



**Bank of Israel**  
**Banking Supervision Department**  
**The Economics Unit**

# **ISRAEL'S BANKING SYSTEM**

**ANNUAL SURVEY 2020**

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## Letter from the Supervisor of Banks, Banking Supervision Department Survey for 2020

In 2020, there were numerous significant health, civil, and economic challenges. The COVID-19 pandemic, the first reports of its global outbreak having arrived already at the end of 2019, began to spread strongly in Israel toward the end of the first quarter of 2020, causing an extensive crisis and considerable uncertainty with regard to its possible effects and manners of dealing with it. The COVID-19 crisis found Israel's banking system robust with capital surpluses and liquidity and prepared for dealing with a high intensity crisis in terms of business and operational continuity. However, the difficulty in assessing the length of the coronavirus crisis and its expected impact created notable complication in the manner of dealing with it and required taking unprecedented steps by many functions in the economy, including from the Bank of Israel. The first half of 2020 reflected the shocks in the economy and the concerns about the development of the crisis, reflected among the banks by high credit loss allowances and among customers by preferring liquid assets—among other things, by notable use of bank credit lines while selling securities portfolios and depositing the redemptions in the banks, which over many years have a reputation for stability. With the outbreak of the crisis, the Banking Supervision Department examined all the tools available to it and began to use them in order to prevent an adverse impact on the supply of credit in the economy and to allow the continued sound activity and provision of services for households and the business sector, alongside maintaining the stability of the banking system. The steps taken by the Banking Supervision Department, as detailed comprehensively in this report, were numerous, varied, and in some cases unprecedented in Israel's banking system.

**Banking regulation worldwide is intended first and foremost to protect the public's deposits, and thus focuses on the stability of the banking system.** Such stability is attained by the implementation of a series of requirements for creating tools that will enable the banks to maintain their stability in routine times and in crises. The business cycle incorporates economic crises and at times even crises of high intensity and **therefore at the base of the fundamental approach of banking regulation is the need to prepare the system appropriately for crises.** In years preceding the crisis, and among other things due to the lessons of the 2008 crisis, the banking system in Israel, guided by the Banking Supervision Department, improved its risk management system, increased its capital and liquidity buffers, scrubbed the credit portfolio and adopted additional means intended to strengthen its resilience and to prepare it for a crisis, including steps to strengthen business and operational continuity abilities. An additional step intended to improve the banking system's preparedness for a crisis is the stress tests that the Banking Supervision Department has been conducting for more than a decade. Within the framework of these tests, the banks are required to analyze how a crisis scenario is expected to impact them, and the Banking Supervision Department learned from the outcomes about the various banks' focal points of vulnerability and worked to formulate, with their help, regulatory tools intended to reduce the adverse impact expected from those main vulnerabilities.

On this strong base, the Banking Supervision Department decided, with the outbreak of the crisis, to reduce some of the regulatory requirements in order to allow the expansion of the supply of credit to the public, to reduce to the extent possible the negative impact on borrowers who encountered difficulties and to make it possible to receive banking services, despite the significant limitations that derived from the health situation, all without, of course, risking the stability of the banking system in Israel.

The rapid outbreak of the coronavirus and the special features of the COVID-19 crisis, led without warning or advance preparations to the complete halt in the operating activities (such as lockdowns, human resources, inventory, remote work infrastructure) of many businesses, together with a halt in their financial/economic activities. Accordingly, we were of the view that expanding the credit supply would be expected to reduce the credit risk in the existing bank portfolio, as it would provide borrowers with “breathing space” for preparing for activity in the new reality and with the informed hope that with the removal of health limitations, the economy would return to activity that would enable them to meet credit payments going forward. Thus, the Bank of Israel adopted a long list of measures including the reduction of capital requirements of banks, extending monetary loans to the banking system for providing credit to the small business sector, and more. Moreover, within this framework and in order to assist households and small and micro businesses that encountered cash flow difficulties as a result of the crisis, **the Banking Supervision Department formulated several frameworks that were adopted by the banking system and the credit card companies for deferring loan payments**, out of the informed assessment that assisting borrowers at this time will help them rebuild, as well as to return with the improvement in the economic situation and repay their loans in the future. This approach has proven itself and a large majority of borrowers who deferred their repayments have already gone back to making the regular loan payments. In addition, and in order to prevent loans building up and economic deterioration, clarifications were given regarding bank processes for collecting the loans, according to which they were required to identify as early as possible customers in economic difficulties and to assist them to get through the challenging period in which they find themselves. Alongside that, it was decided to suspend and cancel the restrictions on bank accounts due to checks refused in view of the expectation that the economic ramifications of the coronavirus crisis will lead to the refusal of many checks, which would lead to placing strict sanctions on many businesses and individuals who were not able to forecast the extent of the crisis and its length. These sanctions, which are intended to maintain the payment ethic in routine times, are liable to impose a significant negative economic impact on many businesses and individuals and to markedly reduce the possibility of their economic rehabilitation when the crisis ends.

