

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, maintaining fairness in the relations between banks and their customers and promoting competition and efficiency in the banking system, assuring the public's assets deposited at banks, and ensuring the continuity of the services provided by banks to the public. These functions are closely related and are crucial to entrenching the public's trust in the banking system.

In 2014, the Banking Supervision Department continued in its efforts to increase the stability of the banking corporations, to ensure their prudent management and to increase fairness in their activities:

- Measures were taken to ensure that the banks meet the framework for increasing capital ratios, as part of the implementation of Basel III, and that they calculate the ratios as required. The Banking Supervision Department also examined whether the banks' internal capital targets are appropriate to their risk profile and how various scenarios affect the attainment of those targets. In addition, directives were issued to introduce a minimum leverage ratio.
- The recommendation of Basel III regarding the liquidity coverage ratio was adopted and the directives regarding management of liquidity risk by the banks were revised, including the directives regarding reporting to the Banking Supervision Department. At the same time, supervisory processes were implemented in order to assess the level of this risk and the quality of its management.
- Emphasis was placed on examining the work plans and business strategies of the banks and on evaluating the derived risk appetite, with focus on the steps meant to improve operating efficiency.
- Close monitoring of the quality, management and control of the banks' portfolio of housing credit continued. The banks were required to increase the capital buffer they allocate in respect of this portfolio.
- In view of the increase in consumer credit (non-housing credit to individuals), the Banking Supervision Department carried out a process to evaluate the risk implicit in this area and the methods for managing it, and required that the group allowance for this type of credit be increased. Steps were also taken to increase the accessibility of information on consumer credit.
- Monitoring continued of the development of risk in the business credit portfolio, and following the assimilation of the main directives regarding risk management, the banks were required to correct the weaknesses and deficiencies that were found in their integration.
- In view of the increasing risk arising from customers' cross-border activity, and in view of the efforts of various countries, particularly the US, to identify money that is liable for taxes, the Banking Supervision Department sought to evaluate the exposure to these risks and to limit their effect on the banks. The Banking Supervision Department formulated directives intended to ensure the prudent management of this risk in general, with emphasis on the FATCA instructions which were published by the US authorities. In particular, the Banking Supervision Department

instructed the banks to identify and evaluate this exposure and also to revise their policies and procedures regarding customer activity and the relevant controls, including the implementation of a risk-based approach to the identification of activity or customers that are likely to expose the banks to risks due to cross-border activity.

- Continuing the Banking Supervision Department's policy of recent years, emphasis was placed again this year on issuing directives that promote fairness in relations between the bank and the customer and that strengthen the consumer's negotiating position and the competition between the banks, as well as directives to reduce the costs of managing a bank account. Among other things, the Banking Supervision Department has introduced a uniform format for reporting to customers, which lists their assets, liabilities and activity at the banks (banking "identity card"). It has also required the disclosure of comparative information to the customer regarding the fees that similar customers pay for activity in securities; it has issued directives to simplify the process of transferring an account from one bank to another; and it has introduced the system of fee tracks while imposing supervision on the price of the basic fee track and limiting it to no more than NIS 10 per month. At the same time, the Banking Supervision Department has implemented most of the recommendations submitted by the joint Committee to Examine Increasing Competition in the Banking System. For some of the directives, future dates were set for their implementation in order to allow the banks to prepare the required computing systems.
- Enquiries and complaints from the public were dealt with and a new Proper Conduct of Banking Business Directive was issued, aimed at ensuring that the banks provide a comprehensive, fair and efficient response to complaints and that they draw the appropriate conclusions from them.
- In recent years, there has been growing risk to business continuity, including the risks arising from the cyber threat. In view of this situation, the Banking Supervision Department has broadened the guidance it provides, in cooperation with the National Information Security Authority, in the area of cyber defense and has published a new directive on its management. In addition, and in view of the threats to business continuity arising from the geopolitical situation, directives have been issued regarding the protection of critical sites. During Operation Protective Edge, temporary exemptions were provided regarding the implementation of certain directives, in view of the situation created as a result of the operation.
- The Banking Supervision Department has supported and has been a partner in implementing measures that have long-term implications for the banking system and on the financial system in general. These include: measures to increase competition in the area of payment card acquiring and increased use of debit cards; a plan for strengthening external auditing by auditing accountants; the recommendations of the Committee to Examine Debt Restructuring Proceedings in Israel; recommendations of the Committee to Reduce the Use of Cash; recommendations of the Committee to Advance the Securitization Market in Israel; and a plan to deal with the situation in which entities that manage ETNs hold bank shares. In addition, the Banking Supervision Department is continuing to advance the legislative amendments regarding a failing bank.

This chapter reviews in detail the Banking Supervision Department's main activities in 2014. Attached to the chapter are appendices that contain a table of regulation for 2014 and the organizational structure of the Banking Supervision Department, including its various divisions and units.

1. STRENGTHENING CAPITAL ADEQUACY AND LIQUIDITY: BASEL III

a. Strengthening capital adequacy

During 2014, the Banking Supervision Department monitored the preparedness of the banks to meet the timetable for integrating capital requirements and examined the implications of the changes in the capital ratios resulting from the implementation of Basel III, as well from as the gradual implementation of the accounting standard regarding workers' rights, the expected increase in risk assets as reflected in the banks' work plans and the possibility that the banks will distribute dividends. The Banking Supervision Department relates both to the system as a whole and to the specific effects on the various banks. In cases where the implementation of the capital requirements constitutes a challenge for a particular bank, its capital planning is examined. In addition, the Banking Supervision Department has evaluated the adequacy of the measurement of capital adequacy.

As in the previous two years, the Banking Supervision Department carried out a macroeconomic stress test for the banking system on the basis of a uniform scenario. The banks were asked to estimate the results of the scenario using 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 top-down 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.

b. The leverage ratio

During 2014, the Banking Supervision Department began preparations to ensure that the banks implement the Basel III recommendations regarding the leverage ratio. In November 2014, the banks were required to carry out a Quantitative Impact Study (QIS) with the goal of determining the effect of implementing the directives on the banking system in Israel. Together with the QIS, a draft translation was distributed of the final recommendations published by the Basel Committee in January 2014 entitled "Basel III Leverage Ratio Framework and Disclosure Requirements", which include the directives for measurement and disclosure. The Basel III recommendations set a three-percent minimum leverage ratio for banks, i.e., the ratio should not fall below three percent. Most countries have adopted this rate, though some have adopted higher levels. The US, for example, has set a ratio of six percent for a Systemically Important Financial Institution (SIFI) and in the Netherlands there is a recommendation to set a ratio of four percent for such banks. In April 2015, the Banking Supervision Department issued Proper Conduct of Banking Business Directive no. 218 entitled "The Leverage Ratio", which requires that a bank's leverage ratio not fall below 5 percent and not below 6 percent for a bank whose total balance sheet assets constitute 20 percent or more of the total balance sheet assets in the banking system.¹ Accordingly, the Banking Supervision Department has issued a revision of the Proper Conduct of Banking Business directives regarding disclosure of the leverage ratio.

¹ The requirement relates to banks on a consolidated basis and currently applies to Bank Leumi and Bank Hapoalim.

The banking system in Israel has been implementing the disclosure directives since April 2015 and is required to meet the imposed minimum leverage ratio requirements starting from January 2018.

c. The liquidity coverage ratio

In 2014, the Banking Supervision Department issued a new Proper Conduct of Banking Business Directive (no. 221) regarding the Liquidity Coverage Ratio (LCR), which adopted one of the two international standards for liquidity established by the Basel Committee.² The Banking Supervision Department is expected to adopt the other standard—the Net Stable Funding Ratio—according to the timetable set by the Committee (i.e., January 1, 2018) and after its possible effects have been examined.

The banking corporations are required to gradually meet the LCR requirement starting from April 1, 2015. From that date, the required ratio will be 60 percent; from January 1, 2016, it will be raised to 80 percent and on January 1, 2017, to 100 percent. This requirement applies to all banks, although branches of foreign banks will face a simpler liquidity ratio.

In parallel to the adoption of the LCR requirement, the Banking Supervision Department has revised the Reporting to Banking Supervision directive on the reporting of liquidity risk, in order to, among other things, apply the monitoring tools that the Basel Committee expects bank supervisors to implement. In addition, the Banking Supervision Department revised the Reporting to the Public directives in accordance with the disclosure requirements recommended by the Basel Committee. Banks will provide disclosure of their LCR starting from April 1, 2015.

The assessment of liquidity risk, at the level of a single bank and of a banking group, focused in 2014 on the manner in which Proper Conduct of Banking Business Directive 342 (“Liquidity Risk Management”) has been implemented in the internal models used by the banks to measure this risk and the quality of its management. For the banks assessed, no shortage of liquidity was found; however, in some of the banks, some corrective measures were needed in the following areas: management of liquidity on a group basis, warning systems, emergency plans for various scenarios, information systems for the management of this type of risk and the involvement of control systems in the management of this risk.

2. IDENTIFICATION, EVALUATION AND MONITORING OF RISK

The Banking Supervision Department monitors the development of risk in the banks and in the banking system as a whole on an ongoing basis. In addition, it carries out an annual process to evaluate the risk profiles of the banks, a process known as Supervisory Review and Evaluation Process (SREP). As in other supervisory methodologies in use worldwide, this process is based on the fundamental documents of the Basel Committee and makes use of the various outputs of the Banking Supervision Department: audit reports, reviews, the uniform stress test, regular meetings with various office holders inside and outside the banking system, reviews of working papers prepared by the banks, etc. In the process, the Banking Supervision Department assesses the structural risks at the banks, the quality of risk management and the

² For further details, see Chapter 1, Section 5—Liquidity Risk.

functioning of corporate governance, and the internal processes of the banks that are used to assess risk and decide on the appropriateness of their capital adequacy. In addition, the process looks at whether the capital ratio target set by each bank—targets that are reflected in the Internal Capital Adequacy Assessment Process (ICAAP) report which is submitted to the Banking Supervision Department—is appropriate to its risk profile.

In addition, the Banking Supervision Department monitors the possible implications of global economic developments on the banks. In 2014, there were several events that were liable to impact on the economy of Israel in general and the banking system in particular, including the drop in the value of the ruble, the changes in the exchange rate of the Swiss franc and the concern that Greece would leave the eurozone. The Banking Supervision Department examined the various exposures of the banks, including direct credit exposures, the exposures in the nostro portfolio, the exposure to the decline in the value of collateral, the exposure to borrowers whose main activity and/or source of income is liable to be negatively impacted on as a result of the crisis or the event, the exposure of players in the capital market, etc.

a. Business policy and risk appetite

In 2014, the Banking Supervision Department surveyed the work plans of the banking corporations, as it does every year. These plans reflect the banking corporations' risk appetite and reviewing them is meant to attain an overall view of the banking system's direction and the risks facing it. This review supports the Banking Supervision Department's process of ongoing evaluation, both on the individual and systemic levels, and the adjustment of the supervisory work plan. The Banking Supervision Department examined the process by which the work plans were formulated and the targets and level of risk implicit in them, as well as the ability of the bank to achieve them. This year, particular emphasis was placed on the change in the banks' business focuses and closer monitoring of the banks' operational efficiency.

b. Risk management

During 2014, the Banking Supervision Department assessed the assimilation of Proper Conduct of Banking Business Directive no. 310 regarding risk management and Proper Conduct of Banking Business Directive no. 311 regarding credit risk management, which went into effect on January 1st, 2014. The assessment of the assimilation of the Directive for the management of risk by banking corporations focused on the effectiveness of the risk management function, i.e., the status of this function, its independence, its involvement in decision-making processes in the bank and its influence on them.

