

Chapter 6

The Banking System and the Activities of the Banking Supervision Department

Much of the work of the Banking Supervision Department relates to controlling the exposure of banking corporations to existing and expected risks in the banking system and maintaining the propriety of bank-customer relations. In 1999 the Department dealt with the following subjects in addition to its routine activities: continued preparation to avoid the Millennium Bug problem; examining the eligibility of groups of candidates wishing to purchase controlling interests in banks; and the effect of technology on the banking system and on its regulation.

Advances and innovations in technology, computers, and communications which enable service to be provided from afar have affected the structure of the banking system for several years. In 1999 the banks extended the range of services they provided via the internet, and began offering online services related to deposits and securities trading. This was made possible after the Supervisor of Banks extended the permit covering this activity at the beginning of the year so that it included the performance of transactions in customers' accounts. Assimilation of technological changes is quite a lengthy process, and the reduction in the number of branches and staff which occurred in 1999 is likely to be the start of a trend expected to continue in the future.

In the last few years there has been lively activity by foreign representative offices and investment banks, mainly in the areas of securities, underwriting, and distribution services. Foreign commercial banks also expanded their activity in Israel in 1999, and two of them officially announced that they intended to open branches in Israel in the second half of 2000.

1. INTRODUCTION

This chapter is divided into two sections: the first reviews the main developments which have affected the banking system during the last few years. The second describes the Supervision Department's handling of matters for which the Supervisor of Banks is responsible, the main ones being regulation of the banking system, bank-customer relations, information and reporting by the banking corporations, research on practical banking topics, and inspection and evaluation of the activity of the banking corporations. The Department's activities relating to the payments system, checks without cover, and banks' activity during emergencies are also described.

2. CHANGES IN THE STRUCTURE OF THE BANKING SYSTEM

General

The number of banking corporations in Israel has remained unchanged at 45 since 1996 (Table 6.1). Their composition has changed, however, as a result of mergers of small banks owned by the banking groups with their parent banks, and the closure of specialized

Table 6.1
The Structure of the Banking System, 1980–99

	Banking corporations ^a	Commercial banks ^b	Mortgage banks	Investment finance banks	Other banking corporations ^c
1980	63	30	16	8	9
1990	58	26	9	8	15
1995	46	24	9	2	11 ^d
1996	45	24	9	1	11
1997	45	23	8	1	12
1998	45	24	8	1	12
1999 ^e	45	23	8	1	13

^a Includes commercial banks, a foreign bank, mortgage banks, merchant banks, investment finance banks, financial institutions, and joint service companies.

^b Includes a foreign bank, investment finance banks, banks in the Palestinian Authority, credit cooperatives, joint service companies, and financial institutions.

^c In 1998, Bank of Jerusalem changed from a financial institution into a commercial bank.

^d In December 1995, banking supervision authority over banks in the Palestinian Authority was transferred to the Palestine Monetary Authority. These banks are included in the data in the table up to 1994, but not thereafter.

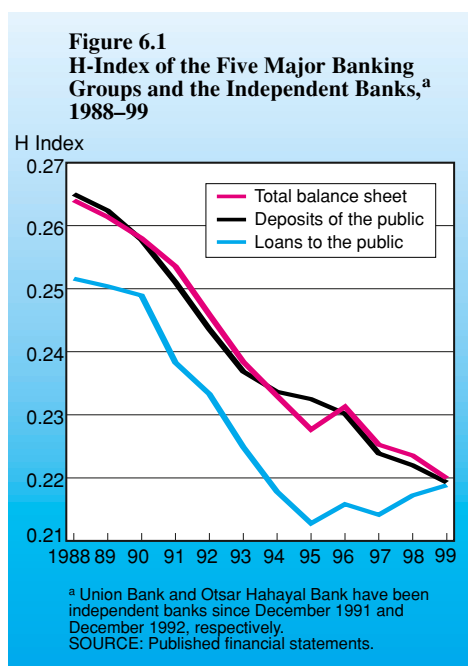
^e Also includes the two foreign banks which have received licenses but are not yet operating.

SOURCE: Returns to the Supervisor of Banks.

banks.¹ In 1999 the financial institution license of the investment company of United Mizrahi Bank was revoked, as was the license of the American Israel Bank, which merged with Bank Hapoalim, and bank licenses were granted to two foreign banks. These changes did not significantly change the structure of the banking system.

Nevertheless, in the last few years there has been lively activity by foreign representative offices and investment banks, mainly in the areas of securities, underwriting and distribution services, examination of due diligence, and consultancy services to Israeli firms and to

foreign investors prior to company acquisitions or mergers.² In 1999 additional representative offices of foreign financial firms were opened in Israel,³ and there were indications of expanded activity by foreign banks, with two of them officially declared that they intended to open branches in Israel in the second half of 2000.⁴ This situation is a natural extension of the process of the penetration into Israel of foreign financial activity as a result *inter alia* of foreign exchange liberalization, the steep rise in the extent of Israeli companies making public offerings abroad, the leap forward of high-tech Israeli companies, as well as nonresidents' increased investment flow. The improvement in Israel's credit rating in the last few years and the increased interest in emerging markets such as Israel's created demand for financial services among foreign investors,⁵ and it



¹ Since 1995 four small banks have merged with their parent banks, and their licenses were revoked. The licenses of two financial institutions were also revoked. A detailed chronological list of institutional changes appears in Table II-7 in the *Annual Information on the Banking Corporations 1995–1999*, Bank of Israel.