The Banking Supervision Department works vis-à-vis the banking system in a range of ways and rapidly in order to ensure that it continues to provide its customers a range of banking services in a valid and continuous manner, among other things by expanding the options for conducting banking activities remotely and reducing costs during this period. The banking system in general has a central role in financial intermediation and in promoting economic activity in the country. This includes the orderly functioning of the payment and settlement systems, the provision of banking services to the public, and the importance of maintaining the public’s confidence in the system and its reputation. The COVID-19 crisis clarified the importance of the business and operational continuity of the banks and even led to an acceleration of the processes and the advancement of developments in order to ensure the stability of the banking system and the compliance with the required service targets.

**The Bank of Israel took many additional steps in order to assist households and businesses to endure the crisis and to continue driving the economy.** It did so by using a broad range of monetary tools with the goal of dealing with liquidity difficulties that adversely impacted the banking system due to the COVID-19 crisis, to ensure the orderly functioning of the financial markets, to ease credit terms in the economy and to support economic activity and financial stability.

**The steps taken for the good of the public throughout the coronavirus crisis are part of a broader regulatory approach, which views banking consumer protection and the strengthening of the public’s confidence in the banking system as a notable target of the Banking Supervision Department.** The Banking Supervision Department therefore takes regulatory initiatives with the goal of protecting the

customers, it carries out examinations and a range of controls in the banking system while implementing enforcement steps against the corporations that violated the guidelines, it provides a response to public enquiries in a broad range of banking issues and works to enhance the public's financial awareness through promoting the accessibility and transparency of banking information to the consumer public.

**Alongside the handling of the COVID-19 crisis and its ramifications, the Banking Supervision Department continued to act to achieve its other goals, including the promotion of competition in the banking system.** In recent years there have been big changes in the economic environment, in which financial system in general, and Israel's banking system in particular, operate. Technological developments allow new financial technological initiatives in a wide range of areas, including digital wallets and payments, led by many entities, including the big tech companies that were not previously involved in the Israeli financial market. These major changes, among other things, serve as a catalyst for changes in consumption habits and are in line with the changes occurring in any case in preferences of customers, who today are more interested than in the past in consuming financial and banking products remotely and via digital means, while improving the consumer experience. These changes encourage the banks to continue and develop products in order to remain important participants in this sphere.

**This year, alongside the technological developments and their ramifications, several significant milestones for encouraging competition were reached, after years of extensive staff work that is still continuing.** The first stage in the open banking project (API) went into effect in the banking system in April 2021 after several years of preparation. This step is expected to leverage customer-information assets through receiving value propositions by, among others, granting the possibility to third party providers to be competition enhancing entities, mainly in retail credit in the short term and from broader banking and financial perspectives in the medium to long terms. The establishment of the banking-automation computer services bureau should also be noted, after several years in which the Ministry of Finance in collaboration with the Bank of Israel have been promoting a solution for the barrier to competition that automation infrastructures pose, identified as a major block that weighs on the entry of new banks into the financial system. Removing this barrier, alongside numerous other barriers, was essentially one of the milestones that allowed the establishment of the first digital bank, the first new bank added to the banking system in Israel in 40 years and that is expected to open its digital doors to the public in the last quarter of 2021. This is alongside the examination of the entry of new participants into the banking system at this time as well. The Banking Supervision Department continues, besides this, to promote the project of switching between banks “with one click”—a system for online transferring of current accounts, which is expected to go live in September 2021, and continues as part of the current routine for examining additional ways to promote competition and transparency for customers in all activity segments of the banks.

