

CHAPTER 2

ACTIVITIES OF THE BANKING SUPERVISION DEPARTMENT

The main objective of the Banking Supervision Department is to protect the public good by maintaining the stability and resilience of the banking system, in order to secure the financial assets that the public deposits in the system; by maintaining fairness in the relations between banks and their customers; by promoting competition; and by ensuring the continuity of the banking services provided to the public. These functions are intertwined and crucial for maintaining the public's confidence in the banking system.

To support these goals, in the second half of 2015, the Banking Supervision Department developed strategic targets for the coming years, including: to promote structural reforms that support competition; promote technology and innovation in banking; and promote and support increased efficiency in the banks. When achieved, these targets are expected to support competition and stability in the banking system, and adapt it to the new era towards which the world is moving. Below is a review of the main activities promoted by the Banking Supervision Department in 2015 and the first half of 2016.

The main activities to strengthen stability

To continue to strengthen stability, the Banking Supervision Department:

- **Took measures to continue to strengthen capital adequacy and liquidity in the banking system.** Within this framework, the Banking Supervision Department examined the extent to which the banks are meeting the outline of the new capital requirements and liquidity targets, and conducted an annual assessment of the banks' risk profiles, which were discussed with the banks.
- **Promoted the issuance of new capital instruments that contain loss-absorbing mechanisms.** These instruments have been promoted worldwide as a result of the lessons learned from the financial crisis; they meet the criteria of Basel III, and the Banking Supervision Department has recognized them as part of regulatory Tier II capital. In 2015, several banks carried out initial issues of this type, and there were additional issues in 2016.
- **Adopted Basel III recommendations on the leverage ratio,** and determined that the banks are required to maintain a minimum leverage ratio of 5 percent (on a consolidated basis), and that the two largest banks are required to maintain a minimum leverage ratio of 6 percent. All five major banking groups met the minimum requirements by the end of 2015.
- **Emphasized procedures designed to identify, assess, and monitor risks stemming from compliance, fairness in dealings with retail customers when granting credit, cross-border activities, and cyber risks,** because these risks are on the rise worldwide. The Banking Supervision Department took steps to reduce the banking system's exposure

to these risks, improve its preparedness for them, and limit the implications of these risks on the banks, in view of, among other things, US authorities conducting investigations of banks worldwide, including several Israeli banks.

- **Continued to monitor the development of risks in the housing credit and consumer credit portfolios**, in view of the continued growth of household credit (credit for housing and consumer credit), and took steps as necessary. The Banking Supervision Department directed special attention to the risks embodied in consumer credit and its management, following the considerable increase in such credit in the last two years.
- **Continued to monitor the development of risks in business credit portfolios** and in the implementation of key directives in the field of risk management and demanded that the banks correct the flaws and deficiencies identified in the implementation process.
- **Further improved the quality of reports the banking corporations make available to the public.** Within these measures, the structure of these reports underwent extensive revision, as a result of which they present information in a more usable, uniform, and accessible manner. Concurrently, the gradual adoption of US GAAP also continued.

The main activities to promote banks' competition and efficiency

The Banking Supervision Department took measures to integrate the policy that was developed in recent years to promote competition, and established a new foundation for structural changes that will support increased competition in forthcoming years. The Banking Supervision Department:

- **Developed a simple, brief and uniform annual report format for bank customers—"the Banking ID card"** —which contains details of a customer's entire assets and liabilities in a bank, including income and expenses in respect of assets, liabilities and ongoing activities, as well as the customer's total expenses due to interest and banking fees. Bank customers received the first reports in February 2016 and these are expected to help customers negotiate with banks and receive competitive offers for banking services.
- **Continued to take measures to improve customer's ability to switch banking corporations;** such measures included reducing costs and removing barriers to switching.
- **Promoted innovation and technology in banking** through a new Proper Conduct of Banking Business Directive regarding online banking. This directive removes all the barriers seen to impede banking through direct services without the need for physical branches, and creates the foundation for establishing a digital bank with no physical branches.
- **Required the banking system to increase efficiency,** through relaxing banks' capital requirements, with the aim of facilitating a significant increase in efficiency. To allow competition and reduce costs to customers, and to support sustainable banking in an era of growing competition, the Banking Supervision Department demanded that the banks present multiyear programs on increasing efficiency and reducing the gap in efficiency between banks in Israel and worldwide. The significance of efficiency is currently increasing, in view of the technological revolution that banks around the world are experiencing: In the future, fewer human resources will be required to perform some banking tasks.

- **Promoted competition in the area of acquiring by relaxing requirements imposed on new and existing merchant acquirers and easing oversight of them.** Among other things, the Banking Supervision Department eased the entry of new merchant acquirers by defining a new outline for receiving a merchant acquirer license; reduced the capital requirements imposed on new acquirers to the globally accepted level based on the Payment System Directive (PSD) approach; promoted the use of debit cards; and removed technological barriers to using the payment card system.
- **Set up an infrastructure for establishing new banks, by removing barriers.** The Banking Supervision Department announced a new policy on banking infrastructures: banks will not be required to own infrastructures of their own and will be allowed to use infrastructure supplied by a joint IT center. The Banking Supervision Department also announced a significant relaxation of the approval process for new banks.

The main activities to enhance fairness

In order to further enhance fairness in the relations between the banking corporations and their customers, and to bolster customers' status, the Banking Supervision Department

- **Developed legislation and directives in the field of bank-customer relations.** The Department also represented the position of the Bank of Israel in Knesset committees and ministerial committees on banking consumerism, rendered professional opinions on numerous legislative bills, and played a role in handling class actions.
- **Took measures to reduce account management costs for customers** by expanding disclosure and increasing transparency, and simplifying pricing methods, among other measures. The Banking Supervision Department reported to the Knesset and to the public on the average fees for the most commonly used services in current banking accounts and the use of a credit card.
- **Required that banks** develop policies, procedures, and processes on contacting commercial customers at the bank's initiative with the aim of **confirming proper and fair management of marketing and loan procedures**, and to confirm that the loans they offer match their customers' needs.
- **Investigated complaints and responded to public inquiries.** In 2015, the Public Inquiries Department handled over 5,000 written complaints and inquiries and thousands of telephone complaints. In response to its intervention in these complaints, the banking corporations paid out NIS 5 million to customers.
- **Handled thousands of inquiries concerning restricted accounts.** The Banking Supervision Department receives requests for information on restricted accounts, the significance of this label and its implications, and requests to confirm that restrictions were imposed legally. The Banking Supervision Department examines whether the banking corporations comply with court orders and accordingly monitors the implementation of such orders in the appeals cases related to the various restrictions.
- **Took measures to improve consumer education provided to bank customers.**

The main activities to improve efficiency and encourage banking through digital communication technologies

To continue to improve efficiency and to encourage banking via digital communications, the Banking Supervision Department:

- **Took measures to encourage banks to improve operating efficiency**, in the framework of encouraging stability and competition in the banking system. Among other things, the Banking Supervision Department took measures to remove regulatory barriers in order to facilitate effective efficiency-improvement processes, and instructed banks to prepare long-term efficiency programs.
- **Took measures to remove regulatory barriers in order to support expanded use of digital banking**, in order to reduce customers' need to visit physical bank branches, and to allow customers to benefit from advanced banking services. The Bank Supervision Department concurrently demanded that the banks offer solutions for customers who are challenged by the transition to digital banking.

This chapter presents a detailed review of the vision of the Banking Supervision Department, its strategic goals, and the main actions performed in 2015. The 2015 regulatory timeline and the organizational structure of the Department of Banking Supervision, including its divisions and units, are included as appendices.

1. THE VISION AND STRATEGIC TARGETS OF THE BANKING SUPERVISION DEPARTMENT

The Banking Supervision Department set strategic targets to maintain stability, encourage competition, and promote fairness in the banking system, and also set supporting targets: to promote technology and innovation, promote greater efficiency, and balance regulation with an emphasis on risk-based supervision.

In 2015, the Banking Supervision Department reviewed its strategic targets and developed its vision for forthcoming years—to be a professional, proactive regulator working for the good of the public and the economy.

The key strategic target of the Banking Supervision Department is to maintain the stability of the banking corporations and to ensure their prudent conduct, in order to protect the public's funds. Two additional strategic targets are to encourage competition in banking services—with an emphasis on retail credit, credit to small businesses, and the field of acquiring and payments, in order to promote structural changes—and to maintain fairness, which is critical for retaining the public's confidence in the banking system.

The Banking Supervision Department will strive to accomplish these primary targets in the forthcoming years through secondary supporting targets and specific initiatives for each of the primary goals. The supportive targets include encouragement of the banks' operational efficiency; removal of regulatory barriers to the adoption of technological innovations by the banks, in order to offer customers banking services at a high standard and high added value, among other things; and balancing the regulatory burden. The Banking Supervision Department will focus on these goals in the next few years.

With respect to specific initiatives designed to achieve the strategic goal of **stability**, the Banking Supervision Department will take measures in a number of areas, including the following two areas: First, it will take steps to allow the banks

to raise loss-absorbing capital, pursuant to the recommendations developed by the Basel Committee on the basis of the lessons learned from the global financial crisis. Second, the Banking Supervision Department will, together with relevant government ministries, promote legislation that will make it possible to impose deposit insurance, and expand the tools available to the Bank of Israel and the government to manage failing banks and bank resolutions.

To achieve the strategic target related to **competition**, a supervisory framework was formulated that is adapted to nonbank financial institutions (this framework is more lenient than the supervision imposed on banking institutions), and an appropriate regulatory framework was defined for new merchant acquirers. Furthermore, measures were taken to establish the infrastructure for increasing competition in the banking system, which included the development of a new policy on online banking, with the aim of creating an infrastructure for the establishment of a digital bank with no physical branches; a directive on efficiency was published, requiring the banks to submit significant efficiency-improving plans to the Banking Supervision Department, this year; steps were taken to increase transparency by expanding and simplifying customer information in order to allow customers to improve their negotiating position vis-à-vis the banks, and facilitate switching banks.

To achieve the strategic goal related to **fairness and public confidence**, the Banking Supervision Department will adopt the global regulation on fairness in banking, extend financial education and informative publications to the public, and create tools for the general public, such as the Banking ID card (a report that presents a summary of a customer's assets, liabilities, and banking in a clear and uniform format that facilitates comparisons among banks and switching between them).

2. ACTIVITIES OF THE BANKING SUPERVISION DEPARTMENT

a. Reinforcing stability and ensuring prudent risk management

The Banking Supervision Department continuously monitors the development of risks in individual banks and in the banking system as a whole. Risk assessment—the process that the Banking Supervision Department conducts alongside the evaluations that the banks independently perform in compliance with regulatory requirements—is used by the Banking Supervision Department to determine capital adequacy; to develop a position on the capital requirement targets for each bank; and to review the quality of the banks' risk management and the corporate governance function, and develop the measures necessary to strengthen them. Furthermore, the Banking Supervision Department monitors the potential implications of domestic and global economic developments for the banking system.

The heavy price that European and US economies continue to pay for the financial crisis and the collapse of major banks eight years ago emphasizes just how important it is to maintain the stability of the banking system in Israel in order to protect the public's funds and the entire economy.

I. Strengthening capital adequacy, liquidity, and leverage

Strengthening capital adequacy

In 2015, the Banking Supervision Department continued to study the compliance of the various banks and the entire banking system as a whole with the emerging capital adequacy framework, and to conduct an annual assessment of risk profiles (SREP).¹ Wherever meeting capital requirements was found to present a challenge to a banking corporation, the Banking Supervision Department entered into a dialogue with the bank on its capital planning and how to achieve its capital targets, and the necessary measures were taken.

Furthermore, the Banking Supervision Department took steps to promote the issuance of new capital instruments with loss-absorbing mechanisms. These instruments meet Basel III criteria, and the Banking Supervision Department recognizes them as Tier 2 capital. In 2015, the banks carried out their first issuances (see Box 2.1).

As in previous years, the Banking Supervision Department conducted a macroeconomic stress test of the banking system on the basis of a uniform scenario. The banking corporations were asked to estimate the results of the scenario using the various methodologies that they have been developing (bottom-up) and at the same time the Banking Supervision Department carried out the test using a uniform methodology (top-down). The uniform stress test serves as a tool for evaluating the resilience of the banking system, ensuring the existence of sufficient capital levels, examining the banks' capital planning, establishing capital requirements and the adoption of other measures when necessary and in accordance with accepted practice in other countries around the world.

The Banking Supervision Department promoted the issuance of new capital instruments that include a loss-absorbing mechanism, in line with international standards that were developed in response to the lessons learned from the global financial crisis.

Box 2.1

Raising Regulatory Capital through Contingent Convertibles

- The recent financial crisis showed that the quantity and quality of capital play a critical role when a banking corporation suffers very large losses. If the capital proves inadequate, governments are forced to use the taxpayers' money to rescue banks.
- As part of the lessons learned from the financial crisis, new criteria were formulated for loss-absorbing instruments eligible for classification as supervisory capital according to the Basel Committee's recommendations. These criteria ensure that in a crisis, the first to suffer the losses will be those holding the instrument, and only afterward the taxpayers.
- The Banking Supervision Department has adopted the Basel Committee recommendations, and in cooperation with the Israel Securities Authority, has permitted the banks to raise loss absorbing capital. In view of the complexity of these instruments, the Banking Supervision Department has ruled that

¹ Supervisory Review Evaluation Process.

Tier 2 capital instruments include a mechanism for absorbing losses with a quantitative criterion—a feature that provides investors with greater certainty—even though the Basel Committee does not require this. In addition, requirements were established for the purpose of preventing households and small investors from buying the instruments, since these investors are often unable to analyze the risk entailed in them.

- The loss absorbing instruments were designed to ensure that when a severe crisis materializes, and a bank or the entire banking system encounters difficulties, the conversion will generate a capital flow, thereby reducing the probability that banks will fail and that the entire economy, investors and taxpayers will be negatively impacted.
- In recent years, banks worldwide have raised large volumes of capital instruments under the Basel III framework. These issuances included additional Tier 1 capital and Tier 2 capital—instruments including the option of conversion into equities and instruments that allow the debt to be permanently or temporarily written off.
- Those purchasing the complex capital instruments are required to understand the risk incorporated in them and the stress scenarios concerning them, to price the risk incurred in a specific instrument according to this analysis, and to decide what proportion of the investment portfolio should be invested in it.

Background

In the mid-1990s, many banks, mainly in the US, began issuing instruments combining characteristics of equity and debt, and these were included in Tier 1 capital. These issuances were designed primarily to bolster the stability of the issuing bank by increasing its regulatory capital. They featured three key advantages: a. They did not dilute holdings in common stock, and therefore did not affect banks' shareholders; b. They were cheaper than issuing shares; and c. Instruments that included a maturity date or an incentive for repayment were relatively attractive to investors, because they provided a regular income and there was a date in theory for repayment of the principal. The capital quality of these instruments, however, was inferior to that of share capital, mainly due to the inability to regularly absorb losses.