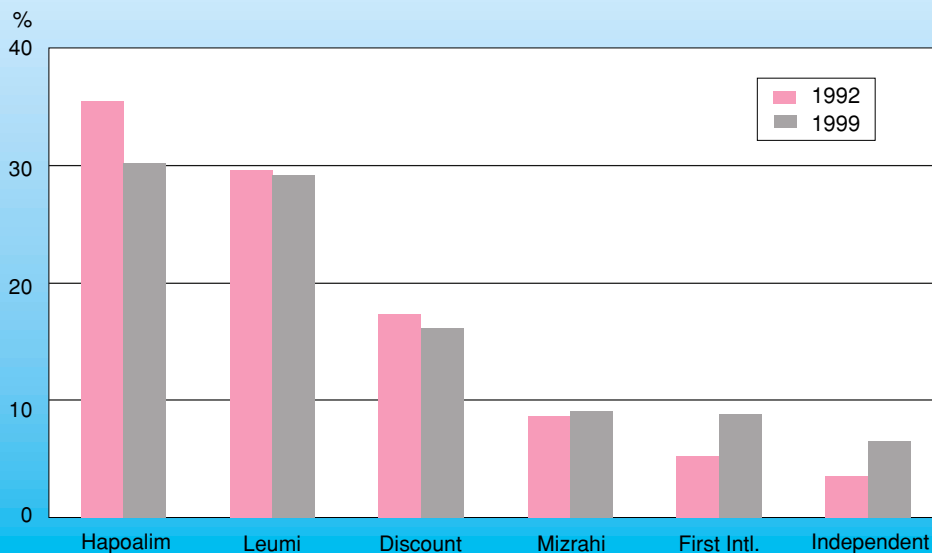
² For further details see Chapter 5 of the *1999 Annual Report of the Controller of Foreign Exchange*, Bank of Israel, which deals with the financial activity in Israel of nonresidents.

³ For a (partial) list of 28 foreign financial institutions, including investment banks and commercial banks active in Israel in the field of financial services, see Appendix 5.2 in the *1999 Annual Report of the Controller of Foreign Exchange*, Bank of Israel.

⁴ In October 1999 Citibank N.A. received a license to operate in Israel as a foreign bank, and a month later the Republic National Bank of New York (Suisse) received a similar license.

⁵ In addition to their periodic and current reports, several large well known international financial companies prepared surveys of Israel's economy. Furthermore, about a third of the shares which constitute the "Tel Aviv 100" share-price index are covered regularly by analysts in well known large foreign investment houses.

Figure 6.2
Distribution of Assets of the Commercial Banks by Banking Group and Independent Banking Corporations, December 1992 and December 1999



Total assets

Dec. 1999: NIS 682,004 at Dec. 1999 prices.
 Dec. 1992: NIS 474,780 at Dec. 1999 prices.

H-Index^a

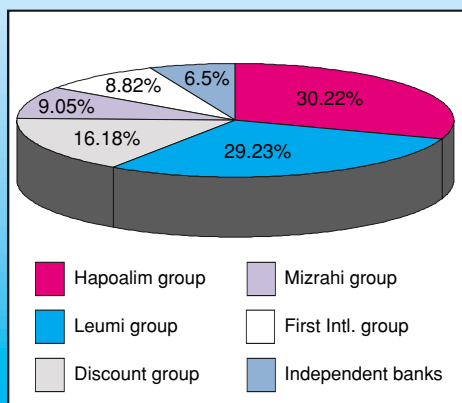
Dec. 1999: 0.223
 Dec. 1992: 0.256

^a The index is calculated for the five major banking groups and the aggregate of the independent banks, which are considered a group.
 SOURCE: Published financial statements.

is only natural that these investors should prefer to use the services of investment banks known to them from their own countries. The success of foreign investment banks created an appropriate infrastructure to encourage foreign commercial banks to penetrate the domestic market.

In contrast to the stability of the number of banking corporations, and against the background of liberalization of the domestic and international money and capital markets, the interbank spread of interest rates on different types of credit contracted, the net interest margin shrank, and commissions on credit card activities, provident fund management, and capital market transactions fell. This was reflected by a reduction in the various indices of concentration, such as the H-index (Figures 6.1 and 6.2), which to some extent express the increased intensity of competition in the industry. Nevertheless, competition is more evident in wholesale banking (large business concerns) than in retail. It is quite

Figure 6.3
Distribution of Assets of Banking
Groups, December 1999



Total assets: NIS 682,004 million
H-Index: 0.223
SOURCE: Returns to Supervisor of Banks.

likely that as a result of technological advances and the reduced importance of the branch in the provision of banking services, interbank competition may increase even without the entry of new financial intermediaries.

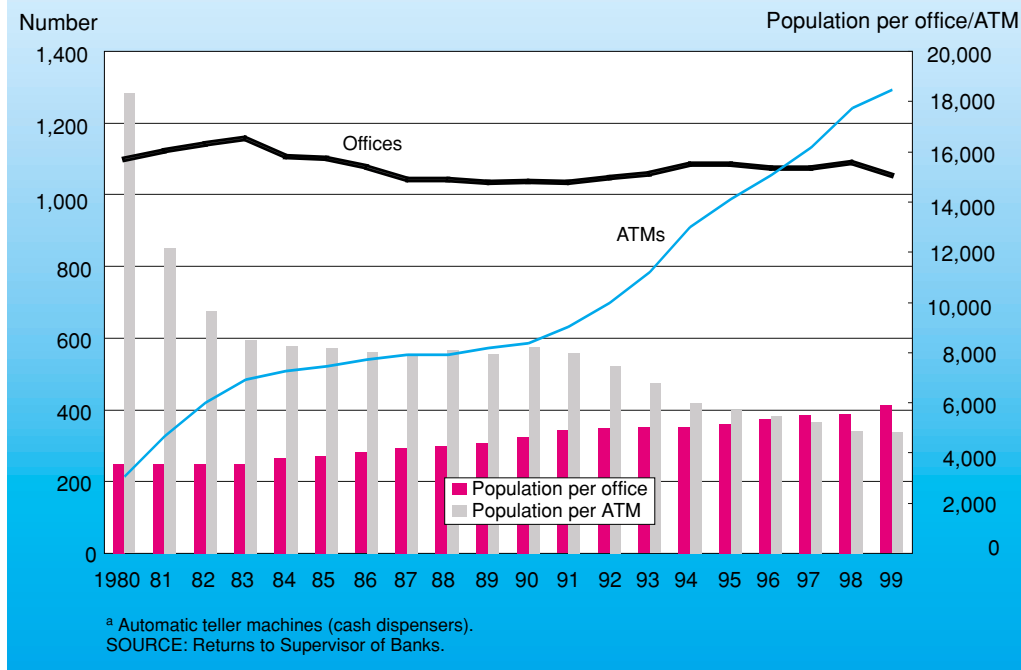
Branch structure

During the 1990s, as a result of the policy of the Bank of Israel and the conduct of the banks, all aspects of the distribution of bank branches—opening, relocation, merging, and closing—changed.

