

**Fintech Conference South Korea, August 2023**

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**Speech by Daniel Hahiashvili, Supervisor of Banks, Bank of Israel**

Distinguish guests,

It is a great honor to speak at this important conference.

Coming from what is known as “The startup nation”, I would like to share with you how the Bank of Israel and its Banking Supervision Department operate in this ecosystem, encouraging and supporting innovation and the development of the fintech market.

I'll begin with a few facts about the nature of the high-tech market in Israel and its significance to Israel's economy, which could explain our country's leadership in the area:

* 17 percent of Israel's GDP was generated by high-tech companies.
* 40 percent of the business GDP growth in the last 5 years is related to the high-tech sector.
* 56 percent of Israeli exports were attributed to high-tech companies.
* 12 percent of Israeli employees worked in high-tech sector, while 25 percent of all income tax is paid by high-tech employees.
* And according to OECD data, Israel continues to lead the world in R&D investment as a percentage of GDP, and was the first to cross the 5 percent threshold (2019), at 5.4 percent. South Korea, by the way, came in second at 4.8 percent.

Zooming in from high-tech to fintech, the Israeli fintech scene is a vibrant sector composed of nearly 500 fintech companies spreading across a variety of financial fields: trading, payments, enterprise solutions, anti-fraud, insur-etech, lending, and personal management. Fintech leads as one of three fields that has attracted the majority of investment in recent years (along with cyber and enterprise software).  Funding reached 8 billion dollars in 2021, decreased significantly to 3 billion dollars in 2022, and continued to decline in the first half of 2023, a dip similar to market behavior around the world. Going forward, we can see a slight improvement though it may bel too early to tell.

So, how do we, as a regulator, fit into the ecosystem that I've described and encourage innovation? We began by setting strategic goals that can be put in four main building blocks:

First, we recognized the importance of technological changes as the basis of an innovative ecosystem, and realized that as a regulator we have to ensure that we are open to accepting such changes at the banks and in the overall financial system. We established an Innovation and Technology Division at the Banking Supervision Department, with the clear goal of encouraging innovation in the banking system. Within this framework, we encouraged the banking system to upgrade its core systems and to promote digital transformation. In recent years we have undergone a significant shift and as of 2022, about 90 percent of total household activity is executed via direct means, with only 10 percent is in person at branches.

The second point of focus has been on the significance of information and its use in developing the ecosystem.  We have made open banking and open finance strategic targets for further development, basing our work on models built in Europe (the PSD2) and in the UK, and even expanding the financial information that is open to third parties.  In Israel, information sources (like banks) are required to share information not only on transactions in customers’ accounts, but also information on credit, deposits, and securities held by customers. "Open banking" project went into effect nearly a year ago, and there are already approximately 20 entities providing services based on it.  We expect to see it entrenching and promoting advanced business models and increasing opportunities for competition as time progresses.

Third, we understood the importance of collaboration between banks and fintechs, where the mutual knowledge transfer between the sectors creates value for both. For example, most fintechs are based on cloud computing. Thus, as the regulator of banks, we need to think how we can assist with transitioning the traditional financial sector into a more cloud oriented one, in order to enhance collaboration between fintech and traditional players. In addition, we introduced a Supervisory Letter to the banking system encouraging them to cooperate with fintechs, to create their own sandbox, and even to increase their appetite for risk.

Last, we have decided to take an active part in projects that establish the infrastructure for innovation and competition. Open banking was of course one such project. Beyond its described advantages, I see it as an infrastructure project, as fintechs prefer to work via API, which is cheaper, faster and more efficient. Our open banking project in Israel requires banks to share their data with third parties via APIs, leading them to enhance communication with fintechs by speaking the same language.

Another project in which we've been deeply involved is the switching banks “with a click” initiative. This project essentially enables bank customers in Israel to switch from one bank to another rapidly and efficiently on a third party built infrastructure. This includes transferring balances, authorized debits in the account and on credit cards, and more.

An additional infrastructure-based project is the Central Bank Digital Currency (CBDC) project. During our work on it, we have examined whether the central bank should issue currencies to the public in a digital format as well as the standard physical format.

Like all central banks of advanced economies, the Bank of Israel has not yet made a decision regarding that issue, but we began studying the issue several years ago and during the last year, we have begun to work on a relatively detailed design of the digital shekel, so it can be issued as soon as possible once a decision its benefits outweigh its risk is made. Our design work is accompanied by technological experimentation. We've recently been fortunate to carry this out as part of an international project fostered by the BIS Innovation Hub—in Project Icebreaker, in collaboration with the central banks of Norway and Sweden, and in Project Sela, alongside with the Hong Kong Monetary Authority.

A digital shekel can increase competition, contribute to the innovation and redundancy of the payments system, and may allow cheaper and more efficient cross-border payments. Yet, another advantage is that it motivates private sector initiatives in this field, for example, tokenization, in a way that some of the mentioned benefits can be achieved through private sector.

In conclusion, as regulators or policy makers we can tremendously influence the development of financial services, its level of innovation—and no less important— its safety. As new technologies such as AI, quantum computing, DLT and biometric, become more present in our lives, our role as regulators to enable the transformation becomes more crucial.

Thank you and I wish you all an interesting and successful conference, and allow me to invite you all to visit the Israeli booth to see some of the innovation I just spoke about.