In view of the growing use of these capital instruments, a 1998 press release by the Basel Committee listed conditions that must be met in order for these instruments to be eligible for inclusion in Tier 1 capital.¹ In addition, the Committee restricted their inclusion in Tier 1 capital, writing that they could constitute up to 15 percent of it. Since the conditions in the press release were never included in any formal recommendations, every country used its own interpretation of these criteria, leading to a lack of uniformity in the basic characteristics of the capital instruments and in the quantitative restrictions on their inclusion in regulatory capital.

The latest global crisis proved that these capital instruments did not succeed in absorbing losses in a situation of failure, because in order to convert them into shares, the bank that issued them had to fall below the specified minimum capital ratio. Since in many cases the conditions for converting the instruments into shares were not fulfilled, the holders of the instruments held on to their investment, and the governments had to rescue the banks with the taxpayers' money.

¹ Instruments Eligible for Inclusion in Tier 1 Capital – <http://www.bis.org/press/p981027.htm>.

The Basel III Recommendations

In December 2010, as part of the lessons learned from the global financial crisis, the Basel Committee published the Basel III framework² in order to improve global capital and liquidity ratios, with the aim of bolstering the banking sector's resilience, stability, and preparedness for the next financial crisis. Among other things, the recommendations refer to the inclusion of the instruments in question in regulatory capital, and establish uniform criteria that must be met in order to include the instruments as Additional Tier 1 capital or as Tier 2 capital. These criteria strengthen the bank's capital, as they ensure that if the bank's situation deteriorates enough to jeopardize its stability, the holders of the capital instruments will absorb the losses, thereby reducing the probability that a need will arise to inject public money into the bank. The following are the principal specifications established by the Basel Committee for the capital instruments:

a. The Loss-Absorbing Mechanism

(1) *Timing of Absorption*

- In order to ensure that investors in the instruments absorb the losses, both when the bank is a going concern and when the bank is close to being a gone concern, it was established that they should include a quantitative or qualitative trigger event, as follows:
- Quantitative trigger—for Additional Tier 1 capital, a trigger event occurs when the proportion of Common Equity Tier 1 capital falls below 5.125 percent. No quantitative trigger was set for Tier 2 capital instruments.
- Qualitative trigger – on January 13, 2011, the Basel Committee published a press release³ on the absorption of losses at the point of non-viability. The announcement stated that two cases should qualify as a trigger event: (a) when in the Supervisor of Banks' judgment it is essential in order to prevent the bank from reaching the point of non-viability,⁴ and (b) when a decision is made to inject public capital into the bank, without which the bank will reach the point of non-viability. This trigger is designed to ensure that holders of the instrument absorb losses before the taxpayers when a bank receives public assistance.

(2) *Method of Absorption*

The Basel Committee established that the losses should be absorbed through a compulsory structured mechanism requiring:

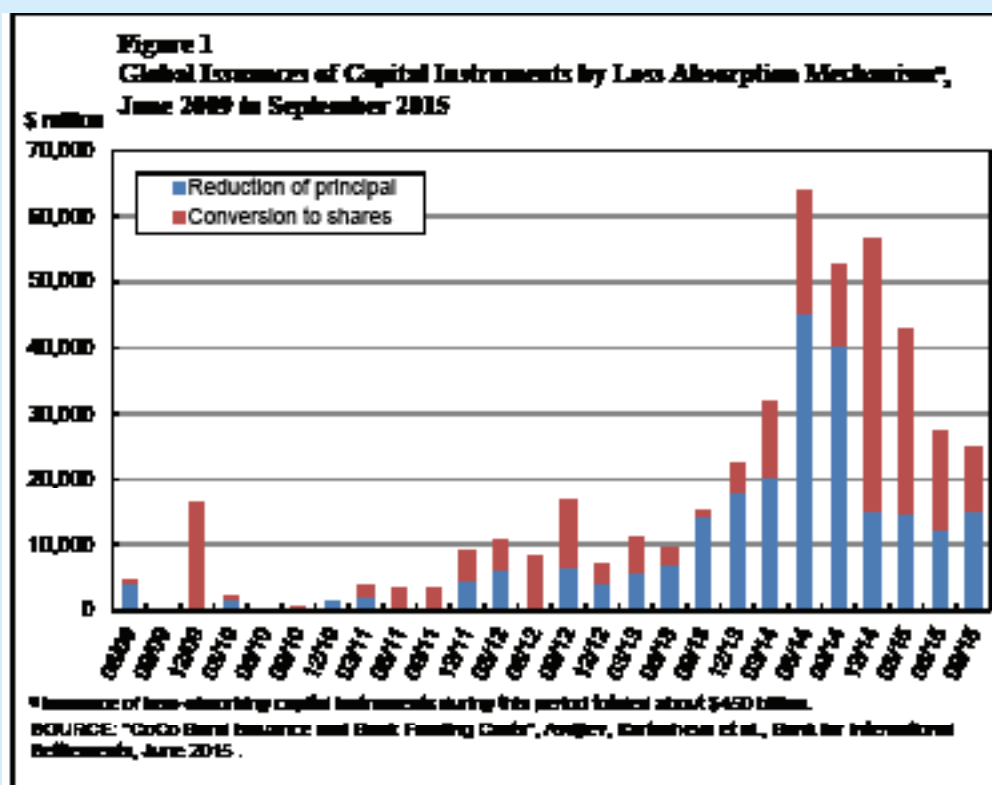
- Conversion of the instrument into common stock of the bank at a predetermined conversion ratio, or
- A total write-off of the principal, or to reduce it until it fulfills the required trigger
- The guidelines published by the European Union in June 2013 (CRD IV) also referred to the possibility that the principal would be temporarily written off, and would be increased if the bank recovers.

² Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems – <http://www.bis.org/publ/bcbs189.pdf>.

³ Loss Absorption at the Point of Non-Viability – <http://www.bis.org/press/p110113.htm>.

⁴ A supervisory judgment that requires converting the instrument into shares or reducing the principal when the bank is incapable of continuing its regular activity.

The following figure displays the worldwide distribution by loss absorption mechanism of the issuances by banks during the period from June 2009 until September 2015. It can be seen that banks raised loss absorbing capital on a very large scale, and the following picture emerges for the past year: about half of the capital raised included a mechanism for conversion into shares, and half included a mechanism for reducing the principal.



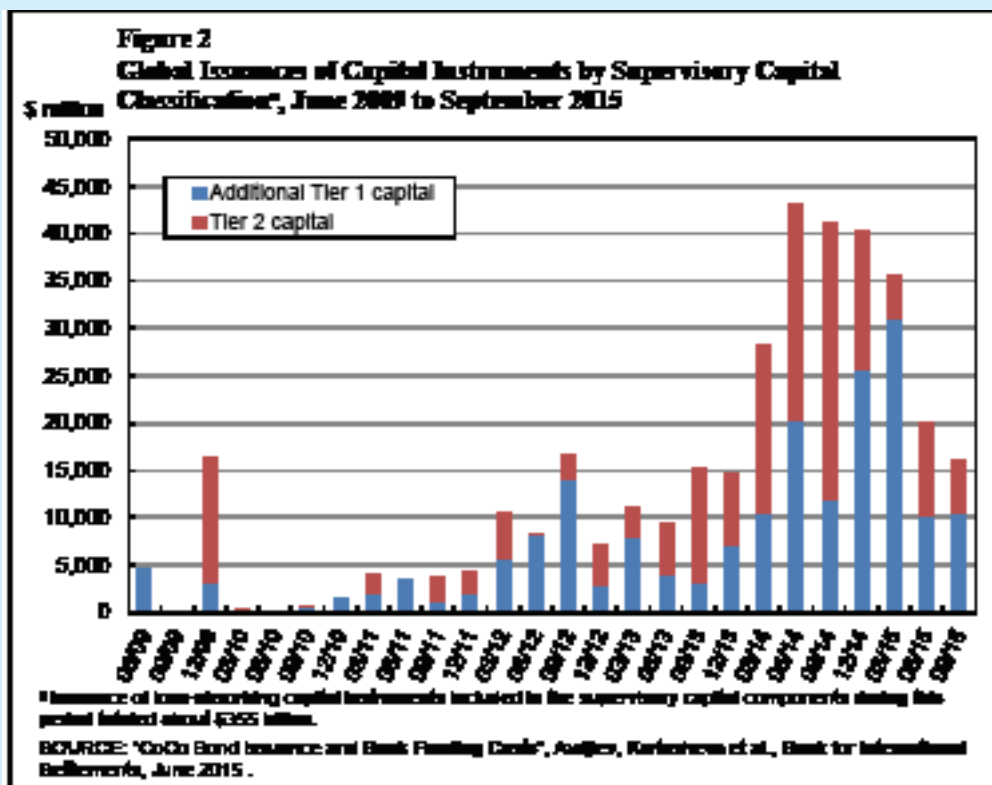
b. Additional Criteria for the Inclusion of the Instruments in Regulatory Capital

Tier 1 capital instruments – must be permanent (without any maturity date). The bank must retain the option of exercising judgment with respect to payments of interest on them.

Tier 2 capital instruments – must have a term to maturity of at least five years.

The new criteria do not allow the inclusion in capital of Additional Tier 1 and Tier 2 capital instruments with incentives for redemption, such as higher interest, because in the past this has detracted from the permanent character of the instrument.

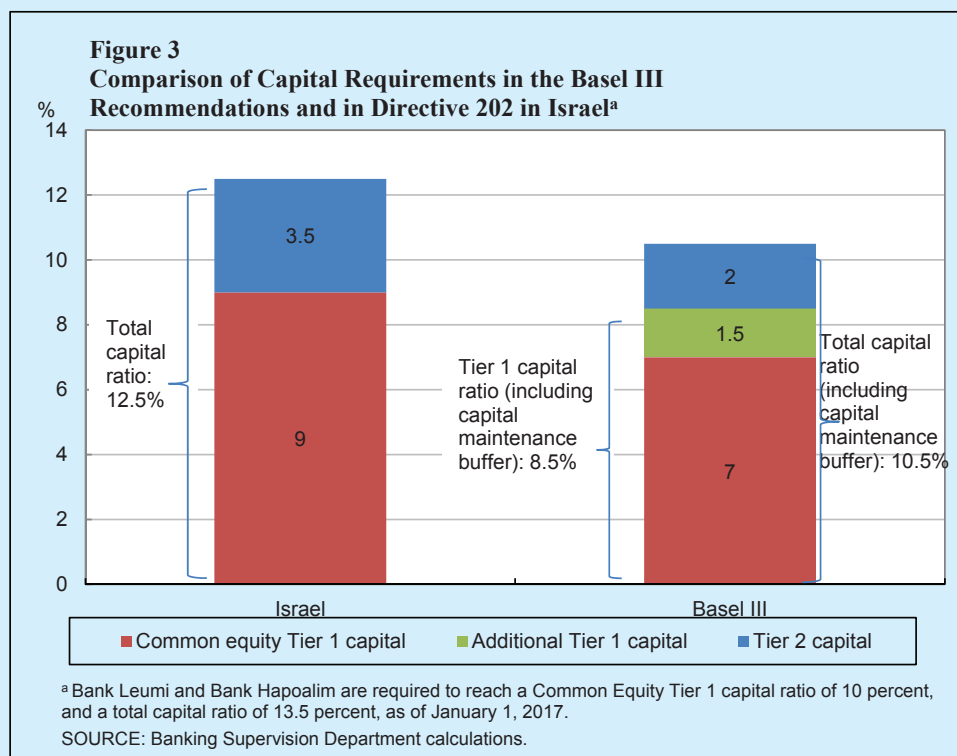
Following the publication of the new criteria, banks throughout the world began issuing Additional Tier 1 and Tier 2 capital instruments meeting these criteria. The following diagram displays the distribution of the issuances according to the type of instrument and the amounts issued during the period from June 2009 until September 2015.



The Situation in Israel

The Banking Supervision Department in Israel adopted the Basel Committee recommendations, and has taken steps in recent years to increase the quantity and quality of capital in order to bolster the resilience of the banking system in Israel. Within this framework, the Banking Supervision Department ruled that the Common Equity Tier 1 capital ratio must not be less than 9 percent, starting on January 1, 2015, and must not be less than 10 percent at the two largest banks, starting on January 1, 2017. The overall capital ratio must be 13.5 percent at the two largest banks and 12.5 percent at the other banks. It should be noted that the minimum Common Equity Tier 1 Capital requirement is higher than the level set by the Basel Committee (see Figure 3).

Israel adopted the Basel III recommendations, with certain adjustments, starting on January 1, 2014, and the particulars are contained in Proper Conduct of Banking Business Directive No. 202 on the subject of regulatory capital. This directive establishes a more stringent quantitative trigger than the one set by the Basel Committee: with respect to additional Tier 1 capital instruments, it was ruled that a trigger event for conversion or reduction occurs when the proportion of Common Equity Tier 1 ratio falls below 7 percent, compared with 5.125 percent in the Basel Committee recommendations. A trigger was also set for absorption of losses for Tier 2 capital instruments—when the Common Equity Tier 1 ratio falls below 5 percent. As noted, the Basel Committee did not set a quantitative trigger for Tier 2 capital instruments.



In order to prevent households and small investors from purchasing the instruments—since at times they do not understand the risk entailed in them—the Banking Supervision Department, in coordination with the Israel Securities Authority, established additional covenants and requirements:

- **Transparency:** the prospectus should include prominent disclosure of the instrument's complexity, and that investors are liable to lose their entire investment.
- **Restriction on the trading unit:** because the character of instrument is more suitable for sophisticated investors, it was stipulated—in coordination with the Israel Securities Authority and the Tel Aviv Stock Exchange—that in the event of an issue to the public, trading would take place in units of at least NIS 50,000.

Until the Basel III recommendations took effect on January 1, 2014, banks in Israel had to obtain specific approval from the Banking Supervision Department for the inclusion of Tier 1 and Tier 2 capital instruments in regulatory capital, and approval was subject to meeting the stipulated conditions. In 2004 and 2006, the banks issued a few Tier 1 and upper Tier 2 capital instruments, and these instruments do not meet the new criteria set in Basel III. The transitional directives allow the balance of these capital instruments to be reduced over a 10-year period.

Due to the reduction in the balances of the existing capital instruments and subordinated debt notes, and in order to comply with the requirements for the proportion of Tier 2 capital, the banks began—toward the end of 2015—to issue new capital instruments meeting the Basel III criteria. In December 2015, the first private placement took place of Tier 2 capital instruments with a mechanism for absorbing losses through a temporary write-off of the amount of the principal. In January 2016, the first issue took place of negotiable Tier 2 capital instruments with a mechanism for absorbing losses through conversion into common stock. In the coming years, the banks are expected to continue issuing these instruments in order to meet the capital adequacy requirements.