During the 1970s and at the beginning of the 1980s the number of branches increased constantly, reaching a peak in 1983 (Figure 6.4). Discriminatory taxation between protected assets and non-protected ones in the period of

hyperinflation led to a preference for investments in real estate, which included opening new branches not necessarily after a thorough analysis of profitability, and this led to an increase in the number of branches at that time. Banks avoided branch closures because of the difficulty of obtaining branch licenses and their concern that requests to open new branches would not be approved. Against the background of this development and the bank share crisis of 1983, the Bank of Israel adopted a limiting policy with regard to new branch openings. Moreover, with effect from the 1986 the Supervisor of Banks determined minimum cutback quotas for the number of branches at both the total system level and for each banking group separately. In 1989 the Banking Supervision's policy eased somewhat, and several small and medium banks were granted permits to open new branches. Thereafter, the large banks were allowed to submit requests to open branches provided they could provide economic justification for doing so. Thus they were permitted to relocate branches based on business considerations, and to do so they had to submit detailed business plans justifying the opening of the branches; every such request was thoroughly examined by the Bank of Israel. At the beginning of the 1990s it became clear to the Banking Supervision that the banks had changed their policy, and their considerations relating to branch openings were based on responsible and prudent economic analyses. As a result, a more liberal approach to granting approvals for the opening or relocation of branches was adopted in 1993. The Bank of Israel also advises all banks of requests for branch openings which have been approved. In the light of this liberal attitude and the relative flexibility regarding branch openings, banks do not hesitate to close branches whose profitability is questionable, and currently more branches are

Figure 6.4
Number of Offices and ATMs,^a 1980–99



being closed than in the past. Despite some volatility, the number of branches (net) fell by 30 in the period from 1995 to 1999.

Concurrently there were changes in all aspects of public demand for services provided by the ordinary branches. Technological advances in telecommunications and the revolution in the use of personal computers enabled banks to offer more and more banking services which did not require the customer's presence in the branch, so that the structure and the traditional functions of the branch altered. The banks extended the hours in which they provided services, some branches only provide services for business and commercial customers,⁶ and others provide private banking services. Banks also operate automatic service centers which enable a wide range of activities to be performed 24 hours a day.

The Banking Supervision Department estimates that new branches will be smaller than existing ones, that they will be technologically advanced, and that they will have fewer staff. These changes enable the number of branches to be reduced without adversely affecting the services offered to customers. The stability of the number of branches over time despite the growth in population is quite marked, however, and reflects the significant

⁶ For example, concentrating integral business services in regional centers.

Table 6.2
Number of Overseas Banking Offices and Branches, 1991–99

	Overseas offices	Branches and representative offices ^a	Subsidiaries' offices ^b	Employee posts ^c
1991	128	70	58	
1992	126	70	56	3,210
1993	123	73	50	2,962
1994	114	73	41	2,717
1995	108	72	36	2,418
1996	105	72	33	2,225
1997	95	62	33	1,972
1998	93	60	33	2,055
1999	93	59	34	2,044

^a Branches and representative offices abroad of Israeli corporations.

^b Branches of overseas subsidiaries.

^c Number of full-time posts (including part-time posts, weighted) in branches, representative offices and subsidiaries overseas.

SOURCE: Returns to Supervisor of Banks.

increase in the average number of customers obtaining services in the branches. In 1980 the average branch served some 3,600 residents, whereas by the end of 1999 the number had risen to about 6,000⁷ (Table 6.4 and Figure 6.4).

An international comparison in 1998 of Israel and the countries known as G10⁸ showed that Israel has the smallest number of banking institutions (45), and also the smallest number of branches (only 1,092, excluding the branches of the Post Office Bank). The number of cash-dispensing automatic teller machines (ATMs) increased both in absolute terms (1,241) and relative to the number of residents (205 machines per million residents, Table 6.6).

The sale of controlling interests and change of ownership

In the wake of the Bank Shares Arrangement, a process of privatizing banks by selling them to identified and stable controlling interests is taking place. Arrangement banks are sold by the Ministry of Finance via M.I. Holdings Ltd., a company formed to act on behalf of the government in the matter of the sale of the banks. It is the Bank of Israel's

⁷ For international comparison the branches of the Post Office Bank are also included. In 1998, 713 branches of the Post Office Bank provided services related to the payment system. Including these branches gives the average number of residents per branch as 3,500.

⁸ The Bank for International Settlements (BIS) publishes statistical data on the payment systems in 11 countries included in this group: Belgium, Britain, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, and the US.

role according to the Banking (Licensing) Law to examine those wishing to purchase the controlling interest in a bank, and to grant a permit to those found suitable. The criteria guiding the Bank's decision whether to grant a permit include *inter alia* personal integrity, business experience, and financial soundness. The Bank also examines the effect of the change in ownership on competition in the banking system, and whether there are conflicts of interest between the business activities of those seeking to gain control and the management of the banking cooperation in question.

Six years have passed since the privatization process started, and in the light of the unsatisfactory pace at which it is proceeding (Table 6.3) a joint committee of the Ministry of Finance and the Bank of Israel was appointed to look into alternative ways of continuing with the privatization of Bank Leumi.

In 1999 the process of selling the controlling interest in Bank Discount continued. In June 1998 M.I. Holdings published a tender for the sale outside the stock exchange of the majority of the shares held by the government, and offers were invited for the purchase of a block of shares constituting between 30 percent and 53 percent of the bank's equity, all in accordance with the operational procedures set in 1993.⁹ The Banking Supervision Department authorized two groups of candidates to participate in the sale procedure. The process is not yet completed, and according to a recently determined timetable the process should be completed in the course of 2000.

