

Introduction – The Supervisor of Banks



The past year has proven to be one of the most complex and challenging periods that the State of Israel has faced in recent decades, including in the economic-financial domain. The year began with significant changes in the economic environment, which was marked by rising inflation and the resulting rise in interest rates. Combined with a tense public and political atmosphere, they had a major impact on the banking system and the implementation of the Banking Supervision Department's strategy. The year continued with the events of October 7 and the subsequent Swords of Iron War, which heightened the geopolitical uncertainty. The resilience and stability of the Israeli economy, which in the past had shown a high capacity for recovery, enabled the economy to adapt to changing conditions and show signs of recovery once again, with the banking

system playing a central role. As demonstrated at the onset of the war, the banking system successfully maintained operational continuity and supported the public considerably by extending assistance to customers affected by the war and by continuing to meet the credit demands of the economy. These roles are crucial during the ongoing war and will be equally important in the expected recovery phase to follow.

The Banking Supervision Department also responded immediately with the outbreak of the war by implementing a series of measures aimed at addressing the various challenges faced by the banking system. The initial focus was on ensuring the continuity of business operations and the providing of services by the system to the public. Banking corporations were instructed to act with sensitivity toward customers and to intensify the monitoring and management of operational and financial risks. Among the measures taken by the Banking Supervision Department, some of which are still having an impact, are: the issuing of guidelines for the operation of bank branches, establishing an emergency help desk in the Banking Supervision Department, presenting plans and assistance measures to deal with various consumer issues, implementing loan payment deferral arrangements, issuing stability-related guidelines to the banking system, and others.

Geopolitical tensions, combined with macroeconomic changes and global developments, have led to an increase in financial risk in the economy, as reflected in the recent decisions of international rating agencies. Examples are the enormous impact of technological advancements and social networks, which was illustrated when the customers of several US banks sought to simultaneously withdraw their money, leading to the collapse of those banks in a surprisingly short time. These factors, combined with changes in the operating environment and evolving public preferences, prompted the Banking Supervision Department to reassess its strategy and goals for coming years. The vision of the Banking Supervision Department has also been redefined, and in coming years it will focus on **"promoting the public good by maintaining the stability and fairness of the banking system through professional, cutting-edge, and transparent supervision."**

Based on these considerations, strategic focuses were decided on, and the Banking Supervision Department's work plan for coming years was updated accordingly. This plan seeks to address both current and future challenges, ensuring that the banking system remains stable, equitable, and competitive in a rapidly changing world.

The stability of the banking system is primarily reflected in the protection of depositors' funds and the assurance of continuous service provision. This stability is essential for the system's role as an efficient mechanism for credit allocation in the economy and as an essential tool for the transmission of the Bank of Israel's monetary policy in both normal and emergency situations. To maintain this stability, we will focus on closely monitoring emerging risks, such as those in the construction and real estate sectors. We will also examine scenarios and conduct stress tests, develop tools to address potential failure events among the banks, assess the capital structure and capital adequacy ratios, and review the implications of technological advancements, including in the field of artificial intelligence, which require risk-adjusted regulatory approaches, among other measures.

The stability of the banking system is deeply intertwined with the public's trust in it. To maintain and enhance this trust, **it is essential for the banking system to operate fairly toward its customers,** alongside ensuring stability and financial strength. We at the Banking Supervision Department believe that fostering a fair and impactful organizational culture is the foundation for providing high-quality and fair services. Based on this belief, we are committed to continuing to improve the level of service that banks provide to their customers by increasing service accessibility to the general public, adapting services to customer needs, and pricing them fairly. This ongoing effort is crucial for maintaining public trust, which has a direct impact on the stability of the system.

The Banking Supervision Department is also promoting several measures in the realm of competition, such as increasing data transparency for the public through the "Equator" tool on the Bank of Israel's website, publishing comparative data on deposits, etc. **One of the steps currently being formulated by the Banking Supervision Department, which touches on the competitive infrastructure of the banking market, involves the possibility for nonbanking entities that wish to do so to engage in activities currently permitted only to banks, namely accepting deposits to be used for providing credit.** To this end, the Banking Supervision Department has issued a call for public input on the planned framework currently being formulated. **As a prerequisite, these entities will be required to operate under a banking license,** even if in a different format from the existing one, and under the stability supervision of the Banking Supervision Department. In this way, the public can benefit from increased competition while depositors' funds continue to be protected and the stability of the banking system is maintained, in accordance with the standards set by the Banking Supervision Department over the years.

Taking a comprehensive look at 2023, the year began with the continuation of the trend of increasing interest rates, aimed at curbing inflation that had surged following the exit from the COVID-19 crisis. The increase in the Bank of Israel's interest rate to 4.75 percent in a relatively short period, and particularly its maintenance at this relatively high level, impacted both the profitability of the banking system and the repayment capacity of the public, thereby affecting the risk profile of the banking portfolio. Additionally, the banking system has in recent years experienced changes in the business and technological environment, along with shifts in public preferences and regulations, some of which have significantly influenced the system's structure, the entities involved, and the nature and range of products and services offered to the public.

During the past year, the Israeli banking system continued its transition to digital services. Traditional activities that used to take place within the walls of a bank branch are now mostly conducted through direct means—via mobile apps and websites. The unbundling of banking products and services allows them to

be offered to customers across a wide range of online platforms and channels, using advanced, innovative, and value-adding technologies. Banking services that were once the exclusive domain of banks are now also provided to the public by technology companies and nonbank service providers, thanks in part to the launch of the Open Banking project. Although the scope of these services is still limited compared to the total services provided by banks, we expect that with the maturing of the various steps taken by the Banking Supervision Department to promote competition, some of them will be expanded, and the range of products offered by data companies will grow. **These changes and developments pose a significant challenge to the existing banking business model but also offer an opportunity to integrate partnerships, diversify income sources, and update and upgrade the current operating model.**

At the same time, these changes expose the system to new risks and the intensification of existing ones. For example, collaborations with third parties, as well as technological developments that use extensive data or advanced technologies, including artificial intelligence, intensify challenges in the realms of data usability and leveraging of data to create value while protecting data privacy and security. Providing services through advanced technologies also exposes the system to nontechnological risks, such as compliance risk in the realm of digital currencies or fairness to the customer risk. The Banking Supervision Department monitors these developments and changes, while examining their potential impact on the banking system, the risks they entail, and the need for appropriate regulation.

This survey seeks to inform the general public about the current supervisory policy and the main steps and activities being promoted by the Banking Supervision Department, including those initiated in 2023, with the goal of implementing its long-term strategy. The survey also presents an analysis of the activities, developments, risks, and opportunities facing the banking system in Israel. Looking ahead, the banking system is expected to continue dealing with uncertainty in 2024 due to the ongoing war and its effects, as well as with additional challenges and risks that may arise. The Banking Supervision Department will continue, as always, to ensure a robust and stable banking system that is equitable, advanced, and innovative for its customers, capable of adapting to changes and developments in the financial and technological world, and will continue to support the growth of the Israeli economy.

On this occasion, I would like to express my deep appreciation for the employees of the Banking Supervision Department for their diligent work in normal periods and their extraordinary contribution during the challenging emergency we are experiencing. You are demonstrating that the flame of public service burns within you, and for that, you have my gratitude.

I will conclude my remarks by expressing my condolences to the families of the fallen in this conflict, my wishes for the recovery of the wounded, and my prayers for the safe return of the hostages and our soldiers fighting bravely on all fronts.

Sincerely,

A handwritten signature in black ink, appearing to read 'Daniel Hahashvili', enclosed within a faint, light-colored oval border.

Daniel Hahashvili
Supervisor of Banks