The assessment of the assimilation of the Directive regarding credit risk management focuses on the process used by the banks to monitor debts whose quality is deteriorating, the process of classifying them, the allowance for loan losses due in respect of such debt and the involvement of the risk management function in the process of approving significant credit exposures. The findings of the examination revealed that the banks had assimilated major portions of the directives, but a number of instructions had still not been implemented.

c. Housing credit

The continuing growth in the housing credit portfolio and its share of the total portfolio of credit to the public led to an increase in the risk implicit in the portfolio, particularly in view of the correlation between this risk and the risk in the portfolio of credit to the construction and real estate industry and the portfolio of consumer credit (non-housing credit to individuals). The increase in risk implicit in the portfolio of housing credit emphasized the need to improve the ability of the banking system to absorb unexpected losses by means of enlarging capital buffers. As a result, the banks were required to increase the Common Equity Tier I capital target at a rate that constitutes one percent of the housing credit portfolio. The banking corporations were required to meet this capital ratio by January 1st 2017 and they must gradually increase the ratio at fixed quarterly rates starting from January 1st 2015.

Among other things, the direct loss to the housing credit portfolio as a result of the realization of a stress scenario was estimated as part of the uniform stress test carried out for the banking system in 2014, with the goal of determining the sensitivity of the housing credit portfolio to various risk factors. The results of this test were used by the Banking Supervision Department as an additional tool to estimate the risk of the housing credit portfolio and to evaluate measures of this risk.

In addition, the Banking Supervision Department carried out a systemic assessment in the area of housing credit, with focus on the following issues, among others: the policy for credit risk management, the ongoing monitoring by means of risk measures and the process of collection and monitoring of arrears. The assessment included a systemic comparison, an analysis of the targets and limits set by the banks on this activity and an assessment of their effectiveness, with emphasis on those that are liable to indicate risk factors in the housing credit portfolio.

d. Consumer credit (non-housing credit to individuals)

In addition to the growth in housing loans in 2013–14, there was also rapid growth in total consumer credit. As a result, in 2014 the Banking Supervision Department increased its activities to assess the risk inherent in consumer credit and the manner in which it is managed. The assessment focused on the following areas, among others: structural risk, marketing and offering of credit to customers, underwriting processes, quality of management of each loan and of the overall retail credit portfolio and the quality of control over them. In order to verify that the loan loss provisions in respect of consumer credit are sufficiently conservative, the Supervisor of Banks set a minimum rate for the quality adjustments included in the group allowance for loan losses due to consumer credit, starting from the 2014 financial statements to the public. In addition, the Banking Supervision Department formulated new requirements for the submitting of detailed information by the banks on consumer credit. Some of the demands were included in the directives for reporting to the Banking Supervision Department that were issued in November 2014 and others will be issued in the near future.

e. Commercial and business credit

There is still a relatively high level of concentration by borrower size in the credit portfolio, reflecting the degree of concentration in the economy. In recent years, there has been a clear downward trend in credit to

large borrowers and at the same time there has been a clear upward trend in the size of the portfolio of credit to small and medium-sized businesses. Therefore, in 2014, the Banking Supervision Department focused not only on examining the management of credit to large borrowers in the economy—a routine focus of risk—but also on the assessment of the management of credit to small and medium-sized businesses. The Banking Supervision Department continued to examine the processes of credit underwriting and management and the processes for validating the banking corporations' risk assessments and the manner in which they classify debts as problematic and make provisions for expected loan losses. In addition, the Banking Supervision Department continued to monitor the process to reduce the concentration of large borrowers in the banking system.

Additionally, the Banking Supervision Department continued to monitor the development of banks' exposure to the construction and real estate industry and the manner in which they are managing the risk inherent in this activity, with focus on focal points of risk, i.e., income-yielding real estate and real estate for residential projects. The Banking Supervision Department looked at, among other things, the scope of the exposure, the policies and limits that have been put in place, stress scenarios and the manner in which the banks are monitoring the development of risks in the portfolio.

f. Market and interest rate risk

In 2014, the Banking Supervision Department examined the banking activity in over-the-counter (OTC) derivatives in the trading room and in particular the supervisory processes and control of this activity and the manner in which counterparty risk vis-à-vis foreign banks and financial institutions is being managed. In the case of several of the banks, the Banking Supervision Department also looked at how they manage interest rate risk and how they implement Proper Conduct of Banking Business Directive no. 333 "Management of Interest Rate Risk".

g. Prohibition on money laundering and financing of terrorism

In 2014, the Banking Supervision Department operated on two levels: First, in the case of the directives regarding the prohibition on money laundering and financing of terrorism, the Banking Supervision Department continued to examine the implementation of obligations imposed by these directives on the banking corporations and the credit card companies, the adequacy of processes for managing this risk in the three control circles and the functioning of corporate governance. When banking corporations have violated the instructions of the law, the Banking Supervision Department has submitted notification of a request for the imposition of financial sanctions. The committee responsible for imposing financial sanctions operates under authority of the Prohibition on Money Laundering Law, 5760-2000. In 2014, it met twice and imposed sanctions in a total amount of NIS 3.1 million.

Second, in the case of the evaluation of national risk, FATF published new recommendations³ in 2012. The first is related to the need for national evaluation of risk. Leading the process of national evaluation in Israel is the Israel Money Laundering and Terror Financing Prohibition Authority. It appointed several

³ The FATF (Financial Action Task Force) Recommendations (2012), "International standards on combating money laundering, terrorism and proliferation".

working groups to accomplish this task. Among others, it created a working group composed of the supervisory authorities of the financial institutions, headed by the Banking Supervision Department. This group is seeking in 2015 to advance the assessment of risk in the area of money laundering and financing of terrorism, both in supervised bodies and in supervisory authorities, in order for the evaluation to assist in the national assessment of risk.

h. Cyber risk

In 2014, the Banking Supervision Department continued to examine the preparedness of the banking system to deal with cyber risk:

1. Collaboration continued with the authorities that are involved in dealing with this threat: the National Information Security Authority within the General Security Service and the National Cyber Bureau.
2. Efforts to strengthen the resilience of the banking corporations to cyber threats were expanded. This process is being implemented in collaboration with experts from the National Information Security Authority.
3. The professional interbank cyber protection forum, which was created by the Banking Supervision Department in 2012, continued to be active this year.
4. Three cyber drills were held: a drill for officials in charge of cyber protection in the banks and the credit card companies (June 2014); a cyber drill at the Bank of Israel and the Banking Supervision Department (June 2014); and a drill for information security managers in the banking corporations and the credit card companies (September 2014).
5. In addition to the immediate reports of urgent warnings, periodic reports of warnings and events—from various sources—were distributed.
6. In March 2015, Proper Conduct of Banking Business Directive no. 361 “Cyber Defense Management” was issued and a draft circular was issued on the management of risk in a cloud environment.

During the year, the Banking Supervision Department dealt with cyber events—or attempts to carry them out—in the banking system, and also a blackmail event that was the result of leaked information from “Leumi Card” (November 2014). The Banking Supervision Department learned the lessons of this event and issued instructions to the banking system on the steps necessary to reduce this exposure.

i. Business continuity

The focus of the Banking Supervision Department’s activity in business continuity risk in 2014 was to deal with the variation in business continuity among the banks. In addition, the Banking Supervision Department formulated guidelines for minimum protection of the bank’s critical sites, taking into account various reference scenarios (fire, earthquake, etc.). The guidelines were formalized at a later stage in a Proper Conduct of Banking Business Directive on business continuity.

As noted, during June 2014 the Banking Supervision Department carried out a joint drill with the banking system, based on the national exercise scenario that was meant to take place on those dates. The drill simulated an ongoing cyber event and also included a daily reporting exercise in a time of emergency (in accordance with the directives for designated reporting to the Banking Supervision Department).

As a result of Operation Protective Edge and the declaration of a special situation in the area up to 40 kilometers from the Gaza Strip, the Supervisor of Banks issued a series of directives dealing with bank branches within range of the threat, including directives regarding exemptions for the population.

Box 2.1: Risks derived from cross border activity

In recent years, various countries have increased their enforcement efforts to locate funds that citizens who are liable for taxes transferred to foreign financial institutions. The US is at the forefront of this effort: In 2008, a US Senate committee published a report listing the damage from the phenomenon. In the wake of the report, the government launched a vigorous enforcement program related to foreign banks that were suspected of aiding US citizens of hiding assets and evading taxes. Within the framework of this program, US authorities launched criminal investigative proceedings against foreign banks operating in Switzerland. As a result, UBS was fined \$780 million as part of a Deferred Prosecution Agreement (DPA) signed with it in February 2008, and Credit Suisse was fined \$2.6 billion in May 2014 as part of a plea agreement.

US authorities also opened criminal investigations against the Swiss representative offices of three Israeli banks—Leumi, Hapoalim, and Mizrahi-Tefahot. In December 2014, the investigation proceedings against Leumi were concluded, following agreements it signed with two US authorities—the Department of Justice and the New York State Department of Financial Services.¹ In these agreements, the bank admitted that between 2000 and 2010 it acted in a manner that helped its customers to conceal their assets from US authorities and to avoid paying taxes. The bank was fined a total of \$400 million², and sanctions and additional requirements were imposed on it in terms of its activity with US customers. The bank was required, among other things, to appoint an external entity to examine the group's compliance plan and supervise its implementation, and to comply with FATCA³ directives and appoint functions that will examine the group's compliance with them. According to these directives, beginning in July 2014, financial institutions operating outside the US are required to report on US customers' accounts to US authorities.

From the date the Banking Supervision Department became aware of the investigations against Israeli banks' subsidiaries, it monitored their development and examined their possible ramifications. Among other things, it verified that the banks included the required information in their financial reports, and that they set aside appropriate provisions in respect of exposure to the matter. In addition, it assessed how various banks manage the risks inherent in activity with nonresidents, through a forward-looking approach and with the goal of reducing the probability of the occurrence of similar events in the future.

¹ It signed a Deferred Prosecution Agreement with the Department of Justice, and signed a Consent Order with the New York State Department of Financial Services.

² The Department of Justice fined it \$270 million, and the New York State Department of Financial Services imposed a financial sanction of \$130 million.

³ Foreign Account Tax Compliance Act.

The banks themselves, as well, were required to go through identification and assessment processes related to their exposure to compliance risks in activity with nonresidents.

In addition to these activities, the Banking Supervision Department published a letter in April 2014, ahead of the FATCA provisions coming into effect. The letter instructs the banks to continue preparations to implement the directives, first and foremost through formulating policies and procedures, taking into account their obligations vis-à-vis their customers. It was established in the letter that, among other things, a bank may refuse to provide banking services to a customer who does not cooperate with the bank's demands that it sets for implementing the directives.