In the last few years the Tel Aviv Stock Exchange (TASE) has served as an additional channel for the exchange of state ownership of banks' shares, but in 1999, despite lively activity in the secondary market, the process of privatization of Arrangement banks via the TASE halted.¹⁰ In 1998 shares were issued to the public on the TASE, and the government raised a record sum of NIS 4.3 billion, of which some NIS 3.4 was from the privatization of banks. In 1999, by contrast, there were no issues to the public on the TASE in the framework of privatization, although the government did sell a block of shares outside the stock exchange. Thus, for example, 4.8 percent of the government's holding in Bank Hapoalim¹¹ was sold for NIS 580 million in an issue on the London Stock Exchange, and an additional 2 percent was sold to Goldman Sachs outside the stock exchange. Lehman Brothers purchased 4 percent of the shares of Bank Leumi for NIS 350 million. During the year the public exercised purchase options issued previously by the state for the purchase of shares of Bank Mizrahi.

⁹ For further details of the principles of Arrangement bank sales and the need to sell controlling interests, see *The Need for Controlling Interest in Banks and the Importance of Large Shareholders*, H. Bar, Discussion Paper 96.02 of the Research Department of the Banking Supervision Department, Bank of Israel (Hebrew).

¹⁰ The process of privatizing nonfinancial companies whose shares are held by the government via the TASE also ceased.

¹¹ Shares of Bank Hapoalim and Bank Leumi are at the top of the list of the most negotiable shares, with a daily average turnover of NIS 19 million. At the end of 1999 the market values of these two banks stood at NIS 16 billion and NIS 11.6 billion respectively.

Table 6.3
Holdings of the Government, Parties at Interest, and the Public in the Arrangement Banks,
December 1998^a and December 1999 Compared with December 1992

	1999						Public, ^b and domestic and foreign investors
	1998		Parties at interest		1999		
	Government	Public	Domestic investors	Foreign investors	Domestic investors	Foreign investors	
Mizrahi	97.0	40.6	62.1	—	62.1	—	37.9
Discount	87.0	26.8	13.2	60.0	13.2	—	26.8
Leumi	95.0	45.9	—	43.6	—	6.6	49.8
Hapoalim	99.9	30.5	32.4	17.4	32.4	13.6	36.7
Union	58.0	4.2	85.9	—	85.9	—	14.1 ^c

^a For holdings of parties at interest in 1998, see Table 5.4 in last year's edition of this publication.

^b Not parties at interest as defined by the Tel Aviv Stock Exchange.

^c Held by Bank Leumi, it being agreed that it will not be a party at interest.

SOURCE: Published financial statements and Tel Aviv Stock Exchange publications.

In 1999 the process of privatizing the financial institution Otzar Hashilton Hamkomi began, the outcome of a decision by the Ministerial Committee on Privatization and the signing of an agreement with the rest of the owners of founders' shares of the company. At the beginning of August 1999 the tender for the sale of the institution's shares was published in accordance with the procedure for the sale of controlling interests.

Technology, computerization, and banking services

Technological advances in the last few years in the fields of computerization and communications, expressed in the greater ability to compress data and transfer them faster via computer and communications equipment (including cellular telephones¹²), served to make banking activities and the provision of banking services to the public more efficient. The banks' preparations to avoid the dangers of the Millennium Bug helped in the upgrading of both software and hardware and in the reorganization of computer infrastructures. It also brought home to senior management and boards of directors the importance of information technology (IT) in the management of banking corporations as an impetus in business activity and as a means of achieving strategic objectives in the various spheres of banking.

The relatively low cost of the new technologies (and in particular communications via the internet) enables medium sized and small banks to use them strategically to develop niches for themselves in banking services, and to compete with larger banks in the provision of those services. The new technologies enable large banks to cut costs, and to add to and broaden the range of their services.

Technology makes it possible for banks to supply their customers with alternative ways of performing banking activities, other than carrying them out in a branch. It also improves the availability of information and makes the performance of transactions more convenient, thus adding to the public's welfare through increased competition and a lower cost of services on the one hand, and by increasing the range of services on the other. For example, all banks which make information on balances and movements in accounts available to their customers via the internet do so free of charge, whereas in most cases they charge a fee for providing the same information via an ATM or in a monthly printed statement.

In several countries, including the US and Scandinavia, there are no special restrictions on the performance of banking transactions via the internet, mainly because their legal and regulatory infrastructures are different from that in Israel. In Israel, in order to ensure the gradual and controlled development of the use of computerized technology, the Supervisor of Banks issued a directive in August 1997 in *The Proper Conduct of Banking Business* intended to regularize the issue of on-line banking in such a way as to

¹² Most cellular telephones have a display enabling the communication of text. Cellular phones which incorporate calculators and a small screen and keyboard are already available.

Table 6.4
Number of Offices and ATMs, 1986–99

	Offices ^a	ATMs	Information machines	Persons per office ^b	Persons per ATM
Average 1986–89	1,052	555	1,320	4,225	8,002
Average 1990–94	1,054	722	1,695	4,910	7,164
1995	1,083	987	1,942	5,174	5,693
1996	1,075	1,056	2,000	5,357	5,454
1997	1,076	1,131	2,055	5,488	5,221
1998	1,092	1,241	2,133	5,537	4,872
1999	1,056	1,292	2,111	5,874	4,801

^a Regular branches, counters, and restricted branches in Israel.

^b Excluding offices of commercial banks operating in the Autonomy.

SOURCE: Returns to the Supervisor of Banks.

incorporate internet banking in the general framework . The permit to engage in activity via the internet was granted in stages: initially only the transfer of information was allowed; at the beginning of 1999 some transactions in a customer’s account were permitted, including securities trading, conversions and purchase of foreign currency, making deposits, depositing in savings schemes etc.; towards the end of 1999 the Supervisor decided to review the policy and the continued regulation of on-line banking, and particularly via the internet, and appointed a special team for that purpose. The team has almost completed its task, and it is expected that in the course of the year 2000 the permit to perform banking transactions via the internet will be extended to include transfers to third parties.

