



Banking Supervision Department

# **Supervisory Policy on Anti-Money Laundering and Countering the Financing of Terrorism**

July 2022

### A word from the Supervisor of Banks

The Banking Supervision Department recognizes the importance of monitoring and thwarting channels of money laundering and financing of terrorism, as an integral part of the ongoing national effort to foil money laundering, economic crime and terror operations.

The Banking Supervision Department acts to maintain the stability and international reputation of the Israeli banking system. In this context, the Banking Supervision Department acts alongside and in collaboration with law enforcement and security forces in Israel. It uses diverse tools that are available to it in order to provide the banking system with better tools to deal with this risk, and requires the integration and implementation of strict, cautious policy with regard to money laundering and terrorism financing risks, emphasizing the effectiveness of management, control and monitoring systems.

Management of money laundering and terror financing risks is high on the supervisory priority list. The Banking Supervision Department applies a risk-based approach, focused on areas assessed as carrying high risk, and on phenomena that may result in increased potential risk.

Technological and digital developments, the ever-changing operating environment and changing client preferences and types of financial services have created a reality in which money laundering and terror financing patterns are growing ever more sophisticated. This reality has led the Banking Supervision Department to act and to adapt the regulatory and enforcement framework with regard to AML and terror financing in view of current and emerging risk.

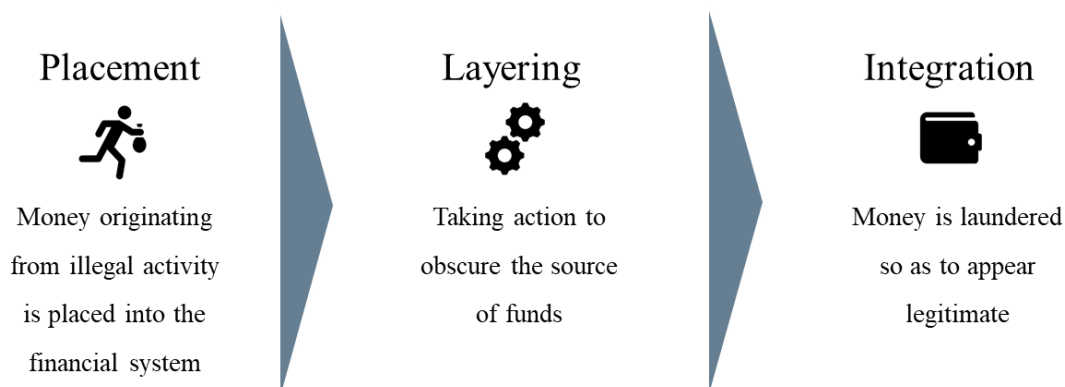
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## 1. Background

Money laundering (ML) consists of a transaction involving assets originating from illegal activity ("Predicate Offences") designed to hide or disguise the source of such assets, the identity of beneficial owners thereof and its location, by assimilating it within legal assets. Predicate Offenses are a closed list of offenses listed in the First Addendum to the Prohibition on Money Laundering Law, 5760-2000 (hereinafter, "the Law")

Generally, ML is a three-stage process:



In recent years, recognition of the importance of monitoring and thwarting terror financing channels, as part of the on-going effort to foil terror operations, has grown due to the understanding that any terror organization requires sources of financing to fund and to carry out their operations and objectives.

Terror financing and money laundering share similar attributes, but unlike money laundering, which is designed to present a legal source for funds originating from illegal activity, with terror financing the source of funds may be legitimate, such as charitable donations, but the intended use of these funds is to support and carry out terror activity, whether directly or indirectly.

The international fight against proliferation and financing of weapons of mass destruction, or means for its proliferation, include *inter alia* promoting the immediate application of economic sanctions on entities that proliferate and finance weapons of mass destruction in certain countries and on those entities that assist them, as declared by the UN Security Council, such as North Korea and Iran.

In 2018, the FATF (Financial Action Task Force) decided to include Israel in this organization. In conformity with international requirements, and as part of the mutual evaluation process applied to Israel prior to joining the organization, a national risk assessment was conducted in the Israeli financial system. It was designed to delineate those financial operations that generate anti-money laundering and countering the financing of terrorism (AML-CFT) risks, to identify and to understand the inherent risk therein and to review the work processes, controls and measures applied in this regard.

