels per year. The easing derives from both the reduced interchange fee and from the reduced number of credit days, in addition to negating the business risk inherent in using checks. In addition, subject to regulation of currency service providers, including credit service providers, the Committee recommends allowing the redemption of checks in amounts greater than the limitation, which have been endorsed only once, to a supervised financial entity, in order to receive credit. Until such regulation is enacted, redeeming a check for an amount greater than the limitation will be allowed, if it has been endorsed only one time, pursuant to the endorsee recording name and ID number on the back of the check.