Other countries act to collect information on their citizens' accounts. In addition, there is a trend of international collaboration in combatting tax evasion, and this is expressed in, among other things, the Common Reporting Standard published by the OECD in 2014. Israel announced it will adopt it as of the end of 2018. Accordingly, the Banking Supervision Department published, in March 2015, a guideline regarding the issue of management of risk derived from customers' cross border activity, with an emphasis on customers' tax liabilities. This guideline requires that banks receive a declaration from their customers that they reported their income as required, and that they waive confidentiality vis-à-vis authorities abroad. It also requires them to implement a risk-based approach to identifying activity or customers that are likely to expose them to cross border risk, and to revise the policy, procedures, and controls related to this risk. This guideline also allows a bank to refuse to provide banking services to a customer who does not cooperate with the bank's demands in this area, or a customer whose activity is likely to expose the bank to the risk that it will be viewed as collaborating in violating foreign legislation that applies to the customer.

International banking standards require banks to adopt measures preventing customers from taking advantage of the banks in order to evade taxes, and to avoid acting in a manner that is likely to assist their customers in evading taxes, whether in Israel or abroad.

International regulation in this sector has become stricter in recent years, and the banking system needs to continue to align itself with the statutory, regulatory, and ethical requirements related to taxes.

3. LEGISLATION, REGULATION AND LICENSING

In 2014, the Banking Supervision Department was active in the areas of legislation, regulation and licensing with the intent of protecting the public and strengthening the stability of the banking system. Appendix A lists the regulatory activities during this year.

a. Handling of a failing bank

The Banking Supervision Department, together with the Bank of Israel's Legal Department, have since 2013 been formulating a draft amendment to the Banking Order regarding the handling of a failing bank. At the beginning of 2014, a special delegation of the IMF visited Israel and examined the draft. In April 2014, the delegation submitted a report to the Bank of Israel that included its main recommendations, according to the international standards in this area.

During 2014 and until the publishing of this survey, the Bank of Israel continued to work on the legislation and advance it. However, as a result of the national elections held in 2015, the work on some of the issues in the draft was delayed in order to discuss them in the framework of the new government.

b. The plan for strengthening external auditing of the banks

In the area of regulation, the Banking Supervision Department also issued directives intended to improve the quality of external auditing of the banks' financial statements. The Supervisor of Banks and the Commissioner of the Capital Market, Insurance and Savings in the Ministry of Finance have together examined this issue and in May 2013 they published a draft for comments by the public entitled "Framework for Structural Change in the External Auditing of Financial Institutions".

The Banking Supervision Department has reviewed the responses of the public and also the regulation and experience accumulated in other countries—the recommendations of the Basel Committee from March 2014⁴ and the European Directive from June 2014.⁵ The Banking Supervision Department based itself on the recommendations and on the Directive in creating a plan for strengthening the structure of external auditing of financial institutions, with the goal of improving its quality, strengthening the mechanisms that are meant to protect the independence of the auditing accountants and improving the ability of auditing committees of financial institutions to supervise the quality of their audits.

c. The Committee to Examine Debt Restructuring Proceedings in Israel

In May 2013, the Minister of Finance and the Governor of the Bank of Israel appointed the Committee to Examine Debt Restructuring Proceedings in Israel, in view of, among other things, the growth in debt restructurings in Israel in recent years. Heading the Committee was the Director General of the Ministry of Finance, and its members included the Director of the Research Department of the Bank of Israel and the Supervisor of Banks.

⁴ Basel Committee on Banking Supervision, "External audits of banks".

⁵ Directive 2014/56/EU of the European Parliament and the Council amending directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts.

In November 2014, the Committee published a report that summarized its findings.⁶ The Committee's regulations are intended to increase the certainty among players in the market and to create incentives for a company in financial difficulties to first enter into a process of debt rescheduling before a major negative impact to its value and in bondholders' value occurs.

In addition to the recommendations to amend the law, the Committee is recommending that regulations be issued by the following supervisory authorities: the Israel Securities Authority, the Capital Market, Insurance and Savings Division in the Ministry of Finance and the Banking Supervision Department. The Banking Supervision Department has adopted the recommendations of the Committee and has revised its directives accordingly.

d. The Committee to Examine Reducing the Use of Cash

The Banking Supervision Department was part of the joint Committee to Examine Reducing the Use of Cash. The Committee was headed by the Director General of the Prime Minister's Office. The Committee was established by a government decision on September 17th, 2013 and submitted its final recommendation on July 17th, 2014. The government adopted the recommendations in October of that year. The recommendations deal with limitations on the scope of transactions executed in cash, negotiability of checks and promotion of alternative means of payment.

e. Securitization in Israel

The Banking Supervision Department is part of the Interministerial Team for the Promotion of Securitization in Israel.⁷ The team published an interim report in 2014, and as a result of the team's work, the Banking Supervision Department intends to revise some of the principles for the execution of securitization transaction in the banking system, which were established in a letter from the Supervisor of Banks in August 2009.

In accordance with the principles of the Basel Committee on Banking Supervision, the Banking Supervision Department intends to permit securitization of a variety of credit types, while emphasizing the securitization of loans to small and medium-sized businesses (SMEs) in order to increase the supply of credit to this sector. However, securitization will not be possible in non-conventional transactions and complex transactions (such as CDO²)⁸, due to the difficulty in properly evaluating the risks implicit in them.

f. Formulation of the framework for holding of banks shares by means of ETNs (in collaboration with the Israel Securities Authority)

In accordance with the Banking (Licensing) Law, 5741-1981, when an investment house holds bank shares, including by means of ETNs that it has issued and manages, they are included in the calculation of the investment house's holdings (and if it has a controlling shareholder, they are included in his holdings) for

⁶ http://mof.gov.il/Committees/DebtRegularizationCommittee/DebtRegularizationCommittee_Makanot_Report.pdf

⁷ The Bank of Israel coordinates the team. Its members include representatives of the Israel Securities Authority, the Ministry of Justice, the Ministry of Finance and the Israel Tax Authority.

⁸ The term CDO² relates to a securitization transaction in which the pool of underlying assets is composed of securitized assets.

the purpose of the limits imposed by the Banking Law on those holdings, i.e., no more than 5 percent of any type of means of control in a bank are to be held without a permit.

With the goal of allowing investment houses to continue offering a variety of asset management activities to its customers, the Israel Securities Authority and the Banking Supervision Department published a joint position paper on August 4th, 2014 that proposes a new work outline, whereby the issuing companies can issue and manage two types of ETNs that track the TA Banks Index:

1. “Sealed” ETN—which operates under the current model.
2. “Transparent” ETN—which operates under a new model, whereby the ownership of each of the means of control in a bank is transferred to the final holder of the ETN.

The assets in a “transparent” ETN will be managed subject to the conditions of the outline and will not be included in the holdings of the company that issues and manages the ETN.

g. Encouraging the establishment of credit unions

On May 5th, 2015, the Banking Supervision Department published an outline for the establishment of credit unions, entitled “Process of Licensing and Establishing Credit Unions in Israel”. The document specifies the features that credit unions should have, features that will enable them to contribute to competition in banking services where competition is insufficient and at the same time will ensure their stability. Changes were made in the document as a result of the comments received from various sources on the draft published in June 2014. At the same time, the Banking Supervision Department is working intensely on the creation of a legal and regulatory infrastructure for the activity of credit unions and to this end it is working together with the Registrar of Cooperative Societies in the Ministry of the Economy and with the Ministry of Justice.

Box 2.2: Issues in the application of deposit insurance

Background¹

Instituting deposit insurance is intended to prevent a “run on the banks”—a situation in which depositors run to the bank during a crisis in order to withdraw their deposits, as a result of which a temporary liquidity crunch may lead to the default of a bank or even to the expansion of the failure to the entire system. The professional literature mentions a number of additional considerations in favor of deposit insurance:

- It increases competition and reduces concentration if the insurance relates separately to deposits at various banks, and not to total deposits made in the banking system. This is because it

¹ The data in this survey are from Demirguc-Kunt A., E. Kane and L. Laeven (2014), “Deposit Insurance Database”, Policy Research Working Paper 6934, The World Bank – Development Research Group. This paper includes a comparison of deposit insurance data from 188 members of the International Monetary Fund, including Liechtenstein.

encourages the depositing public to divide their deposits among various banks in order to insure a larger amount.²

- It reduces the public expenditure burden in times of crisis.
- It provides depositors with a large amount of certainty in relation to their ability to withdraw the deposit rapidly.
- It constitutes part of the international standards, including standards set by the OECD and the Financial Stability Board (FSB).

However, there are also disadvantages to deposit insurance:

- It increases the moral hazard since it encourages the management and shareholders of the bank to take larger risks in order to increase their profits.
- It reduces market discipline because it has a negative impact on the motivation of depositors to monitor the risk inherent in management's behavior and their motivation to take sanctions—through the withdrawal of deposits—when the risk increases.
- It could increase the prices of banking services if the banks pass the costs of financing the insurance mechanism—even partially—on to depositors.

As will be seen below, security nets such as deposit insurance have, in the countries that have instituted them, contributed to financial stability during crises. However, in order for the advantages of insurance during a crisis to outweigh its disadvantages during routine times, it must be implemented with proper supervision. Moreover, the experience accumulated during the last crisis strengthened the position that in order to prevent a situation in which the failure of a large bank negatively affects the entire financial system, deposit insurance is not sufficient, and an implied government guarantee is required.³

b. The features of deposit insurance

Prevalence: Deposit insurance is the most common method used by countries to insure depositors' money during crises, and the number of countries that have such insurance increased significantly in recent years—from 84 out of 189 countries in the sample in 2003 to 112 at the end of 2013. There is deposit insurance in 96 percent of countries in Europe.

Level of coverage: The level of insurance coverage varies significantly from country to country, both in absolute terms and relative to per capita GDP, and ranges from coverage of low amounts—€50,000 and even less—to full coverage. The countries in the eurozone determined that the insured deposit amount would be €100,000, the UK set the amount at £85,000, the US at \$250,000, and Australia at A\$250,000.

² By way of illustration, if the insurance amount is NIS 100, and the depositor deposits NIS 1,000 in one bank, he will receive NIS 100 from the insurance. But if he divides his deposit among two banks, he will receive NIS 200.

³ In professional jargon, an implied guarantee is also called “cover”, and relates to a guarantee that a government may grant in order to protect financial stability even if such a possibility is not explicitly set out in legislation.

Area of coverage: Some of the insurance programs (about 43 percent) ensure the repayment of insured deposits only when the bank defaults, while the rest include additional areas of liability, such as liability for loss minimization and risks to the principal, through using authority to monitor and control insured entities. These other areas vary according to the banks' license, the supervisory authority, and the ability to gather information from the banks.

The mechanism: Deposit insurance programs have a variety of mechanisms. Some of them have “ex-ante financing”, receiving financing in advance through a fund accumulated from premiums paid by the insured banks, and some have “ex-post financing”, receiving financing retroactively by collecting premiums from the banks after the money has been returned to the depositors of a bank that has defaulted.