Adopting the leverage ratio

The Banking Supervision Department adopted the Basel III leverage ratio recommendations.

The build-up of excess leverage in the banking system was one of the causes of the global financial crisis. As a response to the crisis, the Basel III recommendations defined a leverage ratio that aims to constrain the build-up of leverage in a banking corporation and prevent deleveraging processes that can damage the financial system and the economy, and to reinforce risk-based capital requirements. The leverage ratio requirement is simple and transparent. It is not risk based, and it functions as a supplemental and reliable measure alongside the risk-based capital requirements.

In April 2015, the Supervisor of Banks published the Proper Conduct of Banking Business Directive no. 218, “The Leverage Ratio”. This directive determines that, as of January 1, 2018, the banking corporations are required to meet a minimum leverage ratio of 5 percent (on a consolidated basis), and a minimum leverage ratio of 6 percent for banking corporations whose total consolidated balance sheet assets constitute 20 percent or more of the total balance sheet assets in the banking system.² It was also determined that if a banking corporation meets the requirement on the publication date, its leverage ratio may not subsequently decrease. If a banking corporation does not meet the requirement on the publication date, it must increase its leverage ratio, at fixed quarterly increments, by January 1, 2018. All five major banking groups met the minimum leverage ratio by the end of 2015.

The directive was developed following a quantitative impact study (QIS) conducted with the aim of determining the effect of implementing the directives for the banking system in Israel.

Adopting a liquidity coverage ratio according to Basel III recommendations

The Banking Supervision Department adopted the Basel III recommendations on liquidity ratios, and their implementation bolstered the banks' liquidity.

In April 2015, a new Proper Conduct of Banking Business Directive (No. 221) came into effect, adopting the Liquidity Coverage Ratio (LCR), one of the two international standards for liquidity established by the Basel III Committee. The second standard (the Net Stable Funding Ratio, or NSFR) is expected to be adopted by the Banking Supervision Department according to a schedule that corresponds to the timetable set by the Committee (January 1, 2018) and after its possible effects have been examined. The LCR is designed to examine liquidity under a 30 calendar day liquidity stress scenario. As of April 1, 2015, the banking corporations are required to gradually meet the LCR and include a disclosure to this effect in their consolidated and solo financial statements.

The Banking Supervision Department required that the banks address liquidity planning in a detailed manner in their multiyear work plans, and specify the measures they plan to take to achieve the regulatory liquidity targets and maintain them over time. In line with the Basel Committee recommendations, the Banking Supervision Department developed additional liquidity measures designed to assess the banking corporations' liquidity risks. These measures are designed to be used as monitoring tools, and they include, among other things, measures that assess the concentration

² The requirement currently applies to Bank Leumi and Bank Hapoalim.

of financing sources, mismatches in contractual maturity dates, and market-based monitoring tools. In addition to these tools, the Banking Supervision Department revised the regulatory scenarios used to assess responses to local crises, a bank crisis, and a global crisis, and these scenarios now include reference to liquidity-related issues.

II. Improving operational efficiency

In 2015, the Banking Supervision Department took measures to promote efficiency processes in the banking system, with the understanding that such processes can increase competition in the system, reduce the prices of banking services, and improve profitability of the system. In recent years, the banks began implementing internal efficiency programs, and reduced the number of their employees and their expenses, yet a large gap remains between the efficiency of the banks in Israel and that of banks in advanced economies. Therefore, the Banking Supervision Department placed on the agenda the need for significant improvement in efficiency and for reducing the differences between Israel and the world. In January 2016, the Banking Supervision Department issued a guidance letter to the banking system, requiring all banks develop a long-term efficiency-improvement program. At the same time, the Banking Supervision Department relaxed capital adequacy requirements for banking corporations that prepare significant long-term efficiency-improvement programs, and also presented clarifications on the accounting treatment of efficiency-improvement programs that include a voluntary retirement program and a reduction of other expenses.

Most banks are not required to improve efficiency merely because they are currently less efficient than banks worldwide, but also because the operations of the banking system are shifting to direct and digital channels such as the Internet, smartphones, and ATMs, and therefore fewer employees will be needed to maintain a portion of these banking operations (see Box 1.1). The Banking Supervision Department believes that efficiency-improvement measures, in tandem with an expansion of digital banking, may enhance customer service, allow banks to reduce the costs of their banking services—especially for households and small businesses—and enhance competition in the banking sector. Moreover, against the backdrop of these changes in the economic, regulatory, and technology environment in which the banking system operates, both in Israel and worldwide, operational efficiency will contribute to a sustainable business model and to the system's long-term stability.

III. Risks and corporate governance

Compliance risks

In 2015, the Banking Supervision Department continued to implement assessments, audits, and regulatory processes to ensure that the banking corporations identify activities that expose them to compliance and regulatory risks and take measures to manage and use a risk-based approach to reduce these risks.

The Banking Supervision Department took measures to remove regulatory barriers with the aim of allowing banks to implement effective processes to increase efficiency, and guided the banks in preparing programs to increase efficiency.

In 2015, the Banking Supervision Department continued to emphasize the need to strengthen processes designed to identify, evaluate, and monitor risks that stem from violations of laws and regulations (compliance risks), cross-border activities, and cyber threats, as these risks are increasing in the banking systems in Israel and worldwide.

Exposure to cross-border compliance risks has significantly increased in recent years, especially as various countries have stepped up their enforcement efforts to identify taxable funds that citizens transferred to foreign financial institutions, and because these countries enforce various laws on their citizens even when the latter deposit funds outside the country of origin. Such efforts include, among other things, investigations of, and the imposition of sanctions and fines on, banking and financial institutions that conduct international activities or have foreign customers. Within the framework of such efforts, US authorities imposed large fines on numerous banks worldwide, including Bank Leumi, and initiated investigations against Bank Hapoalim and Mizrahi-Tefahot Bank (see Box 1.4). The Banking Supervision Department is involved in this issue and required the banks to draw the appropriate conclusions, and modify all the processes they use to check whether foreign and Israeli residents comply with tax laws. In March 2015, the Banking Supervision Department issued a letter to the banks containing instructions related to the risks arising from their customers' cross-border activities, and a requirement to manage these risks.

In 2015, progress was made in the national assessment of money laundering and terrorism financing risks, a process that the State of Israel is conducting pursuant to Recommendation No. 1 published by the FATF organization in 2012.³ The Banking Supervision Department examined how the banking corporations and credit card companies implement the AML-CFT directives as part of their compliance risk views, and consequently the Banking Corporation Sanctions Committee, headed by the Supervisor of Banks, imposed monetary sanctions totaling NIS 5.4 million.

Box 2.2

Compliance and the Compliance Function in Banking Corporations

- **Materialization of compliance risks has increased in recent years, both in Israel and worldwide**, reflected in a rise in the volume of fines imposed on banking corporations and other financial institutions. At the same time, fairness in the banking system toward consumers has been stressed, because this feature is essential for maintaining confidence in the system, and therefore also for the stability of the banks.
- **In June 2015, the Supervisor of Banks published Proper Conduct of Banking Business Directive No. 308 on the subject of Compliance and the Compliance Function in a Banking Corporation.** This directive, which replaced a directive from 2002, was designed to improve management of the compliance risk in banks, and to enhance the compliance function and the person heading it—the chief compliance officer—in resources and in areas of responsibility.
- **The new directive expands the definition of compliance directives** beyond consumer directives. It stipulates that compliance risk can result from any of the laws, regulations,

³ The FATF Recommendations (2012), International standards on combating money laundering, terrorism & proliferation.

regulatory directives, internal procedures, and the code of ethics applying to the banking corporation's activities, as well as the laws applying to its foreign customers in their country of origin.

- The Basel Committee formulated a risk management concept for banking corporations using the three lines of defense method. According to this concept, **the compliance function constitutes part of the second line of defense**, and its independence from the activity of the first line of defense, business line management, should therefore be ensured, as well as the interfaces with the internal audit function—part of the third line of defense. At the same time, it was stipulated that the functions from the second line of defense can manage part of the compliance risk, provided that the banking corporation establishes the interfaces and areas of responsibility.
- **In order to manage compliance risk effectively, a high level of alertness should be maintained.** Changes in legislation and the interpretation of legislation by courts in Israel and worldwide are to be monitored, and the banking corporations should rapidly adapt their activity to the changes. It should also be verified that the compliance officer and risk manager are involved in the initial stages of the decision about new activities and products, so that the risks can be identified in advance and the requirements for managing them outlined—including activities carried out by the banks in cooperation with external entities (such as fintech companies).

Background

The complexity and development of banking activity require banking corporations to scrupulously observe the compliance directives in a very broad range of areas. These directives include the laws, regulations, regulatory directives, internal procedures, and codes of ethics applying to the activities conducted by the banking corporations in Israel and overseas, as well as the laws applying to their foreign customers in their country of origin. If a banking corporation does not scrupulously observe the compliance directives, it may be exposed to compliance and legal risks—a negative impact on its image and reputation, substantial financial losses (for example, regulatory fines; losses in lawsuits, including class action lawsuits) and sanctions involving a ban on activity, as well as adverse impacts on its officeholders. Damage of the first type might be much more severe than the other types, since reputation and image are the fundamental building blocks on which the public's confidence in a bank rests, and a loss of trust in a bank is liable to destabilize it.

In June 2015, the Supervisor of Banks published Proper Conduct of Banking Business Directive No. 308 on the subject of Compliance and the Compliance Function in a Banking Corporation, and the directive became effective on January 1, 2016. This directive was designed to strengthen management of compliance risk among banking corporations in general, expand the areas of responsibility of the compliance function, and empower it and the person heading it by setting clear principles for their actions and specifying their interfaces with the other relevant parties at the banking corporation.

Underlying the publication of the directive is the increased materialization of compliance risks in Israel and throughout the world, a phenomenon reflected in a rise in the volume of fines imposed on banks and other financial institutions. For example, the US and other countries have levied billions of dollars in fines for violation of directives governing mortgages, securities, and the maintaining of

accounts in private banking (see Box 1.4). Also underlying the directive is the emphasis in recent years on the importance of fairness towards the consumers – among other things following the lesson learned from the global financial crisis – in the understanding that there is a close connection between fairness and trust in the banking system and its stability.

Directive No. 308 replaced the directive on the subject of the compliance officer published in 2002. This directive had not been revised, and after 2002, the Basel Committee published a document of principles for risk-based management of compliance, as well as recommendations concerning risk management adopted by the Banking Supervision Department in recent years (Directive No. 310 – “Risk Management,” Directive No. 311 – “Credit Risk Management,” Directive No. 350 – “Operational Risk Management”). In particular, the Banking Supervision Department adopted the Basel Committee’s risk management concept of three lines of defense: the first line of defense includes the business units, the second line of defense is composed of an independent risk management function, and the third line of defense includes the internal audit function. Like these directives, Directive No. 308 also fits in with this risk management concept: it explicitly states that the compliance function constitutes part of the second line of defense, and that its independence from the activity of the first line of defense should therefore be ensured, as well as the interfaces with the internal audit function—part of the third line of defense. The Banking Supervision Department thereby conformed to the international standard for compliance, and with the most up-to-date risk management concept.

Main Points of the Directive

The directive establishes several guiding principles and rules for the way banks must handle compliance risk, as follows:

- Conformance with the compliance directives applying to a banking corporation’s activity constitutes part of its organizational culture. This is not confined to the compliance function; it applies to every function at the corporation, and should be regarded as an integral part of its business activity. In order to improve compliance and stress its importance for the banking corporation and the extensive responsibility of every function at the bank, the title of the directive was changed from “Compliance Officer” to “Compliance and the Compliance Function in a Banking Corporation.”
- Compliance at a banking corporation begins with the board of directors and senior management, especially the personal example they set. Their responsibility for formulating and approving a group policy that also applies to subsidiaries (corporate governance) has therefore been stated and emphasized, as well as the role of the internal audit function in the context of compliance.
- The board of directors bears overall responsibility for compliance risk management at a banking corporation, and is responsible for approving the compliance policy formulated by senior management. It should assess the effectiveness of compliance risk management at the banking corporation at least once a year. The board of directors determines what reports it receives and how frequently, and in any case is to hold an exclusive meeting with the chief compliance officer at least once a year.

- Senior management is responsible for allocating the resources required for the compliance function to perform its job properly. Senior management should identify and assess the main aspects of compliance risk at least once a year, and should report how it is managed to the board of directors.
- Compliance risk derives from an extremely broad range of directives: in the 2002 directive, it was derived only from consumer directives, but it is now derived from all the directives applying to **all** banking activity. In this context, directives from a broad normative category were listed, including laws, regulations, directives issued by the Supervisor of Banks, and positions expressed during the handling of queries from the public. This also reflects alignment to the Basel Committee recommendations.
- Other functions from the second line of defense can manage part of the compliance risk, provided that the banking corporation clearly specifies the interfaces and areas of responsibility.
- Responsibility for the compliance risk deriving from certain directives must rest with the chief compliance officer and the compliance function, because in our view these directives lie at the core of the compliance function's activity. These consist mainly of consumer directives involving fairness in the relations between a bank and its customer, including directives in the field of anti-money laundering and combating the financing of terrorism. The banking corporations are responsible for mapping the relevant directives.
- The compliance function is responsible for advising senior management about compliance directives; assisting senior management in training employees; answering questions from employees about compliance; identifying, documenting, and assessing the compliance risks incurred in banking activity; being an integral part of the process of approving a new product; and monitoring compliance at the banking corporation.
- The directive emphasizes the issue of resources, and states that compliance function employees carrying out compliance tasks are subordinate to the chief compliance officer. The chief compliance officer must be either a member of senior management or directly subordinate to a member of senior management who is not responsible for managing a business line.
- Requirements were also established at the group level, including a requirement to formulate group policy, make the chief compliance officer at a branch professionally subordinate to the chief compliance officer of the parent corporation, and to pay special attention to a situation in which an overseas branch conducts activity that is legal in the host country, but forbidden by Israeli law.

The directive's taking effect on January 1, 2016 is expected to bolster compliance risk management in banks and reduce the resulting cost when the risk materializes.

Corporate governance and the handling of executive salaries

In 2015, the Banking Supervision Department continued working to strengthen the banks' corporate governance regimes and continued to enforce directives on the issue, in order to anchor an adequate and robust corporate governance regime, alongside activities to improve operating efficiency.