It is reasonable to assume that in the future customers’ contacts with banks will take place mainly via the various forms of telecommunications available (PC, TV/cables, cellular phone, etc.). The contact will combine software and hardware, from automatic electronic bank answering machines, to state-of-the-art computer programs. It may be expected, as stated, that the structure and size of branches, their opening hours, quality of their staff, and the range of services offered, will adjust in line with the changing technological infrastructure.

Technological changes naturally affect staffing.¹³ Due to changing needs, the banking system, and in particular the large banking corporations suffer from a fundamental difficulty in adjusting manpower to the changing needs of providing services, and it takes time before the results of investment in information technology are felt. In the last

¹³ A reduction in the number of employees, recruitment and training of professional staff, and the location, structure, size etc. of branches.

few years the number of office and branch closures has risen, and in 1999 alone there was a net reduction of 36 in the number of offices and branches (Table 6.4). It is early as yet to determine whether this is a trend caused by investment and technological change, or a natural process of adjustment. Based on the banks' estimates as they appear in their annual reports for 1999, the number of branches is expected to contract over the next few years due to branch closures and mergers. It does appear, however, that a wide distribution of branches is still an advantage in the recruitment of new customers.¹⁴

Along with the reduction in the number of branches, a reduction in the number of staff¹⁵ in the banking system is evident. Banks' reports show a downward trend in the average number of staff per branch. The rate of decline—an indication of one aspect of efficiency—is greater in large banks, suggesting that they are improving their efficiency faster than are the other banks. The expansion in the use of ATMs¹⁶ and direct banking¹⁷ continued in 1999. According to sample data from the end of 1999¹⁸ received in the Banking Supervision Department, which must be considered as an estimate, on average about 2.5 queries per month are submitted via the direct banking systems for each checking account; about three quarters of them are via computerized answering machines or ATMs. Every month an average of two cash withdrawals from ATMs are performed on each checking account. The performance of transactions in securities and local-currency deposits via the internet started in 1999, and some transactions in customers' accounts were permitted. The same data indicate that the number of users of these services¹⁹ is growing constantly.

The effect of technology on the nature and extent of banking transactions, and the degree to which customers have become used to this effect are reflected in the data

¹⁴ This is because legislation and directives of the Banking Supervision still require that certain activities take place in the branch, such as opening an account and signing binding documents.

¹⁵ Weighted (i.e., full-time positions equivalent).

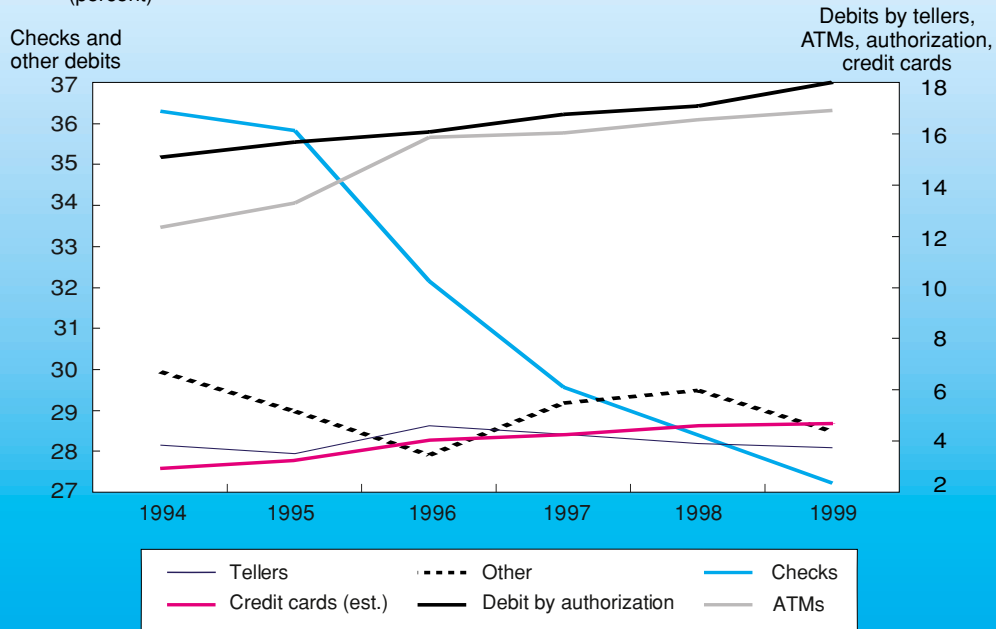
¹⁶ These enable the banks to offer the public financial services 24 hours a day, and with a broader geographical spread, while saving considerably on staffing. The range of services available from the ATMs has increased constantly, but the main activities are still cash withdrawal, clarification of balances, and obtaining print-outs.

¹⁷ I.e., via the Direct Banking Division (formerly "Telebank Discount") of Israel Discount Bank, "Hayashir Harishon" of Bank Leumi, "Poalim Yashir" of Bank Hapoalim, "Benleumi Kol" of the First International Bank, and "Mizrahi Yashir" of Bank Mizrahi, which enable customers to perform bank transactions without the need to be present in the bank, also when the branch is closed, by using computer or telephone communication systems.

¹⁸ The data were received from a sample of the banking institutions and relate only to 1999, as the reporting requirement only became effective in the fourth quarter of 1998. Some of the data are estimates supplied by the reporting banking institutions.

¹⁹ Including institutions and businesses.