The administering entities: In 66 percent of the countries, the government administers the insurance, but there is tremendous variance between countries. In developing countries, the governments administer 82 percent of all insurance programs, while in the advanced countries, they administer 44 percent. In those countries, the banks administer 21 percent of the insurance programs, with the remaining 35 percent administered jointly by the government and private entities.

Financing: Financing for deposit insurance comes first and foremost from the premiums paid by the insured banks, although some of the insurance programs receive partial or complete financing from the government. When the financing is joint, the initial financing comes from the government, and the remainder from the continuing payments from the banks. There is private financing in 77 percent of all insurance programs, government financing in 2 percent, and joint financing in the remaining 21 percent. From this standpoint, there is significant variance between countries, and in countries with high per capita income, the private sector financing 91 percent of the insurance programs.

Government guarantee: About 38 percent of the insurance programs enjoy government support in a case where the principal is not sufficient, and for the most part, the Ministry of Finance provides lines of credit or guarantees for the issued debt. There is a much greater extent of guarantee in countries with high per capita income, because their financial state makes it possible.

Legal standing: Deposit insurance generally (in 86 percent of the cases) constitutes an independent legal entity, separate from the central bank, banking supervision, or the Ministry of Finance.

c. The question of the efficiency of deposit insurance during crises

A study published last year examined the connections between bank risk and deposit insurance, and the fragility of the financial markets both in the years preceding the 2008 crisis and during it.⁴

⁴ Anginer D., A. Demircuc-Kunt and M. Zhu (2014), “How does deposit insurance affect bank risk? Evidence from the recent crisis”, *The Journal of Banking and Financing* No. 48. The sample included 4,109 banks in 96 countries. The measurement was conducted on data from 2004 to 2009. Data from 2004–06 present the period preceding the crisis, and the data from 2007–09 present the crisis period. In order to find the effect of deposit insurance, the researchers compared the risk indices in countries with deposit insurance to the indices in countries without deposit insurance. The bank risk was calculated according to the Z value, which assessed the volatility of asset yields, while the fragility of the system was calculated according to an index of expected losses of a company as a result of price declines in the markets.

The study found that in countries with deposit insurance, the negative effect of the moral hazard—meaning taking larger risks—increases during routine times, while the positive effect on stability increases during crises. It was also found that efficient and strong supervision and regulation increase the positive effect of deposit insurance during crises and reduce the negative effects of moral hazard during routine times.

Deposit insurance, alongside the liquidity and monetary accommodation actions taken by the central banks, helped in preventing a run on the bank. By way of illustration, broad liquidity support provided by the Federal Reserve to the banks, together with the understanding that the Treasury would provide fair support to the Federal Deposit Insurance Commission (FDIC), prevented a run on deposits that the banks insured with the FDIC. In addition, brokers' money market funds⁵, with no insurance, received temporary federal insurance when the crisis strengthened in September 2008, and recorded massive amounts of deposits.

Deposit insurance may therefore moderate a run on the bank during a crisis, but it appears that it cannot prevent it sufficiently. In Europe, there is deposit insurance, but it did not prevent a run on the bank in the Northern Rock case in England⁶ or in the DSB case in the Netherlands. In Greece as well, there is a marked withdrawal from deposits due to the concern that it will pull out of the eurozone and abandon the euro, but the withdrawal was conducted relatively slowly. (Deposits declined by 20 percent between 2010 and 2012.)

A review of the means used by countries to stabilize the financial system during the last crisis shows that deposit insurance did not obviate the need for an implied government guarantee. Many countries provided guarantees that covered deposits totaling more than the volume of insurance set out in the law, and even added a government guarantee for other assets and liabilities of the banks with the aim of maintaining public confidence in the banking system. Government intervention during the crisis was not limited to the liabilities side of the balance sheet, and since 2008, 17 countries nationalized a significant part of the financial system (64 percent of countries that experienced a banking crisis and have deposit insurance).

⁵ These are funds that invest in short-term quality assets (bank deposits, government securities and tradable securities) and that have a stable net asset value of \$1. (The net asset value equals the value of the fund's assets minus its liabilities. A decline below \$1 means that the fund is expected to generate losses for its investors.)

⁶ The UK established special deposit insurance. The initial part of the deposit amount was not insured—only the amount that exceeded that was. However, this did not prevent the collapse of Northern Rock, since no depositor was prepared to lose the first few thousand pounds. The literature written before the crisis praised the British arrangement because it expanded personal liability, but it turned out that the market discipline that appeared correct theoretically did not meet the test of reality.

d. Conclusion

The recent financial crisis brought four facts or developments into sharp relief. First, deposit insurance does not obviate the need for an overall safety net, particularly regarding banks with systemic importance. The connectivity between the banking system and the markets indicates that financing crises in the capital markets can easily spill over to the banks, and financing crises in the banks can rapidly spill over into the capital markets and even into the real economy. History shows that when a real crisis is the result of a financial crisis, it is deeper and longer. The systemic risk from such a spillover emphasizes how important it is to expand the safety net to nonbank entities as well.

Second, one of the most significant tools available for resolution of a failing bank—particularly in the case of medium and large banks—is a designated fund. Most European countries did not have any such designated fund in 2008, and if there were funds, they had accumulated only low amounts. Therefore, the eurozone recently formulated new legislation transitioning it to an overall European fund for financing in future financial crises. This fund is supposed to replace the single mechanism for resolution.

Third, there is a recent tendency in the world to reduce the exposure of public funds to the risk derived from the need to extricate failing banks, particularly large and medium banks. Policy papers from regulators abroad contain wide-ranging discussions of the appropriateness of shareholders and nonsecured bond holders bearing the costs inherent in the failure of the firm⁷ before government assistance is provided.

Finally, before the crisis, many countries attempted to reduce the negative effect of deposit insurance on market discipline and on moral hazard through a low level of insurance coverage and/or joint insurance, with the intention of providing incentives for insured retail depositors—as well as other parties—to monitor the financial institutions. The results of the crisis show that this attempt failed, and as of 2013 only 3 countries left such insurance programs in place.

The lessons of the financial crisis led the International Association of Deposit Insurers (IADI) in November 2014 to publish an update to the core principles of an efficient deposit insurance system. The publication contains 16 principles involving, among other things, the clarity of the objectives of the deposit insurance program, the powers of the insurer, the insurer's independence, the insurer's connections with the other parties participating in the financial safety net, the level of insurance coverage, supervision and monitoring, the program's participants (the requirement that all the banks participate in it), the sources and uses of financing, and more.

In Israel, there is an implied government guarantee, but there is no deposit insurance mechanism. Against this background, the Bank of Israel is examining the advantages and disadvantages inherent in such an arrangement and the need and possibility of applying it in Israel.

⁷ Bail-in.

Structure of the deposit insurance program: comparison of selected countries according to December 2013 data*											
	Australia	Chile	UK	US	Switzerland	Sweden	Singapore	Japan	Canada	Germany	France
Type of deposit insurance program											
Explicit	X	X	X	X	X	X	X	X	X	X	X
Legally separate			X	X	X		X	X	X	X	X
Central bank, regulator or minister	X	X				X					
Publicly administered	X	X	X	X		X	X		X		
Privately administered					X						
Jointly administered								X		X	X
For deposits only (pay-box)	X	X			X	X	X				
For deposits and losses or minimizing risk			X	X				X	X	X	X
Multiple program				X				X	X	X	
Coverage and participants											
Required for domestic banks	X	X	X	X	X	X	X	X	X	X	X
Subsidiaries of foreign banks	X	X	X	X	X	X	X	X	X	X	X
Local branches of foreign banks		X	X		X		X			X	X
Foreign currency deposits		X	X	X	X	X				X	X
Interbank deposits	X			X					X		
Financing											
Ex-ante financing				X		X	X	X	X	X	X
Ex-post financing	X	X	X		X						
Government financing	X	X									
Private financing			X	X	X	X	X	X	X	X	X
Joint financing											
Basis for evaluating the fund's contribution											
Risk-adjusted premium				X		X	X		X		X
Covered deposit						X	X	X	X		
Qualified deposit			X							X	X
Total deposits											
Total liabilities	X	X		X	X						
Payment to depositors											
By deposit account		X									
By depositor and by institution	X		X	X	X	X	X	X	X	X	X
By depositor											
* Source: Demirguc-Kunt A., E. Kane and L. Laeven (2014), "Deposit Insurance Database", Policy Research Working Paper 6934, The World Bank – Development Research Group.											

4. STRENGTHENING OF INTERNATIONAL RELATIONS

The Banking Supervision Department maintains relations with various supervisory authorities in Israel and abroad, with the goal of exchanging supervisory information both with supervisors in countries that host subsidiaries of Israeli banks and with supervisors in the home countries of foreign bank branches in Israel. It does so within the framework of international standards formulated by the Basel Committee. Accordingly, representatives of the Banking Supervision Department participated in working groups of various economic organizations, such as the OECD and the Financial Stability Board Consultative Regional Group for Europe.

The Banking Supervision Department held a series of meetings in 2014 with international rating agencies, correspondent banks and foreign institutional investors in order to increase transparency and deepen the understanding of the Israeli banking system's activity and resilience and the methods used in supervision and regulation.

The Banking Supervision Department is a member of international organizations and therefore is committed to fill out questionnaires that are used as the basis of surveys published by the organizations on various topics.

5. ACTIVITY TO INCREASE COMPETITION AND ENHANCE FAIRNESS

IN THE BANKING SYSTEM

During 2014, the Banking Supervision Department continued to work to encourage fairness in relations between the banking corporations and their customers, support competition within the banking system, and to strengthen the customer's negotiating position. The Banking Supervision Department accomplished this by means of the following: legislation and directives in the area of bank-customer relations, consumer education for bank customers, supervision of bank fees, investigating complaints and enquiries from the public and dealing with restricted accounts and restricted customers.

The Banking Supervision Department held a conference in 2014 on the protection of rights of banking service consumers and the manner in which public enquiries are dealt with. Participating in the conference were key employees in the banking system who deal directly with this issue.

a. Regulation of bank-customer relations

In 2014, the Banking Supervision Department continued to introduce Proper Conduct of Banking Business Directives and to publish circulars and letters within the banking system. It also took an active part in the promotion of legislation dealing with bank-customer relations. In addition, it presented the Bank of Israel's position to the Knesset committees and ministerial committees working on banking consumer issues. It also provided professional options regarding a large number of legislative proposals, some of which were enacted during 2014. In January 2015, the Banking Supervision Department published a report entitled "Regulatory Directives in Bank-Customer Relations for 2014" on its website.

(1) Recommendations of the Team to Examine Increasing Competition in the Banking System

During 2014, the Banking Supervision Department implemented most of the recommendations of the Team to Examine Increasing Competition in the Banking System. Following is a description of the implementation by section:

Support for Internet banking in order to leverage competition and remove barriers to switching banks:

This year, several steps were taken in this direction: 1) Debits by authorization: During 2014, the Banking Supervision Department published an amendment to Proper Banking Management Directive 439 "Debits by Authorization", which deals with the transfer of authorized debits when switching banks. The amendment is meant to remove barriers that existed until now and to simplify the process of switching banks for customers, by means of, among other things, eliminating the need to actually come to the bank branch. 2) Opening of an account through the Internet: The Banking Supervision Department published Proper Conduct of Banking Business Directive 418 "Opening of Bank Accounts via the Internet". The directive is meant to make it easier to switch banks in order to strengthen the bargaining power of the retail customer and thus increase competition in the banking system.