In August 2015, the Banking Supervision Department amended Proper Conduct of Banking Business Directive 301A on the remuneration policy in a banking corporation. The Banking Supervision Department (a) established that directors, including the Chairperson, are only to receive fixed remuneration, (b) added a requirement establishing that the remuneration policy and arrangements need to enable a banking corporation to require a key employee to return to the corporation variable remuneration that was paid to the employee, and (c) published clarifications regarding the prohibition on receiving remuneration directly from the controlling interests in the banking corporation. In view of the legislation of the laws related to limiting executive pay in financial institutions, the Banking Supervision Department will adapt its directives during 2016, and banks will be required to adjust their remuneration policy to the law.

Operational risks

During the year, the Banking Supervision Department acted to monitor operational risks in several main channels:

- **Information leaks:** The Banking Supervision Department required banks and credit card companies to conduct an audit, through an independent external entity, to assess the adequacy and effectiveness of the system to protect from information leaks due to intra-organizational activities. This is because the scope of events related to information security and information leaks is increasing abroad and in Israel in various entities, including financial institutions, and because such events are liable to lead to significant harm to a banking corporation.
- **Cyber:** The Banking Supervision Department continued with activities intended to advance the banking system's preparedness for cyber risks. It (a) published directives related to management of cyber protection and risk management in a cloud computing environment; (b) continued the process of examining how to strengthen the resilience of banking corporations to cyber threats; (c) continued to conduct the activity of the professional interbank cyber protection forum that it established; (d) planned and led two sector-wide cyber drills; (e) promoted weekly and immediate reporting aimed at concentrating the information on weaknesses, warnings, and cyber events, and (f) took steps to advance the establishment of a banking cyber-protection center, in collaboration with the National Cyber Bureau and within the framework of the joint Committee to deal with operational continuity of the financial system.

Alongside these, the Banking Supervision Department also dealt with actual and attempted cyber events in the banking system.

- **Business continuity:** The Banking Supervision Department dealt with handling specific cases of gaps created in the banking system in business continuity and with increasing preparedness for emergencies. This process included examining the extent of meeting the requirements of the directive related to protecting critical sites and participating in a weeklong national emergency drill.

Credit risks

In 2015, the Banking Supervision Department continued to follow on an ongoing basis the development of risks in the banking system's credit portfolio, and to act as necessary. The continued increase in the **housing credit** portfolio, and the growth in its share of total credit to the public, led to an upsurge in the risks inherent in it, which derived from the large total exposure. In contrast, the regulatory requirements imposed by the Banking Supervision Department in recent years—including requirements to increase the payment to income ratio of borrowers to limit the loan to value ratio, and to set aside additional allowances and capital against the credit that the bank provides for mortgages—acted to moderate the risk in the mortgage portfolio. It should be noted that the limitations imposed by the Banking Supervision Department in this area are among the most stringent in the world. In an attempt to estimate the exposure of the banking system to risk attributed to the mortgage portfolio, the Banking Supervision Department conducted **stress tests**. In the uniform stress test conducted this year for the banking system, the Banking Supervision Department estimated, among other things, the direct loss in the housing credit portfolio due to the realization of a stress scenario, in order to examine the sensitivity of the portfolio to various risk factors. The results of the test are a complementary tool to estimate the risk in the housing credit portfolio and to examine the measures in this area.

In addition to the growth in housing loans in recent years, there was also a rapid increase in the scope of consumer credit, alongside a marked slowdown in the amount of business credit and a decline in the concentration of the portfolio to large borrowers. In view of this, the Banking Supervision Department continued its activities to examine the risk inherent in **consumer credit** and the manner of its management. As part of this, the Banking Supervision Department examined the inherent credit risk, the marketing and initiating of credit to customers, underwriting processes, quality of management of the single borrower and of the retail credit portfolio overall, and the quality of control over them. Likewise, the Banking Supervision Department published this year requirements regarding a bank contacting a retail customer, at the bank's initiative, about extending a loan to the customer, and formulated new requirements for receiving detailed information from the banks in respect of consumer credit. The developments in consumer credit emphasized the need to continue the

The Banking Supervision Department continued to monitor the development of risks in the housing credit and consumer credit portfolios, and took action as necessary.

Banking Supervision Department's activities in examining the appropriateness of the underwriting process and examining its management, with an emphasis on the customer's credit consumption being in line with the customer's ability to repay the loan.

In addition, the Banking Supervision Department published, in April 2015, an update of Proper Conduct of Banking Business Directive 311 on the issue of credit risk management, against the background of the publication of the report by the Committee to Examine Debt Restructuring Proceedings in Israel. The report includes, among other things, recommendations related to the activities of banking corporations as credit providers. With the goal of implementing the recommendations, the Banking Supervision Department published new guidelines for banking corporations. The main points of the guidelines are: setting internal limits on leveraged lending and leveraged borrowers; reference to data on credit taken out by the controlling interest in a corporation and on the party's conduct in the past, when extending credit at a material amount to a corporation controlled by the party; anchoring procedures and processes that will allow loans to be written off; including a requirement to examine several alternatives before the write-off, and a requirement to include in the policy and procedures a reference to syndicated transactions, whether as syndicators or participants. At the same time, the Banking Supervision Department published Proper Conduct of Banking Business Directive no. 327—**Leveraged Lending Management**, which establishes a series of principles and rules for managing and monitoring leveraged loans, including requirements related to credit policy, a discussion in the board of directors, underwriting procedures, credit analysis, and reporting to bank management. Furthermore, with the goal of reducing the concentration in the banking system's credit portfolio, and against the background of the recommendations of the Basel Committee regarding large borrowers, the Banking Supervision Department published an amendment to Proper Conduct of Banking Business Directive no. 313 on "**Limitations on the Indebtedness of a Borrower and of a Group of Borrowers**", mainly narrowing the definition of Tier 1 Capital, and making the limitation on indebtedness of a group of borrowers more strict, reducing the level from 25 percent to 15 percent.

The Banking Supervision Department continued to examine the underwriting processes and the management of **business and commercial credit**, while validating the risk assessments of banking corporations and examining the manner in which they classify loans as problematic and make allowances for expected loan losses.

Market and liquidity risks

The Banking Supervision Department continued to act through various channels to monitor the banking system's exposure to market risks.

- **Interest rate risks:** The Banking Supervision Department examined the comprehensiveness of the limitations related to various scenarios of changes, or the extent of the changes, in the interest rate curve, including the scenarios

in the stress tests, assuming that the behavioral assumptions collapse. The manner of measuring the interest rate risk and its consistency across the bank were examined, and various models used for measuring and the manner of their validation were surveyed, with an emphasis on behavioral models—including early redemptions of mortgages and deployment of current-account credit balances—as well as models that were developed by outside suppliers of the audited banks.

- **Risks in the nostro portfolio:** The Banking Supervision Department examined how the banks establish investment limitations and how they analyze the investment risks in their securities portfolio. In addition, it checked their ways of dealing with structured securities, how these are analyzed, assessed the interest rate risks inherent in these securities, and examined the ways of validating the models related to them.
- **Trading room activity:** The Banking Supervision Department examined the risk management in OTC foreign currency trading rooms, and among other things it examined the following areas: how the risks of fraud and embezzlement are managed and monitored, the manner in which the appropriate functions supervise trading room activity, the manner of measuring the exposure to market risks given the limitations, the level of automation of the controls, and the processes of monitoring the room's returns.
- **Liquidity risk management:** The Banking Supervision Department examined, among other things, the risk management policy, covering as well the adequacy of the limitations (including limitations on concentration) and establishment of the means of control and supervision of the board of directors and senior management. It also checked the appropriateness of (a) the internal model to measure liquidity ratios; (b) the diversification indices and indicators that the bank's emergency plan aimed at early detection of liquidity pressures, and (c) an emergency plan and the role of the control and audit functions in this area.

IV. Improving the quality of reporting to the public

In 2015, the Banking Supervision Department continued its efforts to improve the quality of the banks' reporting to the public. During that year, comprehensive changes were made in the structure of the reports, and as a result they present information in a more useful, uniform and accessible manner. The change has already been implemented in the reports for 2015. Other important measures included enhancing the quality of disclosure of activity segments, as well as improving the measurement and reporting of capitalized software expenses and the reporting of allowances for loan losses and of employee benefits. At the same time, the gradual adoption of US generally accepted accounting principles (GAAP) continued.

b. Increasing competition in banking services

As part of the formulation of strategic goals for the coming years, the Banking Supervision Department has set the encouragement of competition as one of its goals. During the year, the following steps were taken: the expansion of information provided to customers with the objective of making it possible for them to improve their negotiating power with the bank or to switch banks; significant changes were made to regulatory requirements with the objective of making it easier for new players to enter the banking and acquiring sector; and a new policy was formulated for online banking, with the objective of creating an infrastructure for the creation of a new digital bank and making it easier for customers to compare between banks and to switch banks by means of the Internet. Alongside these steps, structural measures were introduced that are meant to support increased competition. In particular, a requirement for increased efficiency in the banking system was published. This included requirements to present a long-term plan to increase efficiency, and to assist the Bank of Israel in the construction of the credit data register.

The Banking Supervision Department continued working to reduce the information gaps between banks and customers, and to improve customers' ability to compare banks, though increased transparency and access to information.

A simple, uniform and concise annual report ("Banking Identity Card") was compiled, which allows customers to easily understand their financial situation at the bank and receive competing offers.

I. Consumer access to banking information

During 2015, the Banking Supervision Department continued its efforts to reduce the information gaps between the bank and the customer and to improve the customer's ability to compare between banks. The Banking Supervision Department is working to reduce information gaps by increasing transparency and customer access to information by having information presented in a straightforward, clear and convenient manner. During the year, the Banking Supervision Department took a number of steps intended to achieve these goals. Some of them went into effect during the year and others will go into effect during 2016. It is expected that once these measures are fully implemented in the banking system and among customers, an improvement will be seen in the position of the banking consumer.

The abovementioned measures touch on a large number of issues, starting from changes in specific goods and services to the formulation of rules governing the nature of information, the benefit provided by that information and the way in which it is presented and delivered to the customer. Following is a survey of these issues:

- **Information possessed by the customer:** An annual report format was decided on that is simple, uniform and concise ("Banking Identity Card") and which lists all of the customer's assets and liabilities at the bank, i.e., the total income and expenses recorded that year for assets and liabilities and ongoing activity, including total interest expenses and fees.⁴ The report enables customers to understand their financial situation at the bank and to obtain alternative offers from competing

⁴ The new Proper Conduct of Banking Business Directive is called "Annual Reports to Customers of the Banking Corporations" (Banking Identity Card). It was published on November 19, 2014 and went into effect on February 28, 2016.

banks. In addition, it reduces the gap between information possessed by the customer's bank and that of other financial entities to which the customer can turn to for competitive offers.

- This report appeared and will continue to appear in the client's online account each year on February 28th (a "push" report) and will present information for the previous year. Customers will be able to also request additional reports during the year (a "by request" report), the first of which will be provided free of charge. The report will be delivered within seven business days from the request and will present data that is current as of the end of the previous month. The report belongs to the customer, and its content can be revealed to other entities at the customer's discretion.
- **Notification of the expiry of benefits and the publishing of uniform contracts:**⁵ In order to increase transparency and disclosure to the customer, banking corporations are now obligated to publish uniform contracts, such as that for opening a current account, on their Internet site. In addition, they are required to notify certain customers two weeks ahead of time that a benefit on their account is about to expire.
- **Facilitating early repayment of non-housing credit:** In order to deal with the lack of transparency in the method for calculating the capitalization component in the early repayment of non-housing credit and to improve the customer's ability to repay a non-housing loan before maturity, the relevant directive (Directive 454) was revised and expanded. The revision specified, among other things, that in the case of private customers and very small business customers a uniform mechanism will be used to calculate the capitalization component. This mechanism will be based on an objective average interest rate that the Bank of Israel will calculate and publish each month (based on the reports from the banks of the interest rates actually provided) and it will neutralize the borrower's risk premium.
- **Obligation to inform of interest rate differences:** Customers sometimes wish to place funds in a savings deposit when they have a negative balance. In order to help them understand the implication of making a deposit by taking a loan or making use of a line of credit, the banks have been required to provide information on the difference between the interest rate paid on the deposit and the interest charged on an overdraft. In addition, it is now prohibited for the banks to contact

The mechanism for calculating the capitalization component in early repayment of nonhousing credit was revised, and is now based on an objective average interest rate published by the Bank of Israel.

⁵ On December 30, 2014, an amendment to the Banking (Service to the Customer) (Full Disclosure and Provision of Documents) Rules, 5752-1992, was published which requires the banks to publish uniform contracts on their Internet site (went into effect January 1, 2015) and also to notify the customer of changes in the terms of management of his account, including the expiry of benefits, two weeks ahead of time (went into effect on April 1, 2015).

their clients who are in overdraft and offer them the option of placing funds in a deposit.

II. Improving customers' ability to switch banking corporations

The Banking Supervision Department acted to improve customers' ability to switch between banking corporations and removed barriers that made the switch difficult.

During 2015, the Banking Supervision Department worked to improve the ability of customers to switch banks. To this end, it worked to remove barriers that make it difficult to switch banks and to reduce the costs involved in doing so. A number of measures were implemented in this area:

- **Opening accounts on the Internet:** In order to enable customers to open accounts more easily, the Banking Supervision Department has made it possible to open accounts online, by means of the Internet (Directive 418).
- **Making it easier to transfer activity and close an account:** The possibilities available to the customer's new bank to act on behalf of customers in order to close their old account within a defined period of time have been expanded. In addition, rules were introduced that will make it possible to close an account by means of the Internet or any alternative branch of the bank, and not only at the branch where the account was managed (Directive 432).⁶
- **Delivering instructions on the Internet:** The banks are now required to develop technological platforms that will make it possible to use the Internet (or other technological means) in order to deliver instructions related to closing an individual's account and transferring the activity (Directive 432).
- **Transfer of authorizations to debit an account:** The procedure for setting up an authorization to debit an account and for transferring the authorizations from one bank to another has been significantly improved (Directive 439).⁷ The improved procedure enables customers to set up authorized debits on their own using any means of communication, including, among others, the Internet, and to transfer them easily and quickly without contacting the beneficiaries.

⁶ An amendment to Proper Conduct of Banking Business Directive no. 432 – "Transferring Activity and Closing a Customer's Account" was published on December 21, 2014. The amendment went into effect on July 1, 2015, except for the amendments relating to consolidated and detailed information, which will go into effect with Directive 425 on February 28, 2016.

⁷ An amendment to Proper Conduct of Banking Business Directive no. 439 – "Debits by Authorization" was published on September 1, 2014. The amendment went into effect on October 11, 2015.

III. Measures to increase competition in the areas of payment cards and payment card acquiring

During 2015 and subsequently, the Banking Supervision Department continued to implement steps intended to increase competition in the area of payment cards, with focus on the following issues: easing the requirements for licensing new acquirers and making licensing more efficient; promoting the adoption of accepted international standards and the removal of technological barriers hindering connection to the payment card system; making it easier to open acquiring accounts of very small businesses; and promoting the use of debit cards, etc.

Easing the licensing requirements for new acquirers and alleviating the supervision of entities that do not take deposits:

With the goal of encouraging new players in acquiring activity and thus encouraging competition in credit cards and the small business sector, the Banking Supervision Department has reviewed the policy for licensing an acquirer and the criteria and general terms for a permit applicant to control and hold the means of control in an acquirer. The revision makes the licensing process more efficient and lightens the requirements placed on an applicant for an acquirer license. For example, the requirements related to the size of the controlling shareholder group, the controlling shareholder's financial stability, and the criteria relating to the chain of control were all eased.

As part of the aforementioned revision of policy, Proper Conduct of Banking Business Directive no. 472 regarding acquirers and the acquiring of payment card transactions was revised. For the first time this directive relates specifically to financial entities whose main activity is acquiring, and was instituted because this activity is essential to the efficient functioning of the payments system. This is in view of the growth in the use of payment cards and with the goal of encouraging competition in this area, while taking into consideration the interests of businesses. The directive outlines the main rules for acquiring payment card transactions and eases some of the regulatory requirements that, up until now, applied to the credit card companies and acquirers,⁸ including equity requirements placed on acquirers. These requirements were modified to meet the European Payment System Directive standard.

In addition, the Banking Supervision Department announced that during 2016 it would modify the applicability of Proper Conduct of Banking Business Directives to reduce the regulatory burden on acquirers. This is in view of the uniqueness of these entities and because their activity involves a low level of risk relative to that of the banks. The adjustment will be carried out both for new directives and existing ones.

Overall the changes will create a new and less stringent oversight category, which will apply to financial bodies that do not take deposits but nonetheless have systemic

The Banking Supervision Department worked to increase competition in acquiring and eased the regulatory demands on entities that do not take deposits.

⁸ These requirements were included within the framework of Proper Conduct of Banking Business Directives that applies to banking corporations.

importance. Their stability is important to that of the financial system, the payments system and the economy as a whole.

Adoption of the advanced EMV technological standard for credit cards and the removal of barriers hindering connection to the payment cards system:

Toward the end of 2015, the payment card system (the payment card switch) operated by the Shva company (Hebrew acronym for Automated Banking Services Ltd.) was upgraded according to the guidelines jointly formulated by the Banking Supervision Department, Payment and Settlement Systems Oversight and the Israel Antitrust Authority. The update is, among other things, intended to modify the system to meet advanced international standards (particularly in order to execute transactions according to the EMV standard), to provide support for technological innovation and to enable additional entities to connect to the system quickly and at low cost.

During 2015 and 2016, the Banking Supervision Department worked to promote the use of EMV, a complementary means for achieving the goals of the payment card system upgrade. As part of the revision of Proper Conduct of Banking Business Directive no. 470 regarding payment cards, transitional instructions and directives were issued that support the gradual adoption of the EMV standard, including: the prohibition of issuing payment cards that do not support the standard; a requirement to allow any place of business to clear transactions using the EMV standard if they have the appropriate end user equipment; a prohibition to connect terminals that do not support the standard; specification of a liability shift mechanism to transfer the costs of abuse to the party that does not support the standard; etc.

Providing the possibility for small businesses to open acquiring accounts on the Internet:

As part of the measures being carried out by the Banking Supervision Department to encourage the shift to digital financial services, Proper Conduct of Banking Business Directive no. 418 regarding the opening of accounts by means of the Internet was revised. The revision will enable small businesses (self-employed individuals and very small businesses) to contract with an acquirer on the Internet in order to receive credit card acquiring services and will eliminate the need to physically meet a representative of the acquirer. This measure will make it easier for the self-employed and very small businesses to open a business, or to expand an existing one, and for them to accept credit card payments from their customers, which is expected to make it easier for businesses to switch acquirers. The Banking Supervision Department believes that the measure will encourage the establishment of small and very small businesses which will be able to offer their customers the possibilities of e-commerce.

Expanding the distribution and use of debit cards:

In February 2015, an interdepartmental working group published its recommendations for increasing competition in the area of payment cards. The recommendations emphasized the need for expanding the number of debit cards and their use, in view of the advantages of this type of payment method for places of business and consumers. The Banking Supervision Department worked to implement these recommendations by means of the following steps: an order issued by the Governor declared that the interchange fee in debit transactions will be under supervision and will be set at a level of 0.3 percent for a period of a year; the disclosure to the customer and the date for transferring funds in a debit transaction will be regulated as part of the revision of Proper Conduct of Banking Business Directive no. 470, and instructions that require the banks to offer a debit card to new customers and to all existing customers within a defined time period. These measures will be supported by publicity and consumer education on the part of the Banking Supervision Department.

Recommendations regarding links in the payment card transaction chain:

The Bank of Israel established an interdepartmental working group, led by Payments and Settlement Systems Oversight and with the participation of the Banking Supervision Department, to examine the links in the payment card transaction execution chain.⁹ The working group published its interim report in August 2015 and its recommendations are intended to deal with the existing barriers in the market and in particular to enable the creation of an additional payment-card switch and the development of advanced means of payment. This will make it easier for new players to enter the payment card industry.

IV. Supervision of non-institutional financial services and the formulation of guidelines for the creation of credit unions in Israel

In February 2015, a joint team led by Assistant Attorney General (economic-fiscal) Avi Licht, presented its report, which examined the regulation of currency service providers. The team found that in the currency services industry there are entities operating as financial institutions for all intents and purposes and which provide a broad range of services. These include: check discounting, factoring, foreign currency services and international fund transfers. Some of the currency service providers also provide non-bank loans, an activity which is currently not subject to supervision. The team also found that the non-bank credit market cannot develop without a system of effective regulation to protect customers. Such a system does not currently exist.

On March 1, 2015, the then-Director of the Ministry of Finance, Yael Andorn, appointed a working group headed by the Ministry's Legal Counsel at the time, Attorney Yoel Briss, with the goal of implementing the recommendations of the Licht working group and preparing the necessary legislation to do so. The working

⁹ <http://www.boi.org.il/en/NewsAndPublications/PressReleases/Pages/03-08-2015-SwitchReport.aspx>

group included representatives of government bodies with responsibility in this area, including: the relevant divisions in the Ministry of Finance, the Bank of Israel, the Ministry of Justice, the National Economic Council, the Israel Tax Authority, the Israel Money Laundering and Terror Financing Prohibition Authority, and the Israel Antitrust Authority.

The working group decided to divide its task into three segments:

- The first segment—deals with the **creation of a new financial regulator and its structure**, the regulation of services currently provided by currency service providers and the regulation of all credit services currently provided by non-institutional entities. The legislative memorandum that deals with this segment – the Supervision of Financial Services (Non-institutional Financial Services) Law, 5775-2015 – was presented in August 2015 and is currently being discussed in the Knesset;
- The second segment—will deal with the **regulation of payment, clearing and issuing service providers and platforms for transferring financial assets** (such as P2P platforms);
- The third segment—as part of the regulation of the activity of currency service providers and credit service providers, it was decided to also regulate the **micro banks**, which include: charity loan funds (non-profit organizations that provide interest-free loans) and very small credit unions. This is in accordance with the recommendation included by the Banking Supervision Department in the guidelines for the creation of credit unions (“Licensing Process and Creation of a Credit Union in Israel”) dated May 5, 2015.

The Bank of Israel is leading a process to set a threshold above which credit unions will be able to operate under its supervision, and below which they will not be considered to be a bank and will thus report to the Non-Institutional Supervisor, a regulator to be established in the future, in accordance with the memorandum of the Supervision of Financial Services (Noninstitutional Financial Services) Law, 5775-2015.

The Committee for Increasing Competition in Common Banking and Financial Services (the “Strum Committee”), which includes two representatives of the Bank of Israel, also discussed supervision of non-institutional bodies and the creation of credit unions in Israel.

c. Enhancing fairness in bank–customer relations

The actions taken by the Banking Supervision Department in the area of bank–customer relations focused on the accessibility of banking information to the customer (see section b-I) and on the improvement of the ability of customers to switch banks (see section b-II). At the same time, the Banking Supervision Department continued its efforts in 2015 to promote fairness in relations between the banks and their customers and to strengthen the position of the customer in dealing with the banks. By combining efforts in various areas, the Banking Supervision Department is seeking to

promote transparency and fairness toward banking customers and also to encourage competition.

The Banking Supervision Department is working to increase fairness by means of consumer education among the banks' customers, responding to complaints and inquiries from the public, reassessing banking fees, dealing with customers of restricted accounts and managing legislation and regulations dealing with bank-customer relations. The latter deal with the following activities: opening of a current account with a positive balance, offering credit to customers, closing of branches and reducing the number of tellers and dealing with customer complaints (Directive 308A deals with complaints and since it went into effect in April 2015, the banks have been resolving a significant proportion of disputes directly with the customer).

I. Regulation to protect the banking customer

In order to strengthen fairness in relations between the banks and their customers, the Banking Supervision Department has been active through legislation and the issuing of directives, circulars and letters to the banking system, consumer education among the banks' customers, dealing with the issue of bank fees and involvement in class action suits. In addition, the Banking Supervision Department presented the Bank of Israel's position on the subject of banking consumerism to the Knesset and ministerial committees, it provided professional opinions on numerous proposed laws and reported to the Knesset and to the public on the average cost of common current account services and those of using a credit card.

(1) Measures to promote fairness

- **Opening and managing a current account with a positive balance:**¹⁰

Since owning a bank account is essential to managing one's financial affairs and opening an account is a fundamental right, a new directive specifies which banking services constitute an integral part of managing an account and in which cases a claim of "reasonable refusal" to open an account will be accepted. The directive is meant to increase the awareness among customers of their right to open a current account with a positive balance and their right to have access to a variety of tools to manage it.

- **Early repayment fees for housing loans:**¹¹

The amendment to the Banking (Early Repayment Fees) Order relates to borrowers whom the bank classified as high risk at the time the loan was provided, and therefore it set a relatively high rate of interest on the loan. Following the

A new directive sets which banking services are an integral part of managing an account, and in which cases a claim of "reasonable refusal" to open an account will not be accepted.

¹⁰ Proper Conduct of Banking Business Directive no. 422 regarding the opening of a current account with a positive balance and its management was published on May 27, 2014. Sections 5 and 9 of the Directive went into effect on May 27, 2014; Section 8(b) of the Directive went into effect on January 1, 2015; the remaining sections went into effect on September 1, 2014.

¹¹ An amendment to the Banking (Early Redemption Fees) Order, 5762-2002, regarding the fees charged for early repayment of housing loans was published on August 27, 2014. The amendment went into effect on February 23, 2015.

amendment, these borrowers will pay lower capitalization differentials on the early repayment of a loan.

- **Banks initiating contact with retail customers to offer them credit:**

With the goal of ensuring that the banking corporations are offering their customers credit that matches their needs and that they are marketing credit in a way that does not harm the customer, the Banking Supervision Department distributed a letter to the banking corporations and credit card companies on the subject of initiating contact with retail customers in order to offer them credit. As part of this effort, the banking corporations' policy and procedure documents were checked in order to determine, among other things, whether and how they decide on the manner of contacting customers and how the offer of credit matches their needs.

- **Closing of branches and reducing the number of bank tellers:**

As a result of the expanded use of direct technological platforms, some of the banks are closing branches and reducing the number of tellers. Therefore, the banks have been requested to formulate a branch policy for coming years and also to formulate a policy to assist customers who have difficulty adjusting to the new technological platforms.

- **Encouraging early repayment or rollover of mortgage loans provided by the government to eligible individuals:¹²**

This is a joint effort of the Bank of Israel and the Ministry of Housing and is intended to increase awareness among the public that early redemption of eligibility loans is financially worthwhile and to make it easier for the public to take advantage of this.

The banking corporations were requested to formulate a policy that will be responsive to customers for whom new technological means are difficult.

(2) Measures relating to bank fees

The Banking Supervision Department has taken numerous steps in order to reduce the costs borne by the customer in managing a bank account: improvement of disclosure and transparency, simplification of the pricing method and provision of tools to customers that make it easier to compare various fees between the banks. Following are the main steps taken:

- **Cancellation/reduction of fees:**

- The fee for debiting a depositor for a returned check was cancelled.
- The fee for delayed payment that is charged to debit card holders due to payment in installments carried out with a credit card was cancelled.
- Management fees of a housing loan were cancelled.
- It was determined that for notification and warning services a maximum fee of NIS 5 per notification would be charged.
- It was determined that a bank cannot charge a customer-executed transaction

The Banking Supervision Department took many steps to reduce the account management costs borne by customers.

¹² The Ministry of Housing, in cooperation with the Banking Supervision Department, announced on December 30, 2014 that the two entities are promoting a campaign to encourage early redemption or rollover of mortgage loans provided by the government to eligible individuals. The campaign continued until December 31, 2015.

- fee for a debit card transaction.
- The fee for providing ownership confirmation was reduced. It was determined that a bank can charge a fee for producing confirmation of ownership of a bank account only starting from the second confirmation requested during a calendar year.
- The fee for transferring funds within the Zahav (real time gross settlement) system was reduced. It was determined that the fee would be limited to the cost of one teller-executed transaction for transfers of up to NIS 1 million.
- **Change in the default for defining a small business:**
The requirement to provide the bank with an annual report as a condition for being classified as a small business was cancelled. This will make it easier for small businesses to benefit from the price list for individuals and small businesses.
- **Simplification for debit card holders:**
- The Banking Supervision Department has changed the format of charges for transactions and withdrawals in foreign currency by means of a debit card. It created a simple, straightforward and uniform model for all of the companies. This model enables customers to understand exactly how much they are paying without having to carry out side calculations and it creates a common basis of comparison between the companies.
- **Restrictions to benefit places of business in the acquiring and discounting of credit card slips:**
 - The types of services for which a credit card company can charge a business for acquiring services have been defined and the manner in which the fees are collected has been determined.
 - A maximum price was set for the fee that an acquirer can charge providers of credit card transaction slips discounting services.
 - A maximum rate has been set for the fee for cross-clearing of debit transactions.
- **Fee tracks service:**
The procedure for joining a fee track has been formalized in legislation (a draft letter was already sent to the banks in 2014).

II. Handling public enquiries and complaints¹³

(1) Introduction

The Public Enquiries Unit¹⁴ deals first and foremost with managing the system of handling the public's enquiries to the Banking Supervision Department related to its dealings with the banking corporations (banks and credit card companies). In addition,

¹³ The information in this survey is correct as of the date of publication. The final data will be published in a detailed survey of the Public Enquiries Unit's activities.

¹⁴ The Public Enquiries Unit operates by the authority conferred under Section 16 of the Banking (Service to the Customer) Law, 5741–1981, to the Supervisor of Banks to investigate enquiries from the public regarding their dealings with the banking corporations.

the Unit serves as a “conduit” through which information from the public passes to the relevant entities in the Banking Supervision Department and the Bank of Israel. On the basis of this information, the Banking Supervision Department identifies system-wide deficiencies in the consumer area—whether at a banking corporation or in the overall banking system—and deals with them, regulates customer issues, conducts examinations, and conducts publicity campaigns regarding the Banking Supervision Department’s policy.

Telephone response: The Unit provides an initial response to the public through a call center. In addition, customers are provided with information on cases being handled by the Unit’s employees.

Written response: The Unit provides responses to the public in three areas—enquiries, requests, and complaints. The Unit can be contacted through the Bank of Israel website, by fax, or by mail.

(2) Data on the Banking Supervision Department’s handling of public enquiries and complaints

In 2015, the Public Enquiries Unit handled 5,091 written enquiries and complaints, and responded to more than 18,000 phone enquiries.

In 2015, the total number of enquiries, requests and complaints received in writing by the Public Enquiries Unit was 4,558, and 5,091 were handled. In 2014, 6,028 enquiries, requests and complaints were received, and 5,555 were handled. The decline in the number of enquiries derives from a change in work processes—the call center directs customers to the banking corporations in order to fully exhaust the clarification process with them before being dealt with by the Unit.

As a result of the Banking Supervision Department’s intervention in individual complaints, the banking corporations paid their customers a total of about NIS 5 million in 2015.¹⁵ In 2014, they paid about NIS 3.6 million.

Due to the Unit’s intervention in individual complaints, banking corporations paid more than NIS 5 million to customers.

Table 2.1
Summary of Public Enquiry Unit’s activity, 2013–15

	2013	2014	2015
Number of enquiries received by telephone	21,450	20,346	17,963
Number of enquiries and complaints received in writing	5,067	5,555	5,091
Number of enquiries directed to handling by the banking corporation, in accordance with Proper Conduct of Banking Business Directive 308A	Not relevant	Not relevant	1,239

¹⁵ Including writing off a loan or collateral.

Requests by the public

In 2015, the Public Enquiries Unit received 260 written requests for receiving aid from the banking corporations. A marked share of the requests dealt with the following issues—receiving a loan from a bank, writing off a loan due to special socioeconomic circumstances, cancelling or receiving a discount on fees when paying back a loan early, receiving checkbooks or credit cards, etc. In general, the handling of such enquiries is not within the purview of the Banking Supervision Department. The Banking Supervision Department examines the requests and forwards a notable portion of them to the banking corporations so that they will examine them and provide a response directly. In certain cases the banking corporations are willing to respond *ex gratia* to requests, and the Banking Supervision Department attributes great importance to that.

Public enquiries (clarifications and requests for information)

In 2015, the Public Enquiries Unit responded to 1,160 written requests to receive information. The enquiries dealt with, among other things, rights related to opening an account and access to means of payment and information retrieval, as well as implementation of directives published by the Supervisor of Banks related to housing loans. Information was provided on Banking Supervision Department policy and directives, banking legislation, consumer rights, and the activity of the Banking Supervision Department and the Public Enquiries Unit.

Public complaints

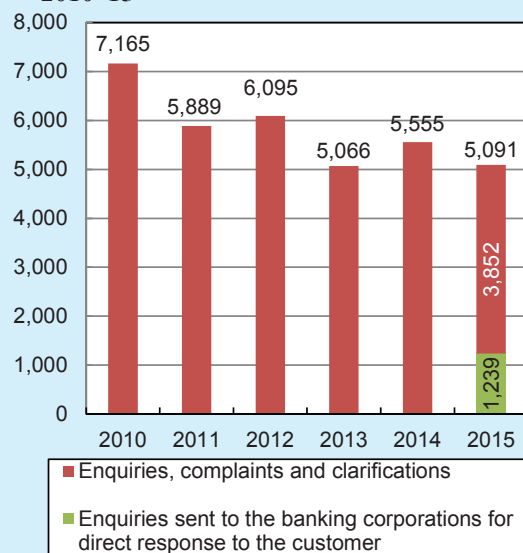
In 2015, the Public Enquiries Unit handled 3,671 written complaints. These enquiries deal with disagreements between the customer and the banking corporation. In most cases, the complaint also includes a request for compensation or a demand that the banking corporation take action, such as to open an account or correct a mistake.

Banking corporations' handling of the public's complaints

In April 2015, a new Proper Conduct of Banking Business Directive (no. 308A), on the issue of handling customers' complaints at banking corporations, came into effect. This directive establishes that a complaint is to be handled first by the banking corporation's customer complaints handling system. If this system does not deal appropriately with the complaint, or does not provide a response within 45 days, the Public Enquiries Unit will investigate the issue in accordance with its authority. The directive is intended to ensure that banking corporations provide fair and comprehensive handling of complaints—through the professional units dedicated to handling public enquiries—and draw the appropriate lessons from the information received from them. It was formulated with the goal of increasing the efficiency of the service and the handling of public enquiries in the overall banking system.

Directive 308A is intended to ensure that banking corporations provide comprehensive and fair handling of customer complaints.

Figure 2.1
Number of Enquiries and Complaints,
2010–15



SOURCE: Banking Supervision Department.

From the date that the directive went into effect, through the end of 2015, 1,239 complaints and requests that were received at the Unit were forwarded to the customer complaints representatives at the banking corporations for handling.

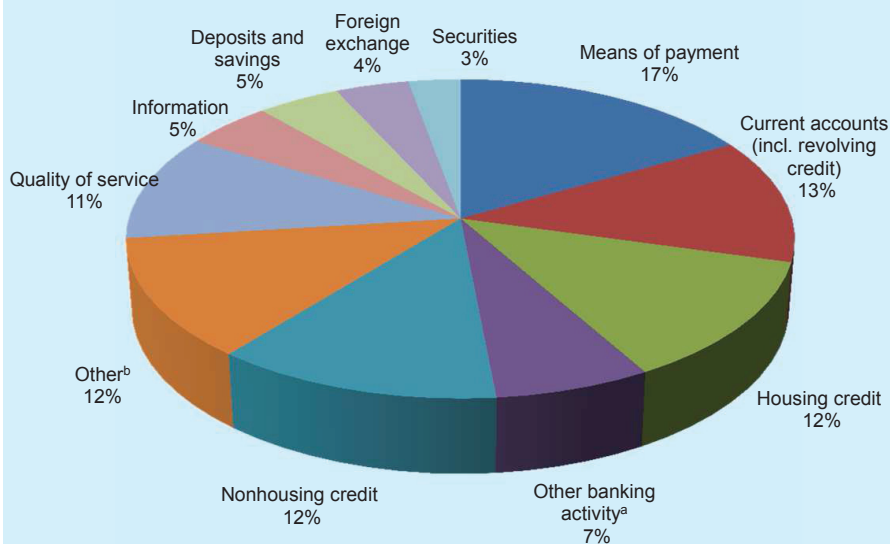
Likewise, the Public Enquiries Unit received 360 complaints dealing with appeals to the response provided by the banking corporation's customer complaints representative.

(3) The issues that were the subject of complaints

Most of the enquiries and complaints received this year dealt with means of payment

(particularly checks and credit cards) and issues related to opening and managing current accounts.

Figure 2.2
Distribution of Enquiries by Subject, 2015



^a Other banking activity: Debt collection, estate distribution, executing lawful orders, reporting to credit data agencies, and more.

^b Other: Enquiries regarding activity or entities regarding which handling is not under the jurisdiction of the Public Enquiries Unit—including enquiries concerning the Postal Bank, insurance companies, provident and pension funds—and enquiries that do not concern bank-customer relations.

SOURCE: Banking Supervision Department.

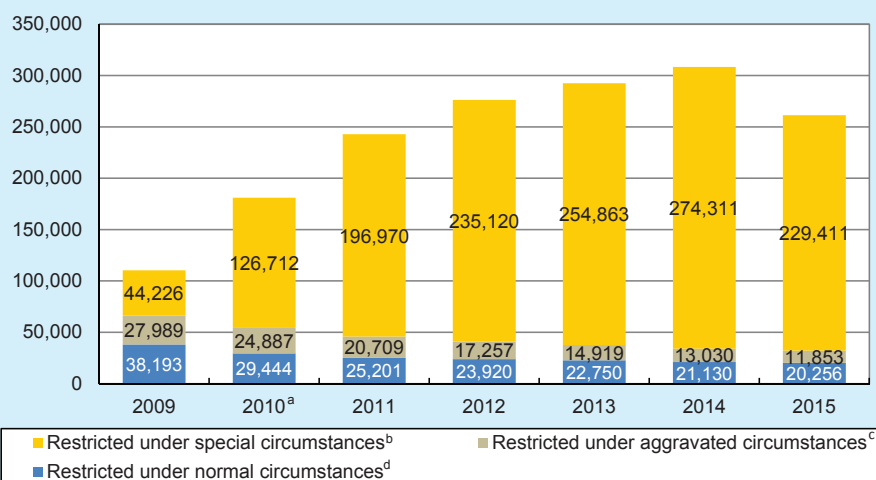
III. Dealing with restricted accounts and customers

(1) The number of restricted customers and restricted accounts

At the end of 2015, there were 261,520 restricted customers (compared with 308,471 at the end of 2014). Of those, 20,256 were restricted under regular circumstances (compared with 21,130 at the end of 2014), 11,853 were restricted under aggravated circumstances (compared with 13,030 at the end of 2014), and 229,411 were restricted under special circumstances (compared with 274,311 at the end of 2014). Customers restricted under special circumstances include those who are restricted by the Execution Office, those who are restricted by the Official Receiver, those who are restricted by the Center for the Collection of Fines, Fees and Expenses, and those who refuse to grant a divorce and are restricted by the rabbinic courts. (See Figure 2.3.)

This year, for the first time in a considerable period, the number of restricted customers declined compared with the previous year. This decline derives mainly from a decline in the number of special restrictions imposed by the entities authorized to do so under the Checks Without Cover Law, 5741-1981, chiefly the Execution Office (Figure 2.3).

Figure 2.3
Number of Restricted Customers, 2009–15



^a Beginning in 2010, the number of customers restricted under special circumstances increased, as a result of a legislative change in the processes accompanying debt collection proceedings (Amendment 29 to the Execution Office Law, 5769–2008).

^b Special circumstances—A customer is restricted under special circumstances if he is a debtor on whom the Registrar of Executions and Collections or the Registrar of the Center for Collection of Fines has placed a restriction, a debtor who has been declared bankrupt by the court, or a person against whom the Rabbinical Court has issued a restriction order.

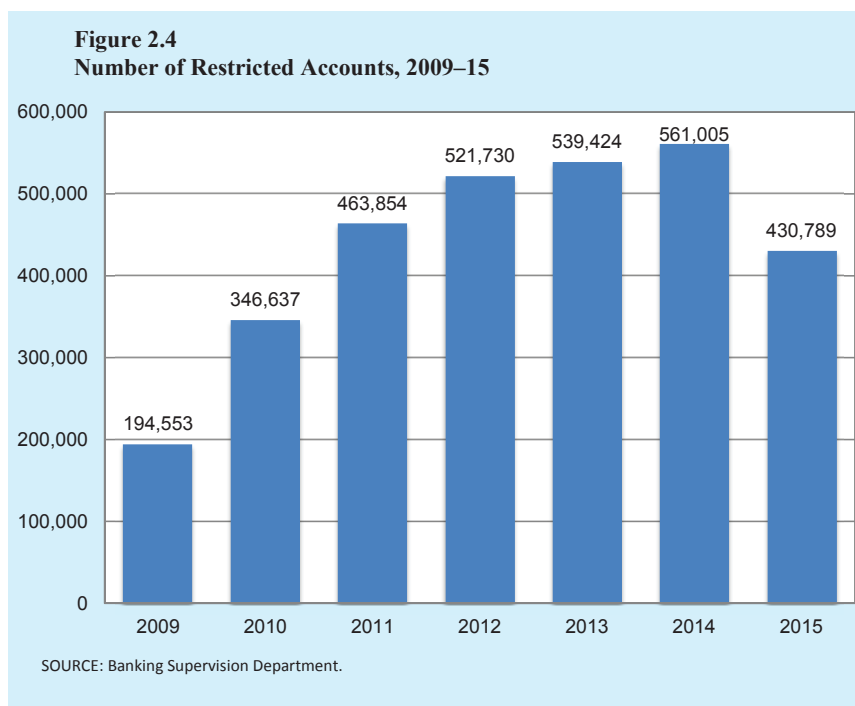
^c Aggravated circumstances—A customer is restricted under aggravated circumstances if he is already restricted and another account of his is restricted, or if he was restricted and his account was restricted again within three years from the end of the period in which he was a restricted customer.

^d Normal circumstances—An account is restricted under normal circumstances if over a period of 12 months, ten (or more) checks drawn on the account were refused, and provided that at least 15 days have elapsed between the first refusal and the last refusal.

SOURCE: Banking Supervision Department.

There were 430,789 restricted accounts¹⁶ (compared with 561,005 at the end of 2014). These are accounts that were restricted due to checks returned for reason of “insufficient cover,” and accounts that were restricted as a result of aggravated restriction or special restriction imposed on the account holders (Figure 2.4).

In the past three years, the number of restricted customers has remained stable, excluding a decline that began in February 2015 as a result of a change in the methodology of counting restricted accounts—currently the number does not include customers for whom the Bank of Israel received a report prior to their period of restriction beginning (waiting for restriction) and historical accounts that are in a customer’s chain of restrictions (Figure 2.4).



The handling of enquiries related to restrictions and appeals of restrictions

Over the course of 2015, the Section handled about 3,441 written enquiries and answered about 15,620 phone enquiries that were received through the call center. Some of the enquiries were requests for information regarding the restriction, its meaning and implications, while others requested that a restriction be cancelled or that the validity of a restriction be examined.

¹⁶ Accounts restricted as a result of special circumstances or aggravated circumstances also include closed accounts.

In addition, the Section monitors banking corporations' execution of court decisions on an ongoing basis, and monitors the appeal files connected with the various restrictions accordingly.

The public can also make use of the website and automated answering service (IVR) for clarification of restricted accounts and of customers restricted under aggravated circumstances. In 2015, about 23,000 calls were received at the automated phone service, and there were about 794,000 visits to the Bank of Israel website's page for detecting restricted accounts.

APPENDIX A: REGULATORY TIMELINE FOR 2015¹⁷

January 7	<p>Amendment to Proper Conduct of Banking Business Directive No. 299 “Regulatory Capital—Transitional Provisions”</p> <p>The US adopted accounting principles on employee rights in respect of employee benefits, where changes in such benefits are charged to other cumulative comprehensive income. In response, it was determined that Proper Conduct of Banking Business Directive No. 299 “Regulatory Capital—Transitional Provisions” will also apply to the effects of this adoption.</p>
January 11	<p>Revision to Reporting to the Public directives on income from contracts with clients</p> <p>The US revised generally accepted accounting principles on income from contracts with clients, and the Reporting to the Public directives were revised accordingly.</p> <p>Revision to Reporting to the Public directives concerning employee rights – discount rate, disclosure format, and transition provisions for initial implementation</p> <p>The US adopted accounting principles on employee rights, and the Reporting to the Public directives were revised, and a format was published for disclosures related to employee rights. These revisions explain the initial implementation of the aforesaid rules by the banking system, and the required disclosure in the financial statements.</p>
January 15	<p>Obligation to inform of interest rate differences</p> <p>The Banking Supervision Department issued a letter to the banking corporations on the matter of customers who wish to deposit funds in a deposit while their current account is overdrawn. The Banking Supervision Department required that the banking corporations give customers information on the differences between the interest rate paid on the deposit and the interest rate charged in respect of their overdrawn account. Furthermore, the banking corporations were prohibited from proactively contacting customers whose accounts are overdrawn to propose that they deposit funds into a deposit.</p>
January 19	<p>Revision to the Reporting to the Public directives on group allowance in respect of credit to private individuals</p> <p>Total credit to individual customers has grown rapidly and the Reporting to the Public directives were amended accordingly. It was determined that, beginning with the reports to the public for the year 2014, the qualitative adjustment rate for group allowances for credit losses in respect of non-problematic credit to private individuals will be at least 0.75 percent of the balance of non-problematic credit to private individuals at that time.</p>

¹⁷ The complete versions of the regulatory activities appear on the Bank of Israel website.

January 25	<p>Amendment to Proper Conduct of Banking Business Directive No. 329 “Limitations on Issuing Housing Loans”</p> <p>In view of accumulated experience, an amendment was introduced to Proper Conduct of Banking Business Directive No. 329 with respect to restrictions on granting housing loans. The main amendment concerns the definition of “payment to income ratio,” and aims to clarify that:</p> <p>No more than one half of the monthly disposable income of a relative who is not purchasing a right in real estate can be taken into consideration, even if said individual signs the loan agreement as a borrower.</p> <p>The monthly disposable income of the borrower’s spouse/partner may be taken into consideration in entirety, if the spouse/partner meets all the conditions defined in the Directive and cohabits with the borrower in the apartment.</p>
January 29	<p>Amendment to Banking (Service to the Customer)(Fees) Rules, 5768-2008</p> <p>The Banking (Service to the Customer)(Fees) Rules, 5768-2008, were amended to reduce the number of fees that banking corporations charge their customers. A considerable portion of the amendment came into effect on February 1, 2015; another portion came into effect on April 1, 2015; and the final portion—on July 1, 2015.</p>
February 24	<p>Disclosing information on minimum index clause</p> <p>The Banking Supervision Department issued a letter to the banking corporations and the credit card companies, requesting them to note whether their framework agreement (the agreement that specifies the general terms on which the various types of accounts noted in the agreement are administered) or their supplementary document (relating to specific transactions) contains a clause that sets a minimum index. The letter came into effect on March 1, 2015.</p>
March 16	<p>Formulation of Proper Conduct of Banking Business Directive No. 361 “Cyber Defense Management”</p> <p>In response to the growing cyber threats facing financial institutions in Israel and worldwide, Proper Conduct of Banking Business Directive No. 361 on Cyber Defense Management was established. The directive includes the regulation of the Banking Supervision Department’s requirements and expectations of the banking corporations in the area of cyber defense, and requires that cyber risks be managed in a structured yet flexible format that allows the banking corporation freedom in its implementation. The directive defines cyber defense principles that a banking corporation is expected to adopt in developing its cyber defense function, based on its scope of operations, nature, and risk profiles.</p>
	<p>Management of risks stemming from customers’ cross-order activities</p> <p>Numerous countries are taking vigorous action to locate funds that their residents hold outside the country of residence. The Ministry of Finance announced that the State of Israel will adopt the international standard for relevant information exchange between countries. In response, the Banking Supervision Department issued a guidance letter to the banks on the risks entailed in customers’ cross-border activities.</p>

April 28

Revision to the structure of banking corporations and credit card companies' report to the public

The complexity of banking corporations' businesses has grown significantly in recent years, a fact that increased the scope and complexity of the information contained in the banks' disclosures to the public, and created the need to modify the structure of the banking corporations' reports to the public. The revision aimed to make the information more useful for, and accessible by, report readers, to increase uniform reporting in the banking system, and to develop a format for the annual report to the public that is based on the presentation practices of the world's leading banks.

Development of Proper Conduct of Banking Business Directive No. 218 "The Leverage Ratio"

Proper Conduct of Banking Business Directive No. 218 adopts the recommendations of Basel III on leverage ratios: the leverage ratio is designed to aim at constraining the build-up of leverage in a banking corporation and prevent deleveraging processes that can damage the financial system and the economy, and to reinforce risk-based capital requirements. The main points of the directive are:

- As of January 1, 2018, the banking corporations are required to meet a minimum leverage ratio of 5 percent (on a consolidated basis), and to meet a minimum leverage ratio of 6 percent for banking corporations whose total consolidated balance sheet assets constitute 20 percent or more of the total balance sheet assets in the banking system.
- The leverage ratio is defined as the ratio between Tier 1 capital (numerator) and the exposure (denominator), and is expressed as a percentage.
- Total measured exposure equals the sum of balance-sheet exposures, exposures to derivatives and securities funding transactions, and off-balance-sheet items.

Reporting to the Public Directive on disclosure of leverage ratio

Following the publication of Proper Conduct of Banking Business Directive No. 218 "The Leverage Ratio," and pursuant to the recommendations of the Basel Committee on disclosure requirements of leverage ratios based on Pillar 3, it was necessary to revise the disclosure requirements in the Reporting to the Public directives. These disclosure requirements are designed to show how the leverage ratio is calculated, and to allow market participants to compare between leverage ratio disclosures and banking corporations' financial statements.

Proper Conduct of Banking Business directive on credit risks

As the Israeli market has been involved in numerous debt restructuring proceedings in recent years, a committee was appointed to review such proceedings. Pursuant to the report that the committee published, the recommendations that refer to the operations of banking corporations as providers of credit were included in directives, and the Proper Conduct of Banking Business directives on credit risks were amended. Following are the highlights of the amendments:

	<p>Directive No. 311 “Credit Risk Management”</p> <ul style="list-style-type: none"> Established guidelines for banking corporations that organize syndicated transactions. Imposed disclosure requirements on credit assumed by a controlling shareholder to finance the acquisition of controlling shares in a borrower corporation, and disclosure of past conduct of controlling shareholders when their controlled companies encountered financial difficulties.
	<p>Directive No. 323 “Limitations on Financing Capital Transactions”</p> <ul style="list-style-type: none"> The Directive was expanded to apply to all credit for capital transaction purposes and not only to credit for the purchase of means of control. The definition of capital was narrowed to Tier 1 capital (after regulatory adjustments and deductions).
	<p>Directive No. 327 “Leveraged Lending Management”</p> <p>As leveraged transactions typically have a high-risk profile, this new directive defines the framework of risk management for such transactions.</p>
May 26	<p>Supervision Order on Notification and Alert Services</p> <p>A supervision order was published announcing that notification and alert services were subject to supervision. The Order came into effect on July 1, 2015. Concurrently, the Banking (Service to Customer)(Fees) Rules, 5768-2008, were amended.</p>
	<p>Supervision Order on services rendered by acquirers to payment discounting service providers. The Order came into effect on July 1, 2015.</p>
June 3	<p>Amendment to Proper Conduct of Banking Business Directive No. 308 “Compliance and the Compliance Function in a Banking Corporation”</p> <p>In response to developments in the field of risk management in general, and specifically in the field of compliance risk management, Proper Conduct of Banking Business Directive No. 308 on Compliance and the Compliance Function in a Banking Corporation was amended. The key amendments were made as a result of accumulated experience, and include adjusting the Directive to the recommendations of the Basel Committee and to the professional standards used in advanced economies.</p>
June 9	<p>Amendment to Proper Conduct of Banking Business Directive No. 313 “Limitations on the Indebtedness of a Borrower and of a Group of Borrowers”</p> <p>To reduce the concentration of credit portfolios in the banking system, and against the backdrop of the recommendations developed by the Basel Committee on major borrowers, Proper Conduct of Banking Business Directive No. 313 was amended. The main amendments were as follows:</p> <ul style="list-style-type: none"> The capital definition was narrowed to Tier 1 (after regulatory adjustments and deductions). Greater restrictions were imposed on the indebtedness of a group of borrowers to a banking corporation: in the past such indebtedness was restricted to 25 percent of the bank’s capital, and now it is 15 percent of the capital. The method for calculating allowable deductions defined in the directive was adjusted to the CRM approach for recognized credit risk mitigants, as stated in Proper Conduct of Banking Business Directive No. 203.

	<p>Revision to Proper Conduct of Banking Business Directive No. 411 “Prevention of Money Laundering and Terrorism Financing, and Customer Identification”</p> <p>The Israel Securities Authority and the Banking Supervision Department issued an outline of principles that permits the issuance of ETNs that track the yields of bank stocks, without such shares being considered a holding—as defined in the Banking (Licensing) Law, 5741-1981—of the issuing companies. The directive was accordingly amended to determine that the provisions of the Prohibition on Money Laundering Order concerning the recording of beneficiaries in a bank account will not apply to accounts owned by trustees where the account is managed for a holder of a “transparent” ETN relative to the Tel Aviv Banks Index. The Banking Supervision Department and the Israel Securities Authority approved the ETNs’ mechanism for exercising voting rights.</p>
June 10	<p>Adjustment of reporting by banking corporations and credit card companies, on specific issues, to US GAAP</p> <p>Disclosures of parties at interest and related parties, as well as the accounting treatment of mergers and acquisitions, consolidation of financial statements, and investment in subsidiaries, are all significant for the banking corporations’ businesses. Therefore, the accounting treatment that the banking corporations and the credit card companies apply to these issues was adjusted to US GAAP.</p>
June 21	<p>Amendment to Proper Conduct of Banking Business Directive No. 454 “Early Repayment of a Nonhousing Loan”</p> <p>The amendment to this directive expanded the application of the current arrangement under the directive, defined a uniform, transparent mechanism for determining the interest rate used to calculate the capitalization component of nonhousing loans. This amendment, as far as possible, unified the treatment of early repayments of housing loans with early repayments of non-housing loans. The amendment came into effect on April 1, 2016.</p>
	<p>Publication of Proper Conduct of Banking Business Directive No. 423 “The Fee Tracks Service”</p> <p>Proper Conduct of Banking Business Directive No. 423 “The Fee Tracks Service” was designed to increase customers’ awareness of the tracks service. The Directive came into effect on January 1, 2016, with the exception of Section 6 of the Directive, which came into effect on August 1, 2015. The Banking Supervision Department concurrently issued letters to the banking corporations, instructing them to identify customers who had not yet joined the service yet met the conditions set forth in the letter, and to notify those customers of the service.</p>
June 23	<p>Proactive communications offering credit to retail customers</p> <p>The Banking Supervision Department issued a letter to the banking corporations and the credit card companies on proactive communications offering credit to retail customers, with the aim of confirming that the credit that they offer customers is consistent with customers’ needs. A second letter on this topic was issued on November 17, 2015.</p>

June 29	<p>Revision to Proper Conduct of Banking Business Directive No. 470 “Debit Cards”</p> <p>The EMV standard includes a series of specifications designed to create a secure, uniform format for transactions made with smart cards (chip cards) using terminals that support the standard (ATMs or payment terminals). The transition to the EMV standard was designed to:</p> <ul style="list-style-type: none"> • reduce the potential for fraud based on magnetic cards; • allow customers to use payment cards overseas in line with international standards, removing the currently existing restrictions on transactions with magnetic stripes; • encourage competition in the field of acquiring payment card transactions; <p>As the payment system in Israel is transitioning to the EMV standard, a service that approves and acquires smartcard transactions has been in operation since January 2016, creating the need to amend Proper Conduct of Banking Business Directive No. 470 “Debit Cards.”</p>
	<p>Revision of Proper Conduct of Banking Business Directive No. 301 “Board of Directors”</p> <p>The main revision determines that resolutions of the audit committee, the transactions with related parties committee, and the remuneration committee, may also be adopted in the presence of the officers whose presence is permitted by the Companies Law.</p>
	<p>Revision of Proper Conduct of Banking Business Directive No. 307 “Internal Audit Function”</p> <p>A requirement of the Banking (Internal Audit) Rules was introduced into this directive, determining that an internal auditor who was convicted of a crime that involves disgrace, in a final ruling by a court—his or her service shall be terminated.</p>
	<p>Risk management in a cloud computing environment</p> <p>The use of cloud computing may expose banking corporations to significant operational risks related to information security, business continuity, control and oversight of IT assets, etc. Therefore, a letter was issued containing instructions to the banking corporations that are considering the use of this technology.</p>
August 2	<p>Annual report to the public on handling complaints</p> <p>The provisions of Proper Conduct of Banking Business Directive No. 308A “Handling of Public Complaints” require that the banking corporations publish an annual report to the public on how they handled public complaints. Following this directive, the format for an annual report to the public on how banking corporations handle public complaints was developed.</p>

August 13	<p>Revision to Proper Conduct of Banking Business Directive No. 301A “Remuneration Policy in a Banking Corporation”</p> <p>Following accumulated experience, and pursuant to the directives of regulatory authorities worldwide, Proper Conduct of Banking Business Directive No. 301A, “Remuneration Policy in a Banking Corporation” was amended. Following are the main amendments:</p> <ul style="list-style-type: none"> • It was determined that remuneration policies and agreements are to include the following clause: They must allow a banking corporation to require a key employee to return the variable remuneration that the corporation granted to the employee, if such claw-back criteria are in place. The claw-back period elapses five years from the award date of the variable remuneration, and this period is extended for an additional two years with respect to officers, subject to the conditions defined in the Directive. • Members of the banking corporation’s board of directors, including the chair, shall receive fixed remuneration only. • Key employees of the banking corporation may not receive remuneration in any form directly from the corporation’s controlling shareholders, the relatives thereof, or from corporations controlled by these parties.
August 25	<p>Extending the campaign to promote early repayment or refinancing of government-awarded mortgage loans</p> <p>This campaign was designed to increase public awareness of the economic expediency of early repayment of loans that bear a relatively high CPI-linked interest rate. The campaign was also designed to assist individuals who wished and were able to refinance their loans, as it provided a quick procedure for doing so at market prices. Due to its great significance, the campaign—which offers a fast-track low-cost option—was extended until December 31, 2015.</p>
August 26	<p>Supervision Order on services provided by issuers to acquirers with respect to interchange of debit transactions</p> <p>This published Supervision Order determines the interchange fee rate of debit transactions. The Order came into effect on April 1, 2016 and will remain in effect for one year.</p>
October 22	<p>Adjusting the banking corporations’ and credit card companies’ reporting on taxes on income and intangible assets to US GAAP</p> <p>As the accounting treatment of taxes on income and intangible assets is an important issue for the businesses of the banking corporations, the accounting treatment of the banking corporations and credit card companies on this issue was adjusted to US GAAP.</p>

	<p>Revision to Proper Conduct of Banking Business Directive No. 315 “Supplementary Provision for Doubtful Debts”</p> <p>Following previous revisions, the need arose to revise the list of sectors included in Appendix B of Proper Conduct of Banking Business Directive No. 315 “Supplementary Provision for Doubtful Debts.”</p>
	<p>Revision to Proper Conduct of Banking Business Directives No. 203 and 204 on capital requirements in respect of central counterparty credit risks</p> <p>To implement the recommendations of the Basel Committee on capital requirements in respect of banks’ exposures to central counterparty risks, the Proper Conduct of Banking Business Directives No. 203 and 204 on capital adequacy and measurement were amended, and a detailed framework was added for the capital requirements in respect of banking corporations’ exposure to central counterparty credit risks. The directives distinguish between nonqualifying and qualifying central counterparties, defining more relaxed capital requirements for qualifying central counterparties.</p>
December 6	<p>Closure of branches and reduction in the number of teller stations in banks</p> <p>Following the expansion in the use of direct and technology-based channels, several banks are closing branches and reducing the number of teller stations. In response, the Banking Supervision Department issued a letter to the banking corporations, requesting that they develop a branch policy for the forthcoming years, and a policy that meets the needs of customers who find it difficult to adjust to the new technological channels.</p>

Directives issued in early 2016

January 12

Publication of a letter related to increasing operational efficiency in the Israeli banking system

An analysis of data on the banking system in Israel indicates that the system's level of efficiency is lower than the efficiency in banking systems in other advanced economies. Therefore, the Supervisor of Banks issued a letter that defines a requirement for the banking system to outline a significant multiyear plan for increasing efficiency. To promote implementation of the plan, the Banking Supervision Department will approve leniencies in capital adequacy requirements, subject to compliance with the conditions stated in the letter. The more lenient requirements will apply to efficiency programs approved from the publication date of the letter until December 31, 2016.

February 28

Granting a permit to open partial and mobile bank branches

As bank customers have expanded their use of banking services through direct means such as ATMs, the Internet, and smartphone apps, they have also significantly reduced the frequency of their visits to bank branches. As a result, a growing number of branches have been closed by being merged with adjacent branches in major cities, or the number of teller stations has been reduced and tellers replaced by ATMs. To improve access to branches for customers who need the branches, including customers in towns that are distant from regular bank branches, a permit format was developed, permitting the banks to open partial branches in various sites and operate them in the form of mobile branches or by limiting their hours of business to certain days of the week.

Pending publication **Online banking**

As bank customers have expanded the use of banking services through bank websites or banking apps, customers now expect to be able to perform banking activities at any time, from anywhere. In response, the Banking Supervision Department has studied and mapped all the existing barriers to online banking. It subsequently published a draft directive on online banking, which removes said barriers and allows the remote execution of a broad range of banking activities, such as:

- Opening a new account in a bank by an individual who is not a known customer of the bank, without any need for the individual to physically visit the branch at any stage of the account opening process or when performing any activity in the account;
- Adding online banking services to an existing accounts;
- Carrying out ordinary activities in an account such as transfers and payments to third parties, updating account details, and signing certain documents.

The directive creates the foundation for establishing a digital bank with no physical branches or with a small number of physical branches. The directive also allows a bank to offer customers a service that gathers information on all the customer's activities in the banking system, the pension system, and with credit card companies. The Banking Supervision Department established a work team whose aim is to define the format in which such information will be conveyed, and to assure that it is secure.

According to the Banking Supervision Department's policy, the customer is the owner of his or her financial information and the customer may convey the information to others in order to obtain alternative financial offers, if he or she wishes to do so.

APPENDIX B: STRUCTURE OF THE BANKING SUPERVISION DEPARTMENT

The Banking Supervision Department contains several divisions—the Off-Site Evaluation Division, the On-Site Examination Division, the Policy and Regulation Division, and the Bank–Customer Division—which work together on supervisory work and on achieving the Banking Supervision Department's goals and targets. During 2016, the Supervisor of Banks announced the formation of a new division—the Technology and Innovation Division—whose goal is to accompany and assist in leading the technological revolution that is occurring in banking.

a. The Off-Site Evaluation Division

The Division formulates periodic assessments of the stability and management of the banking corporations, including auxiliary corporations, banking subsidiaries and overseas branches of the Israeli banks.

The institutional evaluation units' responsibilities are divided by banking groups. The units are charged with assessing the risks of each bank. The risk assessment process makes it possible to determine operational arrangements for assisting in the early detection of negative and unusual developments in the activity and risk exposure of the banks. This process is carried out under the risk-focused supervision method: The overall evaluation of the banking corporation is based on an appraisal of its corporate governance, the quality of risk management, and the level of the bank's risk exposure and the adequacy of the capital that it holds for the purpose of supporting its overall risk profile. (The banks' capital adequacy relative to their risk profile is assessed through the SREP.¹⁸) The evaluation processes include an analysis of the bank's exposure to risk, an assessment of the characteristics and performance of the management and control functions and more.

In addition, the evaluation units are also responsible for the processing of enquiries from the banking corporations, and for ensuring that the banking corporations meet the Supervisor of Banks' requirements.

b. The On-Site Division

The Division carries out on-site examination processes at the banks and the credit card companies. The purpose of these examinations is to identify and assess the risks inherent in the entire range of the banking corporations' activities and to examine the quality of the bank's risk management—whether it is dealing appropriately with the issue at the focus of the audit—with an emphasis on compliance with legislative and regulatory directives, and with the bank's policies and procedures. Examination reports warn of deficiencies and malfunctions, present requirements and set timetables for their rectification. The examination findings and conclusions are used in compiling

¹⁸ Supervisory Review and Evaluation Process.

an assessment of the banking corporations' stability, their risk management culture, and their fair treatment of customers.

The On-Site Division's activity is carried out via five auditing units—each of which specializes in a particular risk area—and by the Financial Reporting Unit.

(1) The Credit Risk Management Examination Unit

The Unit's principal functions are to identify and assess the risks inherent in the extension of credit at the level of the single transaction and the individual borrower and at the level of borrower groups and sectors. Among other things, the Unit examines credit policy and procedures and the manner in which they are implemented, credit approval processes and credit operations, platforms for managing credit risk, the problem loan detection and classification processes, and compliance with the Supervisor of Banks' directives in the area of risk management.

(2) The Market Risk and Liquidity Risk Management Examination Unit

The Unit's principal functions are to identify market and liquidity risks and assess the quality of their management and control processes. The Unit conducts examinations in the following areas: market risk (interest rate risks, indexation basis risk) management, securities portfolio management, the management of risks deriving from dealing rooms' activity in derivatives, liquidity risk management, and the management of risks deriving from bank customers' capital market activities (counterparty credit risk). The audits include an examination of the relevant risk management policies, their assimilation in the management, monitoring and control processes, an assessment of the models used in the risk estimation, an assessment of the management information infrastructure, and an examination of various aspects of corporate governance related to the audit subject and compliance with the Supervisor of Banks' directives regarding market and liquidity risk management.

(3) The Operational Risk Management Examination Unit

The Unit's principal functions are to examine the banking corporation's operational risks and to assess the banking corporations' management of those risks. An emphasis is placed on IT risks, including information security and cyber risks, risks deriving from material changes in the area of information technology, potential risks deriving from the link-up of the banks' systems to external networks, business continuity risks, and outsourcing risks. The unit also examines the propriety of the operational risk management framework, cross-organizational processes, critical systems, and activities with high operational risk.

(4) The Compliance Risk Management Examination Unit

The Unit's principal functions are to examine the banking corporation's compliance with directives concerning the prevention of money laundering and of the financing of terrorism, and the observance of Proper Conduct of Banking Business directives in the bank-customer relations area. In the course of the Unit's audits, it examines the propriety of policy, the implementation of policy and the effectiveness of control mechanisms, including the compliance officer and the internal audit.

(5) The Corporate Governance Risk Management Examination Unit

The Unit's principal function is to examine the characteristics of the various entities which make up the banking corporation's corporate governance. In the course of the Unit's audits, it examines the effectiveness and efficiency of the board of directors, the senior management, the risk management system, the internal audit, as well as the compliance officer.

(6) The Financial Reporting Unit

The Unit is responsible for determining principles for measurement, disclosure and reporting to the public by the banking corporations. In addition, the Unit conducts reviews and audits for the purpose of examining the banking corporations' compliance with these principles. Furthermore, the Unit is responsible for establishing the standards for professional conduct and for the audits conducted by external auditors that review banking corporations.

c. The Policy and Regulation Division

The Division formulates directives for the regulation of the supervisory policy, regulates banking activity, and draws up measurement, disclosure and reporting principles, while collecting and analyzing data on developments in risks and banking activity. This activity is carried out via four units:

(1) The Regulation Unit

The Unit is responsible for the regulation of banking activity, mainly through formulating and interpreting Proper Conduct of Banking Business directives, and also by means of promoting legislation. The purpose of these activities is to assure the proper and cautious management of the banking corporations, to provide regulatory coverage for the activity of the bank's board of directors and management, and to strengthen internal risk management and control systems.

(2) The Information and Reporting Unit

The Unit is responsible for receiving the banks' returns to the Banking Supervision Department, improving and processing these reports, and turning them into readily available information for serving the Banking Supervision Department's purposes. The Unit also publishes data about the banking system on the Bank of Israel's website.

(3) The Economics Unit

The Unit is responsible for analyzing the risks to the stability of the banking system that are inherent in the banks' activities as part of the macroeconomic and financial systems. In addition, the Unit constructs tools to analyze the state of the banking system and the risks it faces (stress tests and other tools), and also compiles and publishes periodic reviews as well as the annual survey of the banking system. The Unit also participates in cross-organizational and inter-organizational work teams and provides responses for various issues that are dealt with by the Banking Supervision Department.

(4) The Head of Banking System Emergency Preparedness

Under the authority of the government decision reached November 13, 2005, and with the authorization of the Higher Emergency Economy Committee, the Bank of Israel will establish and operate a designated financial banking authority, headed by the Supervisor of Banks. This authority will be assigned with the emergency preparedness, and with the operation during an actual emergency, of the entities that are under the supervision of the Bank of Israel during routine times—commercial banks, credit card companies, and Shva and Masav. The Authority is headed by the Supervisor of Banks.

The responsibility of the Head of Banking System Emergency Preparedness is derived from the main functions of the financial authority—to plan and guide the banking system's emergency preparedness, and to preside over its operations during an emergency.

d. The Bank–Customer Division

The Division works to promote fairness in the relations between the banking corporations and their customers while protecting the rights of the banking consumer; enforce bank-customer related legislation and directives; encourage competition in the banking system; and increase the public's awareness of their consumer rights in the area of banking. In order to achieve these objectives, the Division operates via two units and a section:

(1) The Public Enquiries Unit

The Unit examines customers' complaints against the banking corporations and makes decisions regarding disputes that are presented to it. The information accrued from complaints helps to detect and remedy deficiencies in the banking corporations. The Unit also provides information and answers questions from the public on banking consumer matters.

(2) The Regulation (Bank-Customer) Unit

The Unit provides regulatory coverage in the area of banking consumer related legislation and Proper Conduct of Banking Business directives. The Unit monitors compliance with Proper Conduct of Banking Business directives, other provisions of the law in the bank-customer area, and consumer-related directives. In addition, the

Unit applies and enforces provisions of the law concerning fees, including measures for increasing the transparency of the prices of banking services and the ability to compare between them. The Unit also engages in consumer-related explanatory activity to customers in order to increase their awareness of their rights and to reduce information gaps on banking matters.

(3) The Restricted Accounts and Customers Section

The Section collates all the information received from the banks regarding restricted customers and restricted bank accounts, including information on special restrictions imposed by the Execution Office, the Official Receiver, and rabbinic courts (regarding recalcitrant husbands). The Section deals with clarifications concerning restricted accounts and customers, and customer enquiries on these matters.

e. The Technology and Innovation Division

This new Division was established by the Banking Supervision Department in 2016 and will be set up gradually. Its function is to lead the Banking Supervision Department's policy and directives regarding all aspects of technology—innovation, information systems, core systems, outsourcing and interfaces with third parties, etc. To that end, the Division will, among other things, conduct an ongoing analysis of technological developments in banking and payment areas in Israel and worldwide. Likewise, the Division will systematically attempt to identify the risks in the technology areas—both the risks in existing systems and the risks in new initiatives that the banks will want to implement—and will guide the banks on how to deal with them. In addition, the Division will be responsible for initiating requirements in the areas of transparency and availability of the information, for the good of the customers and to increase competition.

The Technology and Innovation Division will collaborate with the Banking Supervision Department's other divisions, including the cyber function, in areas that interface.

f. The International Relations Unit

The Unit maintains regular contact with supervisory authorities worldwide, as part of home-host cooperation required by formal agreements signed with these authorities, and in accordance with the recommendations of the Basel Committee. In addition, the Unit reviews developments that may have implications for the Israeli banking system, and holds meetings with ratings agencies, international entities, and foreign banks, with the aim of increasing transparency to the global financial community and reducing the risk to the Israeli banking system.

h. The Central Services Unit

The Central Services Unit engages in the coordination and monitoring of the Banking Supervision Department's work programs, and in the promotion of cross-organizational projects. The Unit's areas of responsibility include the development of information infrastructures and making them accessible to the Department's employees, the preparation of work plans, budgetary planning, procurement activity, and the cultivation of human resources, including the initiation and implementation of training programs. In 2016, the responsibility for leading public information and financial education campaigns—one of the areas that the Banking Supervision Department will focus on in the coming years—was assigned to the Unit as well.

i. The Licensing Unit

The Unit processes applications that, under the law, require licensing from the Governor of the Bank of Israel or from the Supervisor of Banks. The Unit's activity includes the examination of candidates for control of banking corporations or for holding the means of control in banking corporations, a fit and proper test for senior office holders at the banking corporations, licensing for branches, the activity of foreign banks in Israel, and more.

j. The Cyber Function

The main role of the cyber function is to strengthen the ability of the banks and credit card companies to withstand cyber attacks. As part of its activity, the function maintains regular contact with the banking corporations, external consultants, the National Cyber Bureau, and the Israel Security Agency's Cyber Threat Prevention Unit (formerly the National Information Security Authority).