Figure 6.5
Number of Debits in Demand Deposits, Share of Different Kinds of Debits, 1994–99
 (percent)



SOURCE: Returns to Supervisor of Banks.

reported to the Banking Supervision on the size and composition of debits in checking accounts. The share of non-automatic transactions (checks and over-the-counter transactions) in total debit transactions is falling continuously. This trend is especially marked regarding checks, whose share of total debits fell from 40 percent in 1993–94 to 27 percent in 1999; transactions via tellers in the branches fell more slowly. On the other hand, there was an upward trend in activities requiring some manual intervention by the customer and the bank: for example, the share of standing orders in total debits rose slowly from 15 percent in 1994 to 18 percent in 1999, and the share of debits via credit cards in the total rose from 2.9 percent to 4.6 percent, reflecting also the growth in the number of credit cards. There was a notable increase in the use of ATMs, from 12 percent of total transactions in 1994 to 17 percent in 1999 (Figure 6.5).

The data above clearly indicate both the transition to the use of banking technology—which by saving costs improves customers’ and the banks’ utility—and also the trend away from transacting current banking activities in the branches.

Table 6.5
Indicators of the Structure of Banking Systems, an International
Comparison, 1998

	Number of institutions	Number of branches	Number of persons per office ^c	Number of ATMs per million persons
Israel	45 ^a	1,092 ^b	5,537	205
Belgium	122	8,575	1,191	562
Canada	2,265	13,562	2,240	774
France	510	46,765	1,259	499
Germany	3,234	60,120	1,364	556
Italy	923	40,313	1,429	482
Japan	3,593	68,334	1,851	1,127
Netherlands	120	6,862	2,287	419
Sweden	122	3,683	2,403	281
Switzerland	311	6,757	1,054	722
UK	537	34,698	1,706	416
US	21,680	76,986	3,511	692

^a Commercial, foreign, mortgage, merchant, and investment finance banks, financial institutions, and joint service companies.

^b Offices of commercial banks only.

^c In Belgium, France, Italy, Japan, Netherlands, Switzerland, and the UK post office branches are also included. In Israel, the 713 post office branches are excluded. If the post office branches are included, the number of persons per office is 3,350.

SOURCE: "Statistics on payment systems in the group of ten countries" (1998), Bank for International Settlements.

3. ACTIVITIES OF THE BANKING SUPERVISION DEPARTMENT

The main function of banking supervision is to maintain the stability and soundness of the banking system, including the proper management of the banking corporations so that they can meet their liabilities to depositors. A major aspect of the work of the Banking Supervision Department is thus to direct banks' board of directors to supervise banks' appropriately so that they are properly managed and operate the inputs available to them prudently.

The current work of the Supervision Department consists of monitoring banks:— changes in the extent and mix of their activities, their skill in risk management, and their ability to adapt to macroeconomic and other changes in the economy. This part of the activity of the Supervision Department includes gathering, analyzing and drawing conclusions from different types of banking data. Information gathered belongs to one of two types: 1) quantitative, measurable data, such as income, expenditure, interest

Box 1:
Credit Cards

The credit market in Israel has grown constantly in the last few years, as can be seen from both the number of cards issued and the frequency of their use. In the second half of 1998 Alpha Card, which is 67 percent owned by First International Bank, penetrated the credit card market as a clearing house and issuer. Hitherto clearing activity had been a duopoly, split between Isracard, totally owned by Bank Hapoalim, and Visa CAL, jointly owned by Bank Leumi and Israel Discount Bank; the latter two banks issued only the Visa card, and the banks in the Bank Hapoalim group issued Isracard, Mastercard, and American Express. Several medium and small banks issued all the cards. Alpha Card's entry into the credit card market increased competition, reflected in the marketing activities and other steps taken by the credit card companies. Among other things, the membership charge for the issue of a card was cancelled, and the commissions collected from businesses and suppliers were reduced. These steps resulted in a rise in the number of credit cards and in the frequency of their use, which served to offset some of the fall in operating income from credit card activity. Alpha Card accumulated losses as a result of the high costs of penetrating the market, and First International Bank's share of the loss amounted to NIS 115 million net.

The credit card market is not resting on its laurels. At the end of 1999 ownership of CAL was split, as a result of the Banking (Licensing) (Amendment No. 11) Law regarding the control of an auxiliary body corporate. This requirement was intended to create conditions which would enable the formation and survival of a third large credit card clearing house, as Discount and Leumi together issued more than 50 percent of the total number of credit cards in Israel, and were the sole issuers of the Visa CAL card. As a result of the amendment to the law, Discount Bank purchased Leumi's share of the company, offering a higher price (company value), thereby taking over control of Visa CAL Ltd. In the second quarter of 2000 Alpha Card sold its operational infrastructure to Bank Leumi, which is planning to launch its own card. It may be assumed that in the next two years clearing house activity in the credit card market will find its new equilibrium.

The developments regarding ownership of credit card companies and commissions give an indication of the positive structural changes deriving from the entry of a third party into what was previously a duopolistic market.

rates, fees, credit, and margins, or 2) qualitative data which is nonmeasurable, e.g., the quality of management, protection of data, adherence to the procedures, completeness of information passed on to banks' customers. Much information is gathered in the format of fixed computerized reports, and other information is obtained from discussions between Banking Supervision staff and banks' management. In the course of inspection too valuable banking and non-quantitative data is gathered. Complaints of the public sent to the Banking Supervision Department, which sometimes reflect problems encountered by many customers in certain banking corporations, provide another important source of information. The department keeps abreast of new international approaches to banking supervision, banking research from around the world, and the practical conclusions to be drawn from it.

A review of the activities of the Banking Supervision Department in 1999 follows.

a. Regulating banking activity

The regulation of banking activity combines with primary and secondary legislation as a central tool in banking supervision in guiding banking institutions with regard to the Supervisor's directives on various banking topics. Most directives are intended to regulate the activity of banks' directors and managements, improve internal and external reporting systems, strengthen internal auditing, and ensure that banks' managements act responsibly, properly, and prudently in running their corporations. Regulation is based on the processing and analysis of data received by the Supervision Department from various sources, and is translated into directives and rules of conduct imposed on banks—*The Proper Conduct of Banking Business; Guidelines for Preparing Reports to the Public; and Guidelines for Preparing Reports to the Supervisor of Banks*. The main regulatory directives published in 1999 in the spheres of reporting to the public, risk management, bank-customer relations, etc. are shown in the appendix to this chapter.

b. Inspection

The Inspection Unit consists of six teams (one of which is a joint team with the Institutional Evaluation Unit), five of which are responsible for specific aspects of banking activity: credit and collateral; internal audit and management; risk management; bank-customer relations; information systems; the sixth inspects all these areas in the small independent banks.