Findings of this risk assessment were intended to form the basis for setting national policy and priorities with regard to the prohibition on money laundering and the financing of terrorism. They form the basis for implementation of a risk-based approach by the Banking Supervision Department for risk management, assisting in efficient resource allocation for effective mitigation and management of identified risk. In conformity with FATF requirements, the aforementioned national risk assessment was revised in 2020.

## 2. Legal framework in Israel

In order to comply with the normative framework specified by the FATF, statutory provisions were enacted to govern the AML-CFT regime in Israel. Below is an overview of the primary statutory framework in this field that is relevant for the banking system:

<b>Prohibition on Money Laundering Law, 5760–2000</b>	The purpose of the Law is to govern policy on action to fight money laundering that is appropriate for the current reality in Israel, by providing operational tools and harnessing financial institutions to co-operate with law enforcement authorities in this fight. The Law is based on international standards specified by FATF. Due to the Law, regulations and ordinances have been enacted to help in application of the guidelines and principles of the Law.
<b>The Counter-Terrorism Law, 5776-2016<sup>1</sup></b>	The purpose of the Law is to provide State authorities with appropriate criminal and public law tools to address the terror threats facing the State of Israel. The Law was designed to place Israel at the front with countries that fight international terror and terrorism financing, and to ensure that Israeli legislation is up to international standards specified in this regard.
<b>Prohibition of Distribution and Financing of Weapons of Mass Destruction Law, 2018</b>	The Law is designed to prevent proliferation and financing of weapons of mass destruction, including through application of sanctions imposed by the UN Security Council on entities involved in proliferation and financing of weapons of mass destruction, as well as on entities that assist in such proliferation and financing, all as part of the international fight against such proliferation and financing.
<b>Combating the Iranian Nuclear Program Law, 2012</b>	The Law is designed to impose sanctions on entities that help Iran promote its nuclear program, or obtain weapons of mass destruction, or means of carrying weapons of mass destruction, and to apply restrictions on corporations that conduct business relations with Iran, for Iran or on Iranian territory, all as part of the international effort to combat Iran's nuclear program.

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<sup>1</sup> This Act supersedes the Prevention of Terrorism Ordinance, 1948 and the Prohibition of Financing Terrorism Law, 5765 – 2005.

<b>Prohibition on Money Laundering (The Banking Corporations' Requirement regarding Identification, Reporting, and Record-Keeping for the Prevention of Money Laundering and the Financing of Terrorism) Order, 5761–2001</b>	The AML Order was enacted pursuant to the AML Act and stipulates, <i>inter alia</i> , mandatory identification, reporting and record maintenance applicable to banking corporations.
<b>Proper Conduct of Banking Business Directive 411 "Management of Anti-Money Laundering and Countering Financing of Terrorism Risks" (hereinafter: "Directive 411")<sup>2</sup></b>	The Directive is a risk management directive that governs, <i>inter alia</i> , directives for identification, risk assessment and operational steps to mitigate AML-CFT risks for the banking system based, <i>inter alia</i> , on international standards specified by FATF in this regard.
<b>Proper Conduct of Banking Business Directive 308 "Compliance and the compliance function in a banking corporation" (hereinafter: "Directive 308")</b>	The Directive covers compliance risk management and the compliance function in the banking corporation and defines, <i>inter alia</i> , the roles of the function in the banking corporation that is responsible for compliance risk management based, <i>inter alia</i> , on statutory provisions with regard to AML and CFT.
<b>Proper Conduct of Banking Business</b>	This directive stipulates basic principles for risk management and control from an integrated corporate-wide viewpoint, to

<sup>2</sup> Proper Conduct of Banking Business Directives – pursuant to Section 5 of the Banking Order, the Supervisor of Banks may issue directives with regard to operation and management of a banking corporation to ensure the proper management thereof.

<b>Directive 310 "Risk Management"</b>	improve the capacity of banking corporations to optimally identify and manage risk, so as to be properly reflected in bank activities, in assessment of capital adequacy and in decision making processes.
<b>Q&amp;A files on the implementation of the Order and Directive 411</b>	Q&A files published from time to time by the Banking Supervision Department include clarifications and position statements issued in response to issues raised by banking corporations, with regard to implementation of the Order and Directive, and reflect the position and binding interpretation of the Supervisor of Banks with respect to the Order and Directive.



