



Jerusalem
January 12, 2016
16LM2211

To: **The banking corporations**
Attn: CEO

Re: Increasing operational efficiency of the banking system in Israel

Background

1. The changing economic, regulatory and technological environment of the banking system in Israel, including the entry of competitors into areas of banking activity, is likely to substantially impact demand and prices of banking services and, accordingly, the scope of the banking system's revenues.
2. An analysis of data on Israel's banking system and various performance indices indicate a low level of efficiency compared with banking systems in other advanced economies. As such, and in view of the environmental changes noted in Paragraph 1, the Banking Supervision Department considers processes of increasing efficiency as an important target for ensuring the long term stability of the banking corporations.
3. Accordingly, this letter presents the Banking Supervision Department's requirement to establish a multiyear plan for increasing efficiency. Alongside this requirement, the Banking Supervision Department will take certain steps, including those detailed below, in order to remove substantial barriers to implementing plans for increasing efficiency.

Requirement for long term increase in efficiency

4. A banking corporation's board of directors shall establish a **multiyear** plan for increasing efficiency (hereinafter, a "plan for increasing efficiency").
 - 4.1 The plan for increasing efficiency shall set specific activities for the period of the coming five years as well as principles for increasing efficiency over the longer term. The plan is to reflect a long term commitment to increasing efficiency and to active and ongoing expense management, in line with the current economic and technological environment.
 - 4.2 The plan for increasing efficiency shall include well-defined interim targets, at a frequency of at least yearly, and means for the board of directors to follow up and supervise the meeting of the plan and the interim targets.



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- 4.3 A banking corporation heading a banking group shall establish a plan for increasing efficiency that takes into account efficiency at the group level.
- 4.4 A banking corporation that has already established a plan for increasing efficiency shall examine the plan and update it, as necessary, in accordance with this letter.
5. It is the Banking Supervision Department's intention to define a format for periodic reporting on the plan for increasing efficiency to the Banking Supervision Department. The format will include reporting on interim targets and their attainment.

Banking Supervision Department steps to encourage plans for increasing efficiency

6. In order to encourage the implementation of a plan for increasing efficiency, the Banking Supervision Department shall authorize certain leniencies in capital adequacy for a banking corporation, as detailed in Paragraph 7 below, subject to meeting the following conditions:
- 6.1 The banking corporation has a plan for increasing efficiency that incorporates specific costs (costs that the banking corporation shall bear in order to carry out the multiyear plan, for example, due to a multiyear voluntary retirement plan or change in activity lines);
- 6.2 The banking corporation shows, to an extent that satisfies the Banking Supervision Department, that the leniencies will serve to carry out the plan for increasing efficiency and will not serve other purposes; and
- 6.3 The banking corporation meets the interim targets for increasing efficiency. A banking corporation that does not meet the interim targets shall not continue receiving the leniencies.

Capital adequacy

7. A banking corporation shall receive a deferment of the date for meeting capital adequacy targets as set for it by the Supervisor of Banks. The leniency shall be at the magnitude of the impact of the expected reduction in regulatory capital, at the time the plan is authorized, in respect of the costs defined as per Paragraph 6.1 above. The delay shall be for a period of five years and shall be amortized via the straight line method.

Accounting treatment of a long-term increase in efficiency that includes a voluntary retirement plan



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8. US accounting standards, which have been adopted for the Reporting to the Public Directives, define in which situations the effect of updating the liability for employees' rights is attributed to Other Comprehensive Income, and in which cases it is attributed to the Profit and Loss Statement. Accordingly, in many cases the banking corporation is to record the impact of updating the employees' pension and severance pay liabilities, resulting from the specific activities set in the plan for increasing efficiency over the coming five years and from principles of increasing efficiency over a longer period of time, as "actuarial profits and losses" attributed to Other Comprehensive Income.¹ These profits and losses will be attributed to the Profit and Loss Statement over the employees' average period of service.²
 9. A banking corporation is required to maintain a liability for employees' rights that reflects the estimate of excess grants that it expects to pay to its employees under the plan for increasing efficiency over the coming five years and in the longer term in the future. This estimate is often based on data regarding excess grants that were actually paid in the past, adjusted for the conditions at the time of the reporting. Despite the estimate of retirements over longer terms being based on actual past experience, adjusted to increasing efficiency principles set for a longer term, the banking corporation is not required to assume that the excess grants expected over the coming five years necessarily represent the excess grants expected in the longer term.

Period during which this letter is in force

10. The leniencies detailed in this letter shall apply to plans for increasing efficiency that will be authorized from the date of its publication through December 31, 2016.

Sincerely,

Dr. Hedva Ber
Supervisor of Banks

¹ As noted in Answer A8 of the Frequently Asked Questions file, in cases in which there is a doubt regarding the manner of attribution according to US accepted accounting standards, the head of Banking Supervision Department's Financial Reporting Unit should be approached for receiving advance guidance.

² As explained in Answer A4 of the Frequently Asked Questions file on the issue of employee benefits.