The Inspection Unit's specialty lies in gleaning data directly from banks' books and documentation and the use it makes of them in its inspection procedures. The material gathered is analyzed, processed, and set out in inspection reports which are generally addressed to the banks concerned and which describe any deficiencies found, the steps the banks are required to take to correct them, and the time within which the steps must be implemented. The Institutional Evaluation Unit also uses the reports in formulating its assessment of banking institutions.

In 1999 inspections were performed covering a range of topics: in the sphere of credit inspections, special emphasis was placed on the aspect of the risks of foreign-currency borrowers whose business was in local currency, and on credit to the construction industry and the diamond industry. Regarding other risks, the aspects of managing market risks, banks' investments in other corporations, and their control of their overseas offices were examined. Inspections regarding management and internal audit focused on aspects related to directors' conflicts of interest with their activities in various industries, and the banks' implementation of the directives concerning related parties. The information systems team devoted most of its efforts to completing banks' preparedness for the year 2000, and in fact no significant malfunctions of the system were encountered in the transition to the new millennium. The bank-customer relations team concentrated their attention on credit cards, dormant accounts, third-party guarantees, and portfolio managers' activity via the banks.

c. Institutional evaluation

The Institutional Evaluation Unit consists of seven teams; five are responsible for assessing the banking groups, and two for the small independent banks—one combining assessment and inspection, and the other, assessment and licensing.

The unit constantly monitors the banking corporations, and performs periodic assessments of the general situation, management, and risks of each one of them (including subsidiaries and overseas branches), and carries out special assessments related to specific topics. Assessments are based on data gathered from many sources, including published financial statements, banks' reports to the Bank of Israel, reports of the Banking Supervision inspection teams and of the Research Unit, the press and electronic media, discussions with senior banking corporation personnel, and public enquiries.

The unit's reports help the Supervisor of Banks in making decisions regarding either any specific banking corporation or the whole banking system. In addition to its regular follow-up and assessment activity, the unit focused on the following in 1999:

- Assessment of banks' risk management, i.e., the extent to which banks were complying with the requirements of the Banking Supervision regarding risk management.
- Banking corporations' exposure to foreign-currency credit.
- Follow-up of changes in capital ratios, particularly in banks close to the minimum ratio.
- Follow-up of the banking system's readiness for the transition to the euro in Europe, and for the advent of the new millennium, identifying areas of vulnerability due lack of preparedness.
- The extent of banks' compliance with the Supervision's requirements regarding transactions with interest parties.
- The eligibility of candidates for the purchase of the controlling interest in Israel Discount Bank—a special subject examined in conjunction with staff from other units of the Supervision Department.

- Preparation for the follow-up of the privatization of the financial institution Otzar Hashilton Hamkomi and other banks.

d. Research

The research unit serves the Supervision Department as a task force for the examination and analysis of the effects of macroeconomic and other factors on the performance of the banking system and on the risks it faces. The unit monitors developments in banking throughout the world, and keeps itself abreast of new approaches to the analysis and assessment of capital adequacy, bank management, definition and measurement of risks, and methods of protecting against them.

Information gained from the professional literature and research projects provides a basis for position papers on supervision topics, for the development of new tools, for the formulation of banking regulations, and for the adoption of other measures intended to advance Israel's banking system.

The following are just two of the major subjects researched by the unit in 1999:

- The optimum structure of the banking system, and the effect of mergers and takeovers on competition in the industry, using the normal indices. In this context the subject of risk-adjusted return on capital (RAROC) of various banking activities was examined, using the various indices normally referred to in the professional literature. The recommendations of the Basle Committee regarding the incorporation of external rating agencies as a central component of credit risk in the estimate of banks' capital adequacy were also studied, as was the effect which the adoption of those recommendations would have on Israel's banking system.
- The efficiency of branches in Israel's domestic banking system, a subject which assumes special importance in a period when technological changes affect the nature of the banking activity performed in branches.

In 1999 the unit published No. 7 in its *Banking Review* series (in English),²⁰ and six working papers,²¹ which are initial drafts of papers prior to their publication in the professional literature.

²⁰ This issue contains articles on Linear Programming and Econometric Methods for Bank Efficiency Evaluation; an Econometric Model of Israel's Banking System; and a study of the Implementation of Value at Risk (VaR) in Israel's Banking System.

²¹ "Profitability, Capital, and Risks in the Large Banks in Israel," (No. 99.01, Hebrew); "Salaries of Senior Management in Israel's Banking System," (99.02, Hebrew); "A Study of the Link between Structure and Performance in Israel's Banking System, 1989–98," (99.03, Hebrew); and "A Review of Models for Estimating Banks' Credit Risks," (99.04, Hebrew). Two additional working papers were published at the beginning of 2000: "The Optimal Structure of the Banking System," (00.01, Hebrew); and "Risk Adjusted Return on Capital (RAROC) and the Optimal Composition of Assets (00.02, Hebrew).

e. Bank-customer relations

As well as regulating bank-customer relations, the Banking Supervision Department also deals with enquiries and complaints from the public, monitors fees charged by the banks, checks standard bank-customer contracts, and carries out inspections in banks on these issues. Protecting the rights of banks' customers, as well as being in itself an important issue, is a significant aspect of the maintenance of stability of the banking system. In the long term there is a clear connection between the propriety of a bank's relation with its customers and its profitability and stability. The Banking Supervision attaches great importance to banks' compliance with legal and regulatory requirements in this regard, particularly with respect to transparency and full disclosure.