### 3. Supervisory authority

Supervisory authority over banking corporations, including with respect to AML-CFT, is conferred, in conformity with Section 5 of the Banking Ordinance, on the Supervisor of Banks, who is appointed by the Governor of the Bank of Israel. Moreover, Section 7 of the Prohibition on Money Laundering Law stipulates that in order to enforce the Act, the Governor of the Bank of Israel shall issue a directive listing mandatory identification, reporting and record maintenance obligations applicable to banking corporations.

Pursuant to this authority, the Banking Supervision Department (BSD) applies diverse tools available to it, in order to ensure effective application of the AML-CFT regime in banking corporations.

The Banking Supervision Department is responsible for supervision of how banking corporations apply the AML-CFT regime through, *inter alia*:

1. Preventive actions – Action taken in advance to mitigate risk or deficiencies in supervised corporations:
  - Regulation – Issuing directives and guidelines of the Supervisor of Banks.<sup>3</sup>
  - Licensing – Granting licenses and Approvals as required by law, while determining conditions in the licenses and approvals.
  - Granting of advance approvals – Such as approval of office for Compliance Officer (Fit & Proper). In this context, the Banking Supervision Department structures and demands the strengthening of control systems and gatekeeping functions at supervised corporations.
2. Supervisory actions – In order to identify deficiencies, the Banking Supervision Department takes monitoring, testing and examination actions in order to identify and assess, as early as possible, current and emerging risk and to require the banking corporation to mitigate it.
3. Enforcement actions – Including application of enforcement measures to ensure compliance with supervisory requirements.<sup>4</sup>

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<sup>3</sup> Proper Conduct of Banking Business Directives, Q&A files to provide clarification of various issues encountered in the course of application of the Order and Proper Conduct of Banking Business Directives, and supervisory letters on a wide range of matters.

<sup>4</sup> Supervision, correction and Enforcement Actions Policy, January 2022.

#### 4. Risk-based approach

The Banking Supervision Department role of financial regulator requires it to act effectively on a regular basis to identify risks, assess them and set priorities for addressing them, based on the principle of "Risk-based supervision". Supervisory resources are allocated, first and foremost, to addressing material risk, based on an independent, professional risk assessment that is revised from time to time, as opposed to assessment of bank compliance with technical rules. This principle is a critical one for operations of the Banking Supervision Department and for achieving its objectives—it is designed to focus the Supervisor's limited resources on addressing key risks of the banking system's expanding activities.

As required by FATF, the Banking Supervision Department has formulated an assessment for rating the risk for major focal points of risk, both current and emerging, to which the banking system is exposed with respect to AML-CFT. Moreover, in conformity with FATF standards, the supervisors are required to prepare a specific risk assessment of AML-CFT risks for the corporations they supervise. Accordingly, the Banking Supervision Department has created methodology adapted to the unique attributes of AML-CFT risks. This methodology is derived from a comprehensive supervisory methodology based on assessment of inherent risk, quality of risk management and residual risk. The Banking Supervision Department conducts such risk assessment on group basis.

The risk assessment serves, *inter alia*, as basis for setting priorities, while applying a risk-based approach to risk management and efficient resource allocation for effective mitigation and management of the risks identified.

According to the core principles and the manner conduct of the world's leading regulators, the optimal tool for fulfilling the supervisory functions, besides strengthening the corporate governance and gatekeepers in supervised corporations, is ongoing supervisory activity including, *inter alia*, regulatory proceedings through formulating a regulatory framework based on the international standard, enabling early and rapid intervention aimed at to effectively and quickly reducing the risk to the supervised corporation. Supervisory activities are derived from an comprehensive risk assessment process of the quality of AML-CFT risk management and current and emerging risk concentrations identified in this regard, at the banking system level and at the individual bank level.

The Banking Supervision Department sees great importance in high-quality co-operation with Government and law enforcement, as integral part of promoting the public interest in fighting money laundering and terror financing, and as part of the Banking Supervision Department responsibility to prevent use of the banking system for money laundering and terror financing.

## 5. Supervisory roles and objectives

The primary role of the Banking Supervision Department in fighting money laundering and terror financing is to examine the appropriateness of compliance by the banking system with directives, as part of application of the AML-CFT regime, and formulating a regulatory framework in conformity with the international standard. In this context, the Banking Supervision Department applies its diverse tools to review the organizational compliance culture and appropriateness of resource allocation, to monitor the implementation of high-quality controls and monitoring systems in the banking system, in conformity with the risk level and to issue regulatory directives in this field.

The Banking Supervision Department has specified multiple objectives in order to carry out its primary role in combatting money laundering and terrorism financing in the most efficient manner:

- Develop and maintain good understanding of ML-TF risks, at the entire banking system as well as entity level, based on risk assessment of inherent risk and the quality of risk management in the banking sector and by each supervised entity.
- Adapt the regulatory framework with regard to AML-CFT, as applicable to the banking system in Israel, to changes in international standards, by making the required adaptations and in conformity with changes in the business and technological operating environment.
- Direct supervisory focus to the higher or emerging money laundering and terror financing risk, taking appropriate steps to efficiently address low risks, without impacting unnecessarily on access to and usage of financial services.
- Monitors the evolving risk environment and stays agile to identify emerging risks and respond promptly.
- Promote an effective AML-CFT policy in the banking system in place and where issues are identified, providing targeted guidance and feedback, supervise remedial action and apply enforcement authority in a manner that is deterrent and proportionate to the context and to the nature of the circumstances. Note, in this regard, that the Banking Supervision Department has access to diverse tools and measures in order to identify and remedy deficiencies and to impose applicable sanctions based on identified deficiencies and gaps. These measures include, *inter alia*, requiring deficiencies to be remedied, imposing capital-based sanctions, imposing personal sanctions and imposing monetary sanctions. The supervisory methodology with regard to policy on supervisory, remedial and enforcement measures was made public on the Banking Supervision Department website on January 11, 2022. This methodology describes how the Banking Supervision Department acts to ensure that deficiencies are actually remedied and the various enforcement tools at its disposal.
- Equipping with expertise, powers, discretion, tools needed and adequately resourced to perform its functions.
- Coordinate with other competent authorities when relevant, including the Israel Money Laundering and Terror Financing Prohibition Authority, the National

Bureau for Counter Terror Financing of Israel, the Israel Police, other regulators and foreign counterparts, including by sharing information.

## 6. Supervisory work plan and tools

The Banking Supervision Department applies optimal international standards in its work, as applied by leading regulators worldwide.

In order to carry out its roles and responsibilities, and in conformity with FATF requirements, the Banking Supervision Department shall specify a supervisory work plan to be based on AML-CFT risk assessment in conformity with a risk-based approach. Thus, the work plans of the various supervisory divisions involved in AML-CFT shall focus on at-risk entities and activities.

When deciding on the tools to be applied by the various BSD divisions for the purpose of supervising on AML-CFT risks in the banking system, the following principles shall be taken into consideration:

<b>Outcome focused</b>	<b>Risk appropriateness</b>	<b>Efficiency</b>	<b>Dynamism and responsiveness</b>
			
The tools selected shall be oriented towards achievement of targets and objectives specified by the Banking Supervision Department	The type and intensity of tools to an entity should be aligned with the supervisor's understanding of the nature and level of risks of the entity	In selecting the most suitable tool, supervisors should consider the type of resources that are available. Supervisors should ensure that the tool chosen is the most efficient means of achieving the supervisor's objective	Supervisors should be prepared to respond to identified emerging risks in an agile manner, including changes in the business, technological and legal environment, while amending their supervisory strategy and plans to address such risks

The supervisory work is to be conducted with regular adjustments of work methods, based on risk identified as follows:

- Focus on the management of higher risks associated with particular products or services or on specific aspects of the AML/CFT processes, by using appropriate supervisory tools, such as: examinations, interviews, visits to the bank and applying regulatory proceedings.
- Adjusting the frequency and duration of the supervisory engagement to the identified risk level.
- Adjusting the type, scope and depth of supervisory scrutiny to the identified risk level.
- Appropriate resource allocation to ensure the needed experience and skillsets are allocated to assess the identified risk.

Efficient supervision system involve a spectrum of activities and supervisory tools. The Banking Supervision Department shall use the diverse tools available to it, in conformity with risk type and level as identified by the Banking Supervision Department, including adopting one or more or combinations of these tools.

For details of the various supervisory tools, see Box A below.

#### **Box A: Supervisory tools**

##### **1. Requests for information**

Regular or ad-hoc requests to entities for qualitative and quantitative information relating to key AML risk indicators and general information about the entity and the nature and scope of their activities.

##### **2. Engagements with the Board and Senior Management**

Regular engagements with the Board and Senior Management of supervised entities, particularly those that are systemically important.

##### **3. Surveillance of emerging risk and trends**

Identification of key risk trends through mechanisms such as engagements with other regulators, mining of system-wide risk-relevant data, conversations with regulated entities and ongoing news monitoring.

##### **4. Use of Questionnaires**

The questionnaires could encompass various aspects entities' risk management controls, including the governance framework in place, updates on relevant policies and procedures and robustness of controls execution.

##### **5. Review adequacy of Board and management reporting**

Assessment of robustness of the entities' governance structure and framework of the entities, and adequacy of AML reporting to Board and Management, as indication of the risk culture of the entity. The reviews could be done on site or off site.

##### **6. Review of policy and procedures**

Assessment of the sufficiency and effectiveness of entities' policy and procedures in mitigating AML risks.

##### **7. Conducting interviews**

Interviews with staff of various functions enable the supervisors to assess the level of understanding and ability of employees of the regulated entity to effectively identify and mitigate ML risk through the execution of controls. Discussions with the Board and senior management of the entity allow the supervisors to assess their capability, risk-awareness and approach towards ML risks, and to and get a sense of the tone from the top. In turn, interviews with staff executing the controls allow the

supervisors to assess the actual implementation of directives, to ensure alignment of the working level risk culture with the tone set by the Board and management..

#### **8. Review of internal and external audit reports**

Identify any potential areas of weakness in regulated entities, for further supervisory engagements. The reviews could be done on site or off site.

#### **9. Conducting entity-specific reviews**

The supervisory work plan is arranged in linewith the overall assessment process of the quality of ML-TF risk management and the risk concentrations identified in this regard. This process takes into consideration, *inter alia*: findings of testing or examinations (on site), documents received from banks, reviews conducted at Banking Supervision Department offices and discussions with bank management (off site), periodic reporting to the Banking Supervision Department, focal points of risk identified during risk assessment of the banking system by FATF and by the Israel Money Laundering and Terror Financing Prohibition Authority.

#### **10. Conducting examinations and broad reviews**

Thematicreviews are performed on a number of entities, often from the same sector, focusing on one or a few specific aspects of the entities' AML systems and controls.

#### **11. Tracking of rectification of lapses identified in past inspections**

Monitoring if past observed weaknesses have been satisfactorily remediated in a timely manner, and if additional supervisory actions may be warranted.

#### **12. Interfaces with Government, enforcement and private sector entities**

Conduct outreach activities to convey supervisory expectations to entities, and to increase awareness of AML-CFT risk among supervised entities. Furthermore, discussions are held with Government, enforcement and private sector entities regarding material issues in this area. These interfaces may include workshops, training, forums, round tables or periodic engagement with relevant entities in the industry.

#### **13. Supervisory policy regulation**

Conducting supervisory policy regulatory activities with regard to AML and CFT, by issuing Proper Conduct of Banking Business Directives, Q&A files and supervisory letters. The regulatory process for Proper Conduct of Banking Business Directives includes professional discussions with relevant stakeholders in the banking system, consulting with the Israel Money Laundering and Terror Financing Prohibition Authority and soliciting comments from the public.

The Banking Supervision Department and all divisions thereof shall act to implement this document, and each division, in its assigned field, is an integral part of assisting in realizing supervisory objectives with respect to the fight against money laundering and terror financing:

<b>Onsite Examination Division</b>	<p>This Division consists of subject matter experts, who conduct examination processes at banking corporations and credit card companies, applying a risk-based approach in order to identify and assess any risk inherent in various activities and compliance with laws, directives, requirements and guidelines of the Supervisor of Banks. In this context, testing is conducted with regard, <i>inter alia</i>, to functioning of management, control and corporate governance functions, and actions are taken to ensure that any deficiencies and weaknesses are remedied. Moreover, as experts in various areas, the Division provides a response for ongoing professional issues, upon request from the Supervisor or from other divisions, acts to identify and prevent the development of systemic risk, assists in regulation in their areas of expertise and in assessment of banking corporation stability. Testing conducted by the Division is aligned with the specific circumstances, and therefore includes a wide range of tests, with different intensity, at one bank or at multiple banks or across the entire system, on a specific topic, subject to a risk-based approach and to efficient resource allocation.</p>
<b>Policy and Regulation Division</b>	<p>This Division consists of subject matter experts with extensive professional knowledge, who are responsible for formulating directives as part of setting supervisory policy regarding current and emerging risk to which the banking system is exposed, including AML-CFT risk; for providing professional interpretation of such directives by issuing Q&amp;A files and by promoting legislation and publication of supervisory letters on a diverse range of issues related to AML and CFT; moreover, subject matter experts in this Division regulate banking activity by formulating rules for measurement, identification and reporting, and analyze risk evolution in banking operations. The subject matter experts for AML and CFT regulate the banking system through regulatory directives aligned with international standards issued by leading supervisory authorities, and monitor changes in the business- and technological operating environment and changes to client preferences, making the required changes to supervisory directives in this area.</p>
<b>Offsite Institutional Evaluation Division</b>	<p>This Division is entrusted with ongoing risk assessment, formulating periodic assessments of the stability and management of banking corporations, and assessment of the capital adequacy maintained by supervised corporations in view of their overall risk profile, all on a group basis. The risk</p>