Banking "Identity Card":

The Banking Supervision Department issued published Proper Conduct of Banking Business Directive 425 "Annual Reports to Customers of the Banking Corporations" (Banking "Identity Card"). This directive specifies the obligation of the bank to report to consumers their total assets and liabilities, including their total income and expenses during the year. The annual reports are intended to improve the ability of customers to monitor the activity in their account and to compare various banking services and products. At this stage, the Directive does not include an obligation to include the customer's internal credit rating as set by the bank, since steps have not yet been taken in order to reduce the potential for exploiting this information. The Banking Supervision Department believes that providing information to customers regarding their internal credit rating is an essential component of the Banking Identity Card and contributes to closing the information gap between the banks and their customers.

Making it easier to switch banks and to close an account:

The Banking Supervision Department published an amendment to Proper Conduct of Banking Business Directive 432 "Transferring Activity and Closing a Customer's Account", with the goal of making it easier for customers to close their account or to transfer their activity from one bank to another. The amendment simplifies the steps necessary to accomplish this: it allows the new bank to carry out the steps needed to transfer an account on behalf of the customer; it shortens the processes involved in closing or transferring an account; it saves the customer unnecessary bother in completing these processes; and it establishes rules that will assist customers in exercising their choice to manage their banking activity, in part or in whole, at another bank.

Regulation of aspects of the nonbank credit market:

The Ministry of Justice published a memo to amend the Nonbank Loans Law, according to which the mechanism for calculating the interest rate ceiling will be calculated. In addition, the existing distinction between borrowers within the banking system and outside it will be eliminated and the new interest rate ceiling will apply to all borrowers in the market.

Activity of bank customers in securities:

The Banking Supervision Department published Proper Conduct of Banking Business Directive 414 “Disclosure of the Cost of Services in Securities”. The Directive requires the banks to offer their clients that have activity in securities, along with the fees that they actually pay, the average fee actually collected for similar transactions. In addition, the Directive requires that more detailed information on the fees actually paid by customers for securities activity be provided to them. The Directive went into effect on January 1, 2015.

The small business sector:

The group of small businesses that are eligible to benefit from the retail fee list was expanded, and steps were taken to achieve the following goals: 1) to increase the awareness of small businesses of their rights (for example by means of a requirement to provide a page of explanation that emphasizes the right to join the retail fee list and how to do so); 2) to make it easier to join the retail fee list (for example by submitting an annual report that proves a business’ status as a small business only once instead of each year); and 3) to reduce the cost of managing an account (by creating the expanded fee track).

Preserving benefits and discounts in credit and deposits:

Proper Conduct of Banking Business Directive 421 “Interest Rate Reduction or Increase” has gone into effect. It specifies that when the rate of interest on loans and deposits is not fixed and is not known, the same reduction/addition to the basic interest rate that applied when the loan was given or when the deposit was made will apply. This Directive is intended to make it easier for banking customers to compare banking services and products being offered to them.

(2) Other consumer issues

The Banking Supervision Department worked to regulate other areas of consumer concerns, which included the following:

Fee tracks:

An amendment was made to the Banking (Customer Service)(Fees) Rules, 5768-2008 which requires the banks to include a basic track and an expanded track as part of the services for the management of a checking account that they offer to their customers. The amendment went into effect in 2014. In addition, a supervisory order setting the maximum price of the basic track at NIS 10 went into effect.

Following are the prices of the basic and expanded fee tracks of the various banks.

	Hapoalim	Leumi	Discount	Mizrahi-Tefahot	First International	Union	Mercantile	Otzar Hahayal	Massad	Yahav	Pagi	Arab-Israel	Bank of Jerusalem
Basic track	10.0	10.0	9.0	9.0	9.0	10.0	8.5	10.0	10.0	10.0	9.0	10.0	0.0
Expanded track	22.0	20.0	25.0	29.0	26.0	24.0	26.5	27.0	30.0	20.0	29.0	20.0	0.0

The prices are denominated in NIS and are updated as of January 1st, 2015.

At the same time, an amendment to the Banking (Customer service)(Disclosure and submitting of documents) Rules, 5752-1992 went into effect. The amendment requires that when a customer requests to join a fee track, banks are to provide written information on the fee amounts that were collected from the customer during the quarter prior to the one that preceded the date of the request.

In order to increase the public's awareness of the aforementioned amendment and its ability to reduce the costs of managing an account, a radio campaign was carried out in 2014 on the subject of fee tracks. The campaign provided information on the tracks and also on the fee track calculator located on the Bank of Israel website, a tool that is meant to help customers check whether it is worthwhile for them to join a service, and if so, on which track.

Opening a checking account with a positive balance and its management:

Opening a bank account is a basic right and is essential to the management of a customer's financial life. Therefore, the Banking Supervision Department issued Directive no. 422 "Opening and Managing a Checking Account with no Credit Facility", which clarifies which services constitute an integral part of managing an account and in which cases the claim of reasonable refusal to opening a checking account with a positive balance will not be accepted.

Publishing of uniform contracts and announcement of the cancelation of benefits:

An amendment to the Banking (Customer Service)(Disclosure and submitting of documents) Rules, 5752-1992, imposed an obligation on the banks to publish uniform contracts on their websites, such as an agreement for the opening of a checking account. In addition, a requirement was imposed on the banks to inform certain customers two weeks ahead of time of the cancelation of a benefit that they had received on their account.

Nonbank benefits to customers:

An amendment to Directive 403 "Nonbanking Benefits to Customers" imposed limits on the banks in providing nonbank benefits. The amendment is meant to make it easier for customers to compare services and products offered by the banks and to prevent the binding of customers as a result of benefits they have received in their account.

Fee for early redemption of housing loans:

An amendment to the Banking (Early redemption fees) Order, 5762-2002 was issued. It deals with borrowers whom the banks defined—on the day the loan was given—as having a high level of risk and therefore set a relatively high level of interest. These borrowers will pay lower capitalization differentials in the case of early redemption: The calculation of this payment will not involve comparing the average interest rate in the mortgage market to the interest rate on their loan at the time it was provided but rather to the average interest rate on mortgages that was known at the time the loan was given.

Appendix A (regulatory table) includes additional information on these directives and on other consumer directives that were issued during 2014.

Box 2.3: Steps to Increase Competition in the Payment Card Field

The Bank of Israel is taking steps to increase competition and promote innovation and security in the use of payment cards. These include:

- Steps to expand the number of debit cards and their use;
- Steps to assimilate the Europay MasterCard Visa (EMV) standard, both by promoting the issue of such cards and through the integration of the technology that supports them at the points of sale (POS) at merchants;
- Steps to increase competition in merchant acquiring.

Following is a more detailed description of these measures:

Debit Cards

The Bank of Israel supports the expansion in the number of (immediate) debit cards and their use in order to achieve the following goals: to increase competition among payment cards; to reduce the use of cash and increase the accessibility of electronic means of payment to the general public; to expand the selection of payment solutions available to households and businesses; and to achieve potential cost savings for businesses (cash handling costs, financing costs and settlement fees) and for households (card fees and costs of withdrawing and holding cash).

The Ministerial Committee on the Cost of Living, Concentration and Competition in the Economy, headed by the Minister of the Economy, decided in April 2014 to request that the Bank of Israel examine a series of steps to increase competition in the use of payment cards, and in particular to expand the use of immediate debit transactions (transactions through a debit card or a prepaid card). The Supervisor of Banks and the Director of the Accounting, Payment and Settlement Systems Department appointed an interdepartmental work team for this purpose.

The work team recommended that the debit card should be introduced as a separate designated card, rather than a card that combines several methods of payment, so that cardholders will still be able to choose their preferred method of payment. In addition, the work team recommended that the effort to

increase the number of debit cards should be combined with a financial education campaign, directed at both consumers and businesses, which explains the features of the card and its uses. The financial education should emphasize the advantages of a debit card, i.e., lower costs (card fees and current-account costs) and the ability to continuously monitor household expenses. It should also emphasize the advantages of the card as a substitute for cash, including its accessibility and convenience (the card can be used at any time and there is no need to withdraw cash prior to a transaction), cost savings (the card does not involve a cost for day to day use, while there is a cost to withdrawing cash) and reduced risk (if the card is lost or stolen, it can be cancelled and any losses averted, in contrast to cash). The financial education can be combined with a public relations campaign aimed at reducing the use of cash.

In view of the work team's recommendations, the Bank of Israel took a number of steps to promote the use of debit transactions (which include, as noted, transactions with debit cards and prepaid cards).

- A draft order by the Governor was published declaring that the interchange fee on a debit transaction will be subject to supervision, in accordance with Sections 9k-9l of the Banking (Service to the Customer) Law, 5741-1981. The fee will be set at 0.3 percent¹ for a period of one year;
- The Banking Supervision Department established that a debit card will be viewed as a regularly offered banking product and will become an integral part of managing a current account;
- The Banking Supervision Department has prohibited charging a customer-executed transaction fee for use of a debit card;
- The Banking Supervision Department published a draft guideline that requires the banks to contact the owners of current accounts within a defined period of time in order to offer them a debit card. Customers who have a bank credit card will be able to receive a debit card without any additional card fee for at least the initial holding period (the first three years). In addition, the banks will be required to offer a debit card to any customer that opens a checking account;
- The Banking Supervision Department published a draft amendment to Proper Conduct of Banking Business Directive no. 470, specifying the dates for transfer of funds in a debit transaction so that the entire payment chain—from charging the cardholder until the crediting of the business—will occur close to the time the transaction takes place, and not later than three business days after its presentation. In addition, the amendment regulates that disclosure of debit transactions is to be included in the cardholder's current account statement (disclosure of each transaction separately, including date, amount and name of the business).

The steps to expand the use of debit card transactions will be carried out in parallel to the continued use of deferred debit cards, since they have certain advantages for households and businesses. The Bank of Israel will monitor the issuing of debit cards and their use, in order to determine whether additional steps are required.

¹ During this period, the powers of the Director General of the Israel Antitrust Authority to determine a separate interchange fee for debit transactions will be anchored in legislation, according to the draft Reducing the Use of Cash Law.

The Europay, MasterCard and Visa (EMV) Standard

Banking Supervision is promoting the adoption of the EMV standard, an accepted international standard to ensure the security of debit card transactions at point of sale terminals. The adoption of the standard is meant to, among other things, reduce the potential for fraud using magnetic cards (including forged and copied cards), strengthen the confidence of the public in debit cards, promote innovation in payments and encourage competition in the acquiring of debit card transactions. The use of EMV cards—“smart cards”—will also enable customers to use a card while abroad in accordance with international standards. Accordingly, the Banking Supervision Department has published a draft of an outline to assimilate the use of the EMV standard, which includes a transition to the issuing of smart cards and the replacement of points of sale and of ATM machines with terminals that support EMV (“smart terminals”).

Merchant acquiring

Amendment 18 to the Banking (Licensing) Law, 5741-1981 (August 2011) establishes that the Bank of Israel is responsible for the issue of acquiring licenses to entities that wish to be involved in the acquiring of debit card transactions. Following the amendment, the Banking Supervision Department worked together with the Accounting, Payments and Settlement Systems Department at the Bank of Israel to create an infrastructure for the entry of new merchant acquirers into the market.