**The importance of the processes to increase efficiency that the banks have been undergoing in recent years and that are being carried out in addition to the processes to enhance competition noted above, part of which involve financial technologies that will benefit customers, is considerable, because the increased competition of the banking system is a necessary step in dealing with changes in the business environment.** It can be seen that the various steps taken by the banking system in recent years have in fact made an impact and alongside the continued growth and support for economic activity the banking system has succeeded in reducing its operating expenses. These steps to increase efficiency even enabled the banks to absorb higher credit losses during the COVID-19 crisis, with a more moderate negative impact on their profits.

Housing credit, which can be given special consideration and that grew sharply due to the increase in the number of housing transactions in general, and in the maturity of numerous projects in the “Buyer’s Price” program in particular, this year is a main focal point for growth in the banking system. The low interest rate environment that has been in place for several years contributes as well to some extent to the increase in the rate of mortgage refinancings. These developments put the issue of housing credit regulation at the center of the Banking Supervision Department’s activity, examining from time to time the changes required in view of developments in the housing market and in the macroeconomic environment. Thus it was decided this year to remove the “prime component” limitation on mortgage, leaving just the limitation on the variable rate component. Cancelling the limitation grants the public more flexibility in establishing the composition of the loan, in accordance with the tastes and risk tolerance of each borrower and even contributes to reducing, to some extent, the average interest rate imposed on borrowers. Alongside that, and in view of the importance of the mortgage product to the representative household, we at the Banking Supervision Department continue to examine activities to make it more accessible and to simplify this product with the goal of improving the understanding of the product by households and improving the ability to compete.

Looking forward, I note that when I entered this position, I decided to set an additional goal for the work of the Banking Supervision Department—**to strengthen the role and activity of the banking system in Israel’s socioeconomic fabric**, through the “conscious capitalism” approach, at the center of which is the examining of the interests and needs of all stakeholders and striving for an equal society that is blessed with social and economic resilience. Within this framework we will work for the banking system in Israel to be influential and responsible. This is a significant challenge of especially large scope. Within the framework of this goal, the Banking Supervision Department works and will work to strengthen the financial inclusion in all population groups. It encourages the involvement of the banking system in various issues in the community and promotes various activities among different communities with the goal of providing financial and digital literacy and education. We also strive to act to strengthen the aspects of gender equality in the banking system, all through the approach of banking that is initiative, responsible and impactful.

**Environmental and climate risks**, in terms of their financial aspects and as part of impactful banking and corporate responsibility, are an additional issue the regulation of which we have begun to promote and that we intend to continue advancing in the coming years. Global awareness of the existence of environmental risks and their impact on economic and financial activity has been increasing in recent years. In particular, there is growing concern related to risks deriving from climate changes, among other things in view of climate events occurring worldwide and in view of scientific data illustrating the scope of climate risks and the great urgency in dealing with them. The banking corporations are among the entities exposed to significant environmental risks. **The Banking Supervision Department attributes great importance to handling environment and climate risks from the financial perspective, as a complementary step to implementing government policy in this area, within the framework of our joining the Paris Agreement, so we intend to broaden our activity in this area.** The Banking Supervision Department decided in particular to formulate up to date and comprehensive regulation on the issue, which is expected to be based on principles of regulation accepted worldwide, with the required adjustments for the domestic environment.

As regulators responsible for the banking system and credit card companies in Israel, we were required in view of the COVID-19 pandemic and we continue to be required, in view of the challenging economic, political, and security environment in which we are living, to act with determination, originality, and professionalism in order to lead our banking system to be a significant pillar in the promotion of our economy in particular, and our country in general. Technological developments, the expansion of digitization, the rise of technological

platforms and companies alongside changes in methods and features of consumption, the distribution of products and services—on their own each one is a significant business challenge alongside which there are very important regulatory changes. These are challenges facing the Banking Supervision Department, which is required to lead the modernizing market together with the traditional market and formulate its prolonged and proper activity while maintaining the stability of the banking system and the general consuming public.

Sincerely,

Yair Avidan

A handwritten signature in black ink that reads "Yair". The letter "Y" is tall and has a long, sweeping horizontal stroke that extends to the right, crossing over the "a" and "i".

Supervisor of Banks

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