	<p>assessment process is conducted using a risk-based approach and with reference to all risk factors, including AML risk. This assessment is used, <i>inter alia</i>, to focus current activities, to allocate resources to risk concentrations, to identify any negative, unusual developments in activity and risk to which banking corporations are exposed, and thereby to take corrective action as soon as practicable.</p>
<b>Bank-Customer Division</b>	<p>This Division acts to integrate a fair, inclusive and effective culture towards clients, and to protect the rights of banking consumers by simplifying banking products and making them accessible, increasing transparency of the banking system, promoting competition, protecting customer rights and promoting the rights of special demographics, initiating measures to improve service to the public—providing optimal service to the public and increasing transparency of actions taken by the Division and promoting digital banking—support for transition of consumers to digital channels, while setting appropriate protective measures.</p>
<b>Technology and Innovation Division</b>	<p>This Division is engaged in diverse areas related to technology, cyber and innovation, including implementation of supervisory methodologies along with promoting innovation in financial activity in general, and in banking activity specifically. The Division's strategic focal points include: transition to fully digital operations at banks, development of the payment domain, leading infrastructure projects to promote innovation (such as Open Banking) and infrastructure for regulatory enforcement (assessment and examination) in areas of technology, cyber and innovation, and technology regulation (removal of barriers to introduction of advanced technologies and technological and cyber aspects). Along with Division activities to promote innovation in financial technology among supervised entities, the Division is involved with, and often leads regulation related to AML and terror financing issues, jointly with the Compliance Section.</p>
<b>International Affairs Unit</b>	<p>The International Affairs Unit reports directly to the Supervisor of Banks and acts to improve supervisory understanding and capabilities and to incorporate forward-looking viewpoints in the process of setting supervisory policy. The Unit is tasked with bringing about cooperation with international bodies and with financial supervisory authorities around the world and is tasked with identification and analysis of trends and developments in global banking,</p>

which may impact the Israeli banking system. In this regard, the Unit handles Home-Host relations with foreign supervisory authorities, as recommended by the Basel Committee and as required by formal agreements signed with these authorities; the Unit represents the Banking Supervision Department in forums convened by international bodies; acts to enhance transparency of supervisory work vis-à-vis the public and the global financial community; maintains relations with local and global rating agencies; represents the Banking Supervision Department position at professional work meetings with various entities and supports the work of the Banking Supervision Department and setting supervisory policy, by reviewing professional literature, monitoring publications of international bodies, reviewing developments and changes in global banking; and reviewing best practices put in place by leading financial regulators around the world.

#### **Licensing and New Banks Unit**

The Unit handles applications which require, by law, a permit or license from the Governor of the Bank of Israel or from the Supervisor of Banks. Activities of this Unit include, *inter alia*, review of applications for establishing new banks and settlement providers, review of applicants for controlling or holding means of control over banking corporations and acquirers; conducting Fit & Proper review of officers of banking corporations; branch permits; license for operations of foreign banks in Israel; consent of the Governor to use of the word "bank" (mostly for representatives of foreign banks). With regard to the fight against money laundering and terror financing, note that the considerations evaluated for issuing a license to a new bank, as well as permits to control and to hold means of control, include the integrity of holders of means of control, Board members and managers of the applicant. Furthermore, the Supervisor may object to appointment of an officer at a banking corporation due, *inter alia*, to considerations regarding the candidate's integrity.