In December 2013, the Banking Supervision Department published its policy with regard to the issue of an acquiring license, as well as the criteria and general conditions for the controlling shareholder in a corporation that is requesting an acquiring license. This policy includes a list of considerations that play a part in the decision of whether or not to grant a license, the standard requirements of a merchant acquirer, the processes included in the licensing, and the information required in order that a license request be considered.

In order to enable new acquirers to receive service from the payment card switch, the Banking Supervision Department is in the process of improving the technological systems of the Automated Banking Services Ltd. (Shva) company. In addition, the Banking Supervision Department is working to amend the Banking (Licensing) Law, 5741-1981 to enable the connection of licensed non-bank merchant acquirers to the payment card switch operated by Shva.

The Banking Supervision Department is currently reviewing the requests submitted for a merchant acquirer license.

The Banking Supervision Department is examining additional steps to increase competition in the area of acquiring, particularly the regulation of disclosure of acquisition services to businesses and regulating the date of transfer of funds between the issuer and the acquirer in deferred debit transactions.

b. Handling public enquiries and complaints

(1) Introduction

The Banking Supervision Department fulfills its role in maintaining fairness in the relations between banking corporations—the banks and credit card companies—and their customers primarily through the Bank–Customer Division.⁹ The Public Enquiries Unit operates within this division.¹⁰ Its role is to respond to customers' enquiries, investigate customers' complaints against banking corporations, and to derive lessons from the information obtained in handling complaints. This activity includes, among other things, deciding on complaints and providing suitable relief, detecting and handling systemic deficiencies, and providing information to the banks' customers in order to reduce the knowledge and information gaps between them and the banking corporations.

Another major function in handling customer complaints is the banking corporations. With the goal of ensuring that they provide appropriate handling of their customers' complaints, and suitably draw lessons from the information obtained from such handling, a new Proper Conduct of Banking Business Directive (308A) was established on the issue of handling customers' complaints at banking corporations. This directive came into force in April 2015, and it regulates the status and purviews of customer complaints representatives (ombudsmen) and their subordinates at banking corporation. Among other things, it establishes a time limit for providing answers and sets guidelines regarding their quality, for learning lessons from the handling, and for reporting to the board of directors, management, and the Banking Supervision Department. In addition, the directive establishes that a complaint is to be handled first by the banking corporation's complaints handling system. If this system does not deal appropriately with the complaint, or does not provide a response within the time limit, the Banking Supervision Department will investigate the issue.

(2) Handling public enquiries and complaints: general data

The total number of enquiries and complaints submitted in writing¹¹ by customers of the banking system, the handling of which was completed in 2014, was around 5,600, an increase of about 10 percent compared with 2013. In addition, about 20,000 phone enquiries were dealt with, a decline of about 5 percent from 2013.

In 2014, the Public Enquiries Unit dealt with 4,022 complaints. It formulated a judgement—that is, justified or not justified—on 1,602, in which the share of justified complaints was 15.8 percent. No position was taken regarding the remaining complaints, among other reasons due to the inability to decide between contradicting verbal claims, due to concurrent legal proceedings, or due to the bank's readiness to accede to the customer's request before the Banking Supervision Department took a position.

⁹ Other banking consumer protection activities are also carried out through the On-Site Audit Division of the Banking Supervision Department.

¹⁰ 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.

¹¹ Via regular mail and email, through the Bank of Israel website.

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

Table 2.1

Summary of Public Enquiry Unit's activity, 2014 compared with 2013

	2013	2014
Number of enquiries received by telephone	21,450	20,346
Number of enquiries and complaints received in writing <i>of which:</i>	5,067	5,555
Number of complaints ^a	1,549	4,022
Number of complaints on which a position was taken	1,131	1,602
Number of complaints found justified	251	253

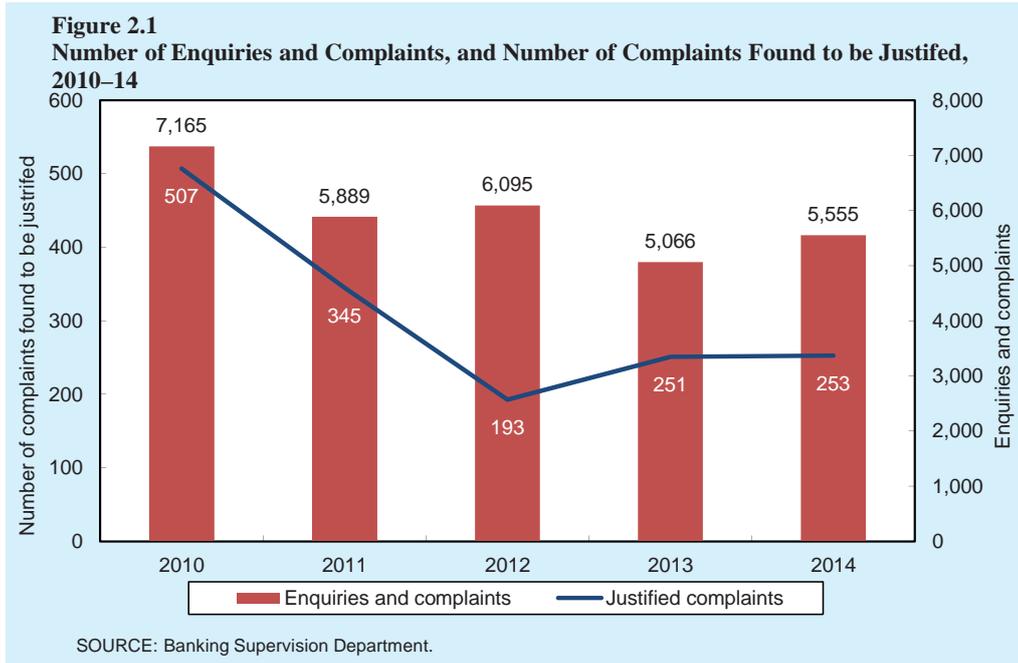
^a The increase in the number of complaints is explained primarily by the Public Enquiry Unit's switch, at the end of 2013, to a new system for handling enquiries, in which the classification methodology for enquiries and complaints, and decisions regarding them, was changed.

As Table 2.1 indicates, there were 253 justified complaints in 2014, similar to the 2013 figure. Table 2.2 refers to written enquiries and complaints, the handling of which was completed in 2014, and presents their distribution by the length of time spent in processing them. Telephone complaints are generally answered within one or two days and are not included in these data. More than 80 percent of the written enquiries and complaints were handled within 3 months. Sometimes, the handling of complaints takes longer, as clarification is needed from the banks or credit card companies. In complex cases, a number of clarifications are necessary in order to make a decision on a complaint. In contrast, enquiries regarding requests for information are answered shortly after they are received.

Table 2.2

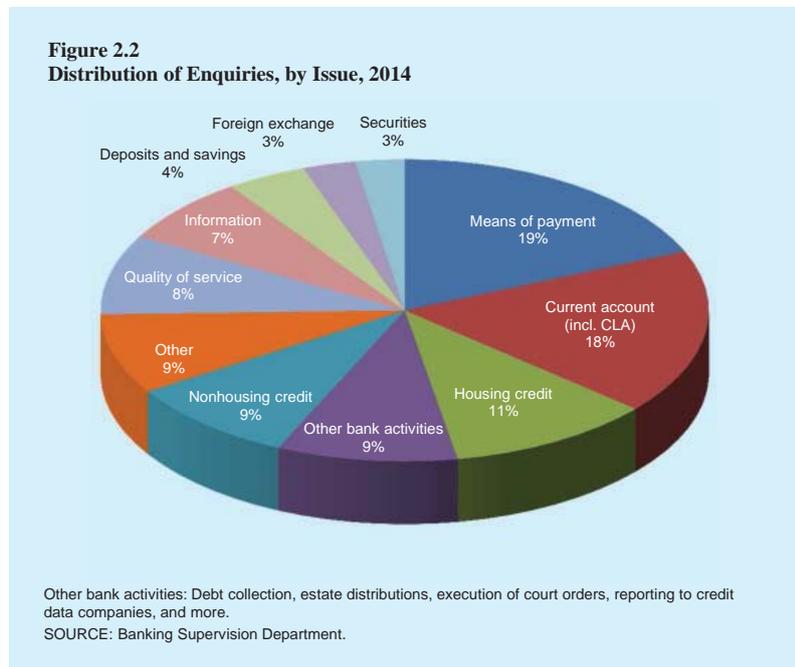
Enquiries and complaints in writing: Distribution of handling time

Up to 3 months	3–6 months	6-9 months	9-12 months	More than 12 months
81%	12%	5%	1%	1%



(3) The issues that were the subject of complaints

Most of the enquiries and complaints received in 2014, similar to result from 2013, were regarding means of payment (in particular checks and credit cards) and issues related to opening current accounts, and their management. The share of complaints regarding housing loans increased markedly in 2014, compared with their share in 2013 (7 percent).



c. Dealing with restricted accounts and customers

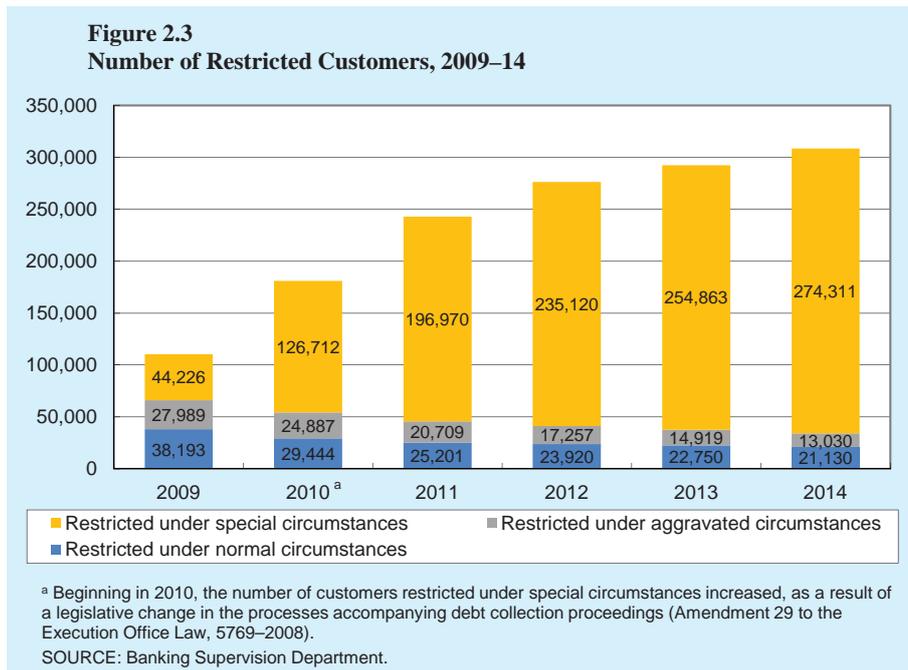
The issue is handled by the Restricted Accounts and Customers Section.

(1) The number of restricted customers and restricted accounts

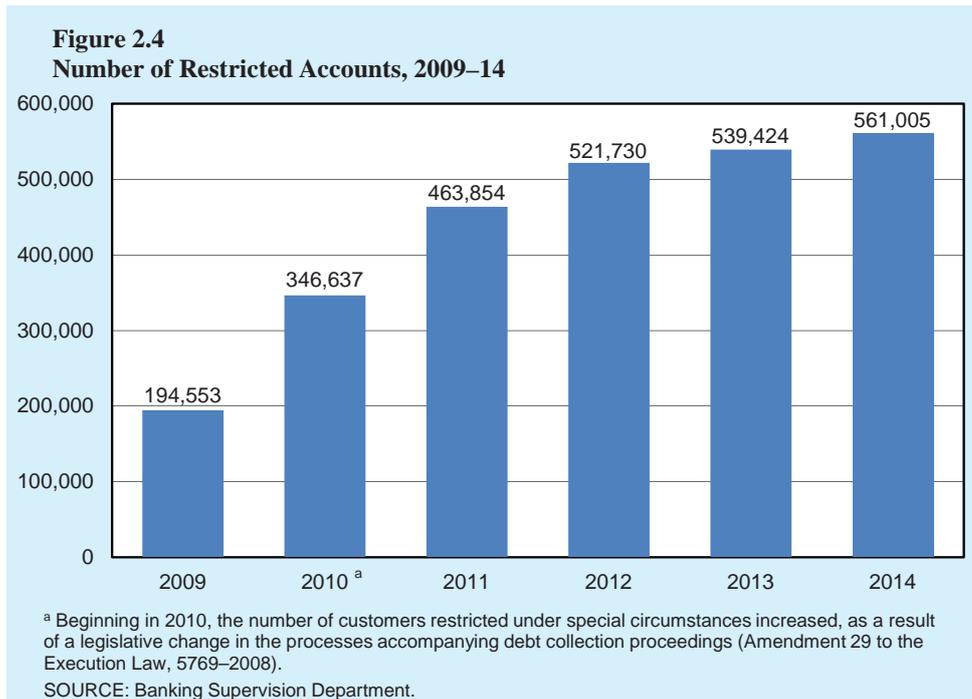
At the end of 2014, there were 308,471 restricted customers (compared with 292,532 at the end of 2013). Of those, 21,130 were restricted under regular circumstances (compared with 22,750 at the end of 2013), 13,030 were restricted under aggravated circumstances (compared with 14,919 at the end of 2013), and 274,311 were restricted under special circumstances (compared with 254,863 at the end of 2013). 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.)

There were 561,005 restricted accounts¹² at the end of 2014 (compared with 539,424 at the end of 2013), including 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. (See Figure 2.4.)

The number of restricted customers increased markedly beginning in 2009, as a result of an increase in the number of customers restricted under special circumstances in Execution Office debt collection proceedings (an increase that derived from a change in legislation dealing with processes related to debt collections through the Execution Office). However, in the past two years this trend has begun to moderate.



¹² The restricted accounts also include closed accounts.



(2) Enquiries and appeals of restrictions

Over the course of 2014, the Section handled about 4,000 written enquiries and answered about 16,500 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 propriety of a restriction be examined.

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

The public can also make use of the website and automated answering service for clarification of restricted accounts and of customers restricted under aggravated circumstances. In 2014, about 27,000 calls were received at the automated phone service, and there were about 402,000 visits to the Bank of Israel website's page for detecting restricted accounts.

(3) Legislative amendments in the area

Under certain circumstances, tax authorities are able to impose special restrictions on debtors, through the Center for the Collection of Fines, Fees and Expenses, by power of an amendment to the Enhanced Tax Collection and Increased Enforcement Law (Amendment No. 2), 5774-2014. The amendment came into effect on August 7, 2014.

(4) Easings for emergencies

During Operation Protective Edge, the Banking Supervision Department instructed banks to provide a series of easing measures to the public that manages accounts on the confrontation line. An expanded discussion appears in the section dealing with business continuity risks (Section 2.i).

The Minister of Justice also legislated amendments due to the Operation, under her authority based on Section 21(b) of the Checks Without Cover Law, 5741-1981:

- Checks Without Cover Amendments (Qualifications to the Law's Application), 5774-2014: The amendments instruct on the exclusion of checks¹³ to soldiers called to reserve duty under emergency situations or in connection with a special home-front situation. The amendments came into force on July 30, 2014.
- Checks Without Cover Amendments (Qualifications to the Law's Application), 5775-2014: The amendments refer to checks returned for insufficient coverage between July 8, 2014 and September 21, 2014, and they instruct on the exclusion of citizens who have a proven connection to municipalities located in the area declared a special home-front situation. The amendments came into force on October 26, 2014.

¹³ According to the law, an account will be restricted, and a customer will be restricted if during the course of the previous 10 years, ten or more checks drawn on the account were refused. The amendments discussed instruct to exclude from the tally checks that were refused under the circumstances described.

Appendix A: Regulatory Timeline for 2014

- January 28 **Amendment to Directive No. 304a “The External Auditor—Performing Audits and Reviews in Accordance with Certain US Standards”**
 A practice alert was published in the United States concerning audit considerations to be employed in auditing internal controls over financial reporting, and the Proper Conduct of Banking Business Directive No. 304a “The External Auditor—Performing Audits and Reviews in Accordance with Certain US Standards” was amended accordingly. The Directive is effective from the annual financial statements for the year 2013.
- February 10 **Amendment of Directive on Disclosure of Credit Card Companies’ Quality of Credit of Debts and Allowance for Credit Losses**
 In the United States, the disclosure requirements concerning the credit quality of debts and allowance for credit losses were revised, and the formulation of the note on credit card companies’ credit risks was revised accordingly. As part of this revision, a disclosure requirement was added regarding details that facilitate better understanding of credit card companies’ underlying risk with respect to consumer credit. The effective date of the majority of the revisions is the financial statements for the first quarter of 2014.
- March 26 **Publication of the Banking (Customer Service)(Supervision of the Basic Tracks Service) Order, 5774-2014**
 An amendment to Banking (Customer Service)(Fees) Rules, 5768-2008 requires banks to include a basic track and an extended track in the account management services they offer to their customers. The Supervision Order provides that the maximum fee for the basic track shall not exceed NIS 10. The effective date of the Supervision Order is April 1, 2014.
- April 2 **Publication of Directive No. 414 “Disclosure of the Cost of Services in Securities”**
 Proper Conduct of Banking Business Directive No. 414 “Disclosure of the Cost of Services in Securities” requires banks to present to customers who are engaged in activities involving securities the fees they are actually charged alongside the average fees charged in actuality for similar transactions. The Directive also requires banks to provide more detailed information on securities-related fees that banks effectively charged their customers. The effective date of this directive is January 1, 2015.

April 6 **Publication of the Supervisor's letter on preparations for implementing FATCA provisions**

The US government is expending efforts to prevent income tax evasion through bank accounts opened outside the United States. As part of its steps, the US Treasury Department set regulations to implement the provisions of the Foreign Account Tax Compliance Act (FATCA). The effective date of these provisions is July 1, 2014. Since these provisions may affect the banks in Israel, they were required to continue to prepare for such implementation. The banks were also required to appoint a person responsible for implementation and to establish work teams to coordinate implementation and report directly to a member of management.

April 9 **Amendment to the Directive on Employee Rights**

On substantive issues, the Banking Supervision Department adopts the financial reporting system that applies to US banks. As employee rights constitute one such issue, the Supervision adapted the requirements for recognition, measurement, and disclosure on this topic to US GAAP. The effective date of this Directive is January 1, 2015.

Amendment to the Directive on Credit Risks by Industry

The economy has been affected by structural changes, in response to which the Central Bureau of Statistics replaced the uniform classification of industries with a new classification system. The Reporting to the Public Directives were amended accordingly. The effective date of the amended directive is January 1, 2015.

Amendment to directive on reports of the external auditor

The Institute of Certified Public Accountants in Israel has issued a new auditing standard concerning the uniform format (unqualified opinion) of the report of the external auditor of financial statements, and the Reporting to the Public Directives were amended accordingly. The effective date of the amended directive is its publication date.

April 23 **Amendment to Directive No. 453 "Third Party Guarantees in Favor of a Banking Corporation"**

Amendment No. 19 to the Banking (Service to the Customer) Law, 5741-1981 defined and added obligations that banking corporations have toward customers when banks demand immediate repayment of a loan or take legal action when a customer fails to meet the terms of a loan. This amendment required adjustments concerning the dispatch of notices to guarantors, and therefore Proper Conduct of Banking Business Directive No. 453 "Third Party Guarantees in Favor of a Banking Corporation" was amended. The effective date of the amended directive is September 10, 2014.

May 26

Amendment to Directive No. 355 “Business Continuity Management”

Following a critical site protection survey of the banking system, Proper Conduct of Banking Business Directive No. 355 concerning business continuity management was amended. The amendment defines standards for securing such sites. The effective date of the amended directive is its publication date.

Publication of Directive No. 422 “Opening and Managing a Current Account with no Credit Facility”

Proper Conduct of Banking Business Directive No. 422 “Opening and Managing a Current Account with no Credit Facility” was designed to clarify the services that constitute an integral part of account management, and the circumstances under which claims of reasonable grounds for refusal to open a bank account are not accepted. The effective date of the provisions of this Directive is gradual, up to January 1, 2015.

July 6

Amendment to Directive No. 403 “Nonbanking Benefits to Customers”

The amendment to Directive No. 403 “Nonbanking Benefits to Customers” imposes on banking corporations restrictions on granting nonbanking benefits, in order to help customers compare the products and services offered by banking corporations and to prevent restrictions that bind customers as a result of such benefits. The effective date of the amended directive is January 1, 2015.

July 10

Amendment to Directive No. 312 “Related Parties”

The provisions of the Proper Conduct of Banking Business Directive were adapted to changes in the Banking (Licensing) Law, 5741-1981 and in the Banking Ordinance, 1941, and to the current directives in this area in the United States and Europe. As part of the amendment, Proper Conduct of Banking Business Directive No. 312 “Related Parties” was amended. The main amendments are:

- The criterion defining a related party was reduced from 10 percent to 5 percent holding in means of control in a banking corporation;
- The definition of “officers and their relatives” was expanded;
- The definition of “related parties” was extended to also include any person who holds any type of means of control in a corporation controlled by the banking corporation;
- Liabilities of related parties will be measured with respect to Tier I Capital rather than to the capital base.

The effective date of the amended directive is January 1, 2015.

July 15

Drafting of Directive No. 329 “Limitations on Issuing Housing Loans”

Letters published in recent years included guidelines and restrictions related to housing loans, and these were compiled in a new Proper Conduct of Banking Business Directive—Directive No. 329, “Limitations on Issuing Housing Loans.” Furthermore, the amount of a housing loan that may receive a reduced risk-weight according to Proper Conduct of Banking Business Directive No. 203 was limited to NIS 5 million. Loans in amounts exceeding NIS 5 million will be risk-weighted at 100 percent. The effective date of the directive is determined in each letter.

Publication of Directive No. 418 “Opening of Bank Accounts via the Internet”

Directive 418 “Opening of Bank Accounts via the Internet” was designed to facilitate customers’ transfers of accounts among banks in order to increase the competitive leverage of retail customers—households or small businesses—and to increase competition in the banking system. The directive described several restrictions in detail as well as the minimum criteria that were designed to address risks such as anti-money laundering and terrorism funding risks, and operational risks such as fraud and impersonation risks. The effective date of the directive is its publication date.

August 27

Amendment to the Banking (Early Repayment Fees) Order, 5762-2002

The Banking (Early Repayment Fees) Order, 5762-2002 deals with the fees that are charged when housing loans are repaid early. The amendment to the Order refers to borrowers whom the bank assessed (on the loan grant date) to be high-risk borrowers, and therefore granted the loan at a relatively high interest rate. Such borrowers will pay lower capitalization differentials when their loan is repaid early. The effective date of the revised order is February 23, 2015.

September 1

Amendment to Directive No. 439 “Debits by Authorization”

Proper Conduct of Banking Business Directive 439 “Debits by Authorization” regulates the process of establishing and transferring standing orders to charge bank accounts when customers transfer their accounts from one bank to another. The amendment was designed to remove currently existing obstacles, simplify the transfer of customers’ authorized debits, and prevent unnecessary inconvenience to customers by eliminating the need to physically appear at the branch, among other things. The effective date of the amended directive is October 1, 2015.

September 28

Amendment to Directive No. 329 “Limitations on Issuing Housing Loans”

- Proper Conduct of Banking Business Directive No. 329, “Limitations on Issuing Housing Loans”, was amended following previous changes in this area, with the aim of increasing the capital buffers that banks allocate against their housing credit portfolios, and improving banks’ resilience to withstand unexpected losses. The amendment provides that when calculating capital requirements pursuant to Proper Conduct of Banking Directive No. 201, banking corporations should increase their Common Equity Tier I Capital target by a rate that represents 1 percent of their outstanding housing loans. The effective date is gradual, in fixed quarterly rates beginning from January 1, 2015 and ending on January 1, 2017.
- It was also provided that banking corporations may reduce the risk-weight attributed to variable interest leveraged loans from 100 percent to 75 percent. The application date is January 1, 2015.

Publication of Directive No. 221 “Liquidity Coverage Ratio”

Basel III recommendations defined, among other things, a minimum liquidity standard with the aim of improving the short-term resilience of banking corporations’ liquidity risk profile. The standard requires banking corporations to hold an appropriate stock of unencumbered high-quality liquid assets—in other words, assets that can be easily and quickly converted into cash in private markets—to meet liquidity requirements for a 30-calendar-day liquidity stress scenario. Directive No. 221 adopts the Basel III recommendations regarding the liquidity coverage ratio for the banking system. The effective date of the directive is April 1, 2015.

Amendment to Directive No. 342 “Liquidity Risk”

Following the enactment of Proper Banking Conduct Directive No. 221 “Liquidity Coverage Ratio,” Proper Banking Conduct Directive No. 342 “Liquidity Risk” was adjusted with regard to foreign banks. The effective date of the amended directive is April 1, 2015.

Defining disclosure requirements related to liquidity coverage ratios

Following the enactment of Proper Banking Conduct Directive No. 221 “Liquidity Coverage Ratio,” Reporting to the Public directives were amended, and a Temporary Directive was established, adopting Basel III disclosure requirements. These requirements were designed to improve the transparency of the regulatory liquidity requirements, improve market discipline, and reduce market uncertainty regarding implementation of liquidity coverage ratios. The effective date of the amended directive is April 1, 2015.

- September 30 **Amendment to directive on reporting according to US GAAP regarding distinctions between liabilities and equity**
- On substantive issues, the Banking Supervision Department adopts the financial reporting system that applies to US banks. As the distinction between liabilities and equity is a substantive issue, it was decided to adapt the Reporting to the Public Directives to US GAAP. Furthermore, a series of Q&A documents was published to clarify the position of the Banking Supervision Department on this issue. The effective date of the amended directive is January 1, 2015.
- Publication of Directive No. 308A “Handling Customer Complaints”**
- Directive No. 308A “Handling Customer Complaints” was designed to ensure that banking corporations address customer complaints in a comprehensive, efficient, and fair manner, and draw the appropriate conclusions from the information contained in public complaints. The effective date of the directive is April 1, 2015.
- October 7 **Amendment to Banking (Customer Service)(Due Disclosure and Provision of Documents) Rules, 5752-1992**
- The amendment to Banking (Customer Service)(Due Disclosure and Provision of Documents) Rules, 5752-1992 provides that in any event in which a banking corporation is required to display information in its branches or in daily newspapers, it is required from now on to present said information also on its website;
- In any event in which an individual wishes to open a corporate bank account, the banking corporation is required to provide a term sheet explaining that businesses classified as “small businesses” may be charged according to the retail fee schedule;
 - In any event in which a customer wishes to join a tracks service, the banking corporation is required to provide to the customer, before his joining, written information on the fees that he was charged in the quarter preceding the quarter prior to the application date.
- The application date of the amended directive on joining a track is October 7, 2014; the effective date of the remaining amendments is November 6, 2014.
- November 3 **Amendment to directive on business activity segments**
- Due to the need to improve the possibility of comparing the activity segments of various banks, and to improve the usability of this information, the Reporting to the Public Directives were amended. In addition, a series of Q&As was published, clarifying the Banking Supervision Department’s position on this issue. The effective date of the amended directives is 2016. The application date of the transition provisions is 2015.

- November 19 **Publication of Directive No. 425 “Annual Reports to Customers of the Banking Corporations”**
Proper Banking Conduct Directive No. 425 “Annual Reports to Customers of the Banking Corporations” defines a banking corporation’s duty to report to its customers about all their assets and liabilities, including total income and expenses over the year. These annual reports are designed to improve customers’ ability to monitor the activity in their accounts and to compare various banking products and services. The effective date of the directive is February 28, 2016.
- November 23 **Amendment to Directive No. 311 “Credit Risk Management”**
Proper Banking Conduct Directive No. 311 “Credit Risk Management” was amended to reflect accumulated experience, as part of efforts to adapt the Proper Banking Conduct Directives to the recommendations of the Basel Committee on Banking Supervision, and to professional standards in the world’s leading countries. The effective date of the amended directive is April 1, 2014.
- November 25 **Amendment to Directive No. 325 “Management of Credit Facilities in Current Accounts”**
Proper Banking Conduct Directive No. 325 “Management of Credit Facilities in Current Accounts” was amended, and the main amendment concerns amounts overdrawn beyond credit facilities: In private accounts this amount will be increased to NIS 2,000 and in commercial accounts — to NIS 5,000. The effective date of the amended directive is January 1, 2015.
- December 15 **Amendment to Directive No. 432 “Transferring Activity and Closing a Customer’s Account”**
The amendment to Proper Banking Conduct Directive No. 432 “Transferring Activity and Closing a Customer’s Account” was designed to simplify, streamline, and shorten the procedure used to transfer a customer’s activity or close a customer’s account. The effective date of the amended directive is partly on January 1, 2015, partly on July 1, 2015, and partly on February 28, 2016.

December 30

Amendment to Banking (Customer Service)(Full Disclosure and Provision of Documents) Rules, 5752-1992

The additional amendment to Banking (Customer Service)(Full Disclosure and Provision of Documents) Rules, 5752-1992 includes adjustments to Proper Banking Conduct Directives Nos. 418 and 425. The amendment also imposes obligations on banking corporations to publish uniform contracts on their websites, and to notify certain customers two weeks in advance of the discontinuation of benefits that they received in their account. The effective date of the amended rules is partly on January 1, 2015, and partly on April 1, 2015.

Promoting steps to encourage refinancing or early repayment of government-backed mortgage loans granted to eligible borrowers

The Ministry of Construction and Housing, in conjunction with the Supervision of Banks, has advanced an initiative to encourage early repayment, or refinancing, of mortgage loans that the government granted to eligible borrowers. This move was designed to increase public awareness of the economic expediency of early repayment of loans—either using borrowers' own funds or by refinancing loans through loans granted by banking corporations—because such loans carry a relatively high CPI-indexed interest rate (4 percent or higher). The initiative was also designed to facilitate the refinancing procedure for individuals able to refinance, as it allows refinancing to be performed in a rapid procedure at market prices.

APPENDIX B: STRUCTURE OF THE BANKING SUPERVISION DEPARTMENT

a. The Off-Site Evaluation Division

The Division collates and compiles the Banking Supervision Department's periodic appraisals of the stability and management of the banking corporations, including auxiliary corporations, banking subsidiaries and overseas branches of the Israeli banks. The Division is also responsible for preparedness for business continuity during emergencies. Since the Banking Supervision Department serves as the banking financial authority, it is tasked with ensuring that the entities under the Bank of Israel's supervision during routine times—the commercial banks, credit card companies, Shva and Masav (automated clearing house)—operate during emergencies as well.

The Institutional Evaluation Units

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.¹⁴) 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 units are also responsible for the processing of enquiries from the banking corporations, and for ensuring that the banking corporations meet Supervisor of Banks requirements.

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 emergency preparedness—and with the operation during an actual emergency—of commercial banks, credit card companies, and Shva and Masav, all of which are essentially the entities supervised by the Bank of Israel in routine times.

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.

¹⁴ Supervisory Review and Evaluation Process.

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

Auditing activity is carried out via five auditing units, each of which specializes in a particular risk area:

(1) The Credit Risk Management Audit 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 and credit operations processes, control over these processes, 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 Audit 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 audits in the following areas: market risk (interest rate risks, indexation basis risk), 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. 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 that serve 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 Supervisor of Banks directives regarding market and liquidity risk management.

(3) The Operational Risk Management Audit Unit

The Unit's principal functions are to examine the banking corporation's operational risks and to assess the 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 Audit 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 Audit Unit

The Unit's principal function is to identify the functions and 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 department and the compliance officer.

c. The Policy and Regulation Division

The Division formulates directives for the regulation of supervisory policy, regulates banking activity, and draws up measurement, disclosure and reporting principles, while 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 regulatory arrangement of banking activity, mainly through formulating and revising Proper Conduct of Banking Business directives and Supervisor's circulars, 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 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. In addition, the Unit is responsible for establishing the standards for professional conduct and for the audits conducted by external auditors that review banking corporations.

(3) The Information and Reporting Unit

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

(4) 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 work teams and provides responses for various issues that are dealt with by the Banking Supervision Department.

d. The Bank-Customer Division

The Division is charged with promoting fairness in the relations between the banking corporations and their customers while protecting the rights of the banking consumer; enforcing bank-customer related legislation and directives; encouraging competition in the banking system; and increasing 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 (banks and credit card companies), and makes decisions regarding disputes that are presented to it. The information accrued from complaints helps to detect and remedy deficiencies at 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 the Supervisor of Banks' 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, as well as 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 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 organizations, and foreign banks, with the aim of increasing transparency to the global financial community and reducing the risk to the Israeli banking system.

f. 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 construction and application of training programs. The Supervisor's Office also coordinates meetings and prepares material for discussions with the Supervisor.

g. 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.

h. 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 National Information Security Authority.

The Bank of Israel's Banking Supervision Department