Public enquiries

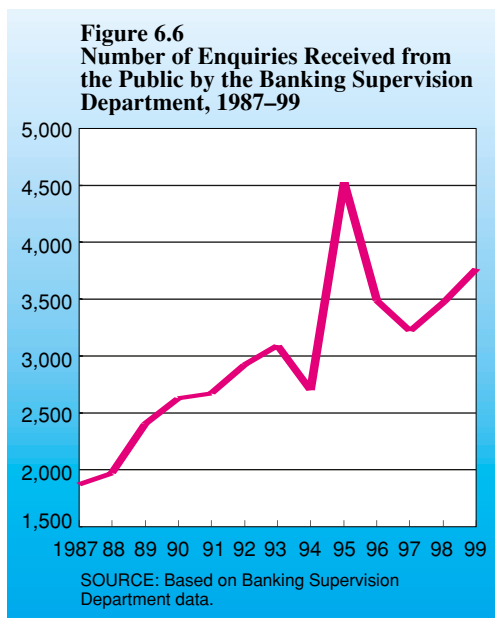
The Banking (Service to Customer) Law, 5741–1981 makes the Supervisor of Banks responsible for the protection of bank customers' rights, and the Public Enquiries Unit operates by virtue of this law. Enquiries received include complaints about many matters—misleading information, the provision of one service being made conditional on another, exaggerated or unjustified fees, discriminatory clauses in contracts, unacceptable service, etc. When the complaints reveal issues requiring attention throughout the banking system, the matter is dealt with by means of directives in *The Proper Conduct of Banking Business* issued by the Supervisor of Banks, or via legislation.

Activity in the field of bank-customer relations may lead to conclusions which serve

the Supervisor of Banks as a supervisory tool, as the complaints may highlight a basic weak spot in an individual bank or in a banking group, a situation which calls for a report to that bank's management or a more comprehensive supervisory response.

In 1999 the Public Enquiries Unit received 3,801 written enquiries, an increase of 9 percent from 1998 (Figure 6.6). The number of investigations completed rose by 8 percent, to 3,951, some of which had been received in previous years.

Of the 2,039 complaints on which the unit adopted a position (i.e., justified, partially justified, or unjustified), 837 (41 percent) were found justified or partially justified, the same proportion as in 1998.



The unit did not take a position on 734 enquiries (832 in 1998), either because the complainant withdrew the complaint, or due to conflicting versions between the bank and the customer, or because the matter was taken to court, or an agreement was reached between the customer and the bank, or for some other reason (Table 6.6 and Figure 6.7).

One hundred and forty-eight of the enquiries received (171 in 1998) were found to fall outside the unit's authority, and were passed on to the bodies responsible, for example, the Capital Market, Insurance, and Savings Division of the Ministry of Finance.

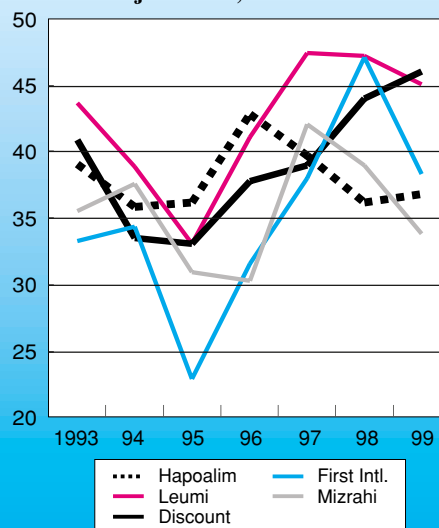
In 1999, 1,178 approaches were classified as requests for clarifications or information (1,052 in 1998).

The resolution of about 222 queries had implications either for the individual bank or for the whole of the banking system, and required some rules to be changed, employee's work procedures revised, or bank documents amended, etc.

The following were some of the general topics dealt with in 1999:

- An arrangement between the Bank of Israel and the Association of Banks to make it easier for customers to transfer accounts from one bank to another. As a result of the arrangement, which was finalized after years of preparation, it is much simpler, since February 1, 2000, to transfer direct debits between banks: a customer wishing to transfer an account to another bank signs a form which transfers all the direct debits to the new bank, which is responsible for the transfer.
- In 1999 the department encountered several instances of promotional campaigns in which banks offered benefits which were not consistent with the *Proper Conduct of Banking Business—Customer Benefits*. The directives prohibit banking corporations from offering the public benefits in kind or entitlements with a retail value of more than NIS 200 (indexed to the CPI). The department's intervention led to the cessation of these campaigns.
- Banks' nonperformance of court orders—banks' managements were asked to emphasize to their staff the serious implications of the failure to carry out court orders in full and in the specified time, to fix appropriate supervisory procedures in this area, and to strengthen the mechanism for fulfilling court orders and ensuring the appearance in court of bank officials when necessary.

Figure 6.7
Percent of Justified Complaints^a
among Total Complaints against the
Five Major Banks, 1993–99



^a On which the unit took a stand (i.e., justified or partially justified/unjustified).
SOURCE: Based on Banking Supervision Department data.

Table 6.6
Results of Enquiries, Treatment of which was Concluded, 1998–99

	1998		1999	
	Number of enquiries	Percent of total enquiries	Number of enquiries	Percent of total enquiries
Number on which stand was taken				
Number found wholly or partly justified	739	20.1	837	21.2
Number found unjustified	1,049	28.6	1,202	30.4
Total	1,788	48.7	2,039	51.6
Number on which no stand was taken				
1. Treatment stopped due to legal action	163	4.4	173	4.4
2. Treatment stopped for other reasons	244	6.6	181	4.6
3. Not within unit's jurisdiction	171	4.7	148	3.7
4. Unable to take a stand	254	6.9	232	5.9
Total	832	22.7	734	18.6
Requests and clarifications				
Requests	308	8.4	422	10.7
Clarifications	744	20.3	756	19.1
Total	1,052	28.6	1,178	29.8
Total number of enquiries treatment of which was concluded	3,672	100.0	3,951	100.0

SOURCE: Based on Banking Supervision Department data.

- Increasing the public's awareness of the existence of bodies which handle public enquiries in banks—a general directive was issued obliging banks to display a sign in their branches drawing attention to the existence of a public enquiries section and to the method of making an enquiry.

Incognