

**BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

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Press Release:

**Governor of the Bank of Israel Professor Amir Yaron addressed the Banking Supervision Department’s 2022 Conference on “The Effectiveness of Information in a Changing Supervisory Environment”**

Good morning.

I would like first to commend the Banking Supervision Department on this conference, and the conference’s honored participants. The new world of financial information is a fascinating issue that is at the center of daily activity of financial entities, the banking system, and the Bank of Israel.

I will begin my remarks with a description of the importance of the concept of “information” in economics; I will then present in brief the steps we have taken at the Bank of Israel to improve the flow of information and thus to increase the efficiency of the financial system, and primarily to shift control over the information that exists about the public—to the public itself. Finally, I will say a few words to summarize the issue and to look ahead.

Information is a basic product in the world of economics. In many ways, information is the basis for the existence of the financial world. Financial intermediation is intended, among other things, to bridge the information asymmetry between savers and borrowers, and to adjust the investment horizon between the sides. In addition, technology creates new bases of information for us, which in turn allow the development of new business models and the improvement of existing ones. Thus, information not only makes it possible to act better in the existing financial sphere, it also makes it possible, in certain aspects, to develop a new reality.

Nearly all activity in the financial world involves uncertainty and risk. Economist Frank Knight clarified the difference between these important concepts, which at times tend to get mixed up in regular speech.

Risk is a basic concept for anyone in finance: making an investment, extending a loan, etc. are steps intended to increase profit, but they nearly always bear risk: the future profit is not known in advance, and is liable to be lower than expected, or even negative.

Knight discerns a state of risk—in which the future is uncertain, but we can think of the various probabilities of various natural states existing. Thus, we can rank various situation s in accordance with their level of risk.

In contrast, the term “Knightian Uncertainty” describes a situation in which participants do not have sufficient information to assess the probability of every possibility.

In a situation of “risk”, the participants in an economy can carry out risk management, and as a result there is an equilibrium in which there is more business clarity regarding investments and the risks taken, and then decisions are made by examining the expected return vis-à-vis the inherent risk.

In contrast, in a case of uncertainty described by Knight—of lack of knowledge about the risk characteristics of every situation in the world—every participant ascribes a maximum weight to avoiding the worst possible situation, and acts in accordance with the “worst case scenario” principle. From an economic perspective, the outcome is an equilibrium in which the risk premium is higher than in a world where information makes it possible to calibrate risk. In such a situation, many investments—including those that would have been made if there was an ability to suitably estimate their risk—will likely not be made at all, which adversely impacts the economy and welfare.

This can also be thought about as crossing a street: there is a difference between crossing a street after looking at the traffic and crossing a street blindfolded.

This distinction clarifies the importance of information in the economic world. The more information participants in an economy have, the more the economy moves from a state of “uncertainty” to a state of “risk assessment”—the ability to assess risks and to make informed investment decisions, increases. In recent years we have seen a tremendous increase in everything related to worlds of information: the ability to collect and store information—big data, the ability to better analyze it—sophisticated analysis tools for deriving insights from the data such as AI, ML, etc. The more that the financial entity has broader information, the greater its ability to correctly assess the risk, and to make an efficient decision—from an economic perspective, regarding extending credit, allocating resources and uses, and more. In summary, information is the force that makes it possible to switch from a state of uncertainty to a state of risk management.

The distinction I presented between “uncertainty” and “risk” may seem abstract and theoretical, but it is very practical and impacts on the daily lives of all of us. Every household that applies for a loan from a bank or other lender, or entrepreneurs trying to obtain financing, will receive appropriate terms that best match their characteristics if they and the bank have more information. There are two reasons for this: first, to the extent that the entity offering the credit will have more information about the borrower—the history of loans taken out, payment ethic, consumption habits, the state of his assets, etc.—uncertainty will decrease, and therefore the risk premium taken by the bank will decrease. Second, to the extent that the borrower will be able to make the relevant financial information about him accessible to additional financial entities, and the information will not be owned exclusively by the credit suppler to which he currently belongs, his pricing ability will increase, and thus his negotiating power will increase, and the offer he receives will be more worthwhile.

This is not only correct for the side extending the credit, but also for the side consuming the credit. The more information the consumer has about the available possibilities—supply of entities, various investment instruments, the range of loan tracks, etc.—the more he will make wiser decisions that are more appropriate for him.

We at the Bank of Israel understand very well the importance of enhancing information in the financial system and making more it more transparent. This is the reason that from the beginning of my tenure I have worked intensively to enhance the power of the financial consumer, with an emphasis on shifting the control over the information about him—to him.

Thus, for example, the Bank of Israel promoted in recent years the open banking reform. We expect to be one of the first countries in the world that requires, through regulation, the possibility to transfer information between financial entities, in addition to current accounts and credit, including deposits, savings, loans and securities of customers—all in order to strengthen customers’ control over their information.

In this regard, I am of the view that it is important that there be an “open finance” world, with access by all the financial entities to all the information required, as generally accepted worldwide. These entities will be able to provide information and with that to offer advanced services.

An additional example is the establishment of the credit data register at the Bank of Israel. Already now, not long after the system went live, its benefit in increasing competition and enhancing the consumer’s power can be felt—the credit data system improved the ability of credit card companies to offer attractive offers to new customers, about whom they did not have information before the register was established, and there is initial research evidence of a decline in the spread for consumer credit.

In addition, in recent weeks we have begun to publish information on interest rates on deposit and credit products for households, at each of the various banks.

**This is how we are enhancing the flow of information in the economy, this is how we are creating competition, and this is how we are giving more power to the customer. We will continue to do so.**

An additional significant step that we’ve taken at the Bank of Israel is the mortgage reform—a significant consumer reform, which will impact indirectly on every mortgage borrower in Israel. As of today, mainly due to lack of information, mortgage borrowers find it difficult to understand the offers and to compare among them. A series of steps that we are advancing is intended to give more power to customers and to make it easier for them to make, on an informed basis, one of their most significant financial decisions, and will even help in the economic conduct of the household in the present and in the future.

These steps join additional reforms that we promoted in recent years to enhance consumers’ power in Israel—rapid switching between banks, removing barriers to entry for new entities, and the establishment of a new digital bank, promoting immediate payments, the entry of smart contactless payments via the EMV standard, and more.

In addition, we continue to act in these areas—implementing digital checks, establishing a business credit data register, and promoting cross-border faster payment. Likewise, we are examining the possible issuance of CBDC (central bank digital currency)—a digital shekel, with the collaboration of central banks from leading economies such as Hong Kong, Norway, and Sweden, and additional applications of blockchain and DLT technologies in the financial system.

What is common to all that I mentioned is their main motive—innovation, progress, and the use of digitization and information systems that the current age offers us in so much abundance.

The Bank of Israel is marching into the future and to technological progress, and is constantly examining additional processes, some of which are even ahead of banking entities in advanced countries worldwide, with the goal of offering the best, as fast as possible, and to benefit from the advantages of technological development.

I will say straightforwardly that in view of the technological development that is picking up pace in recent years in the spheres of Big Data, artificial intelligence, DLT and blockchain technology, digital assets, and more—we, as regulators, are also facing changing worlds. These certainly create many possibilities—automation of processes that in the past were only carried out by people, increased efficiency of financial processes such as underwriting, and new financial and business models.

In some understanding, the division that I presented, between risk and uncertainty, is also correct in the regulatory environment and the requirements of laws to which the financial entities are subject. As a central bank, which also serves as economic advisor to the government, identifying and dealing with the risks currently facing the financial sector is particularly challenging. We need a deep understanding of the dramatic changes the economy is going through and to prepare ourselves for the existing and future challenges. This, by balancing the promotion of innovation and design of appropriate regulation alongside prudential and consumer regulation.

And now to return to the issue of the importance of information to the financial system, and through it, the economy. Many research papers have been written about the economic phenomenon in which economic crises tend to be longer and deeper if there is a financial crisis in parallel to the real economic crisis. Recently, former Federal Reserve Chair Ben Bernanke won a Nobel Prize for identifying the phenomenon.

One of the explanations for the phenomenon derives from the importance of the information at the center of the connection between the customer and his credit provider. At its base, the financial system is built on the meting of 3 groups: those interested in saving and investing, those seeking financing, and a third party that intermediates between them. What creates the connection between the entities is the mutual information based on years-long familiarity.

Trust is something that is built slowly and carefully over time. Therefore, when in addition to a real economic crisis, the financial system experiences a shock, the entire crisis becomes longer due to the need to restore the trust and information that were lost, a process that as noted takes time—and thus the stability-related importance.

As I near the end of my talk, I would like to address the representatives of the banking system sitting here and participating in this prestigious conference. I noted how much we, at the Bank of Israel, have worked to enhance the transparency and competition in the financial system. I say now straight out: we will continue to work to enhance the competition in the financial system—of course while maintaining its stability—and to enhance the power of the consumer.

The customer of 2022 is smarter, more aware, and as I said, also has more information. To customers I would like to say, “Take advantage of the various tools that the wealth of information and technology allow, and use them to obtain the most worthwhile and appropriate offer”.

To the banks, and other representatives of the financial system: See new world, where information has become so dominant, as an opportunity. Create and adopt new business models, which you can use to offer customers the most worthwhile offers and the most reliable service.

The recent increase in the inflation and interest rate environment led to high profits at the banks. In this regard, I noted the importance of trust in the financial system and I expect of you to rollover to the public the increase in the interest rate not only by increasing the cost of credit but also through increasing the interest rate on deposits. We see that there is a material improvement in this direction and I expect that this process will continue strongly.

I will also say something about inflation. The Bank of Israel is dedicated to bringing it back to the target. We always act with an inclusive view of all the data and their impact on the economy, businesses, and households. The interest rate is a broad tool and the main tool to reduce inflation, and it will continue to be that, to the extent necessary, in order to ensure that the inflation rate returns to its target. Price stability is a condition for economic stability. Inflation first adversely impacts the weaker segments, and thus the pain inherent in raising the interest rate is understood and is taken into account, but is intended to prevent greater pain in the future—whoever does not understand that and tries to find miracle solutions is first and foremost liable to negatively impact precisely the weaker segments.

In addition, frequent changes or excess legislative creativity, which has no parallel anywhere in the advanced economies, create risks—for the banks as well as for the private and business customers—in challenging the business and legal environment.

These changes are liable to ultimately miss the targets of the legislation or regulation. Such uncertainty is liable to negatively impact the entry of new participants, the development of advanced products, and the international approach to the Israeli market and its very state as an advanced economy based on a free economy.

Israel has made a long and commendable trek to switch to an advanced country with an advanced economy—let us not underestimate that or allow steps that will negatively impact that.

We should not take for granted the trust of the markets and the various global economic entities in the Israeli economy. Countries in which the political echelon adversely impacted the independence of the central bank discovered that the trust of the markets and international institutions is gained through hard and dedicated work over decades, but can be lost in the blink of an eye.

I wish you all a productive and educational conference.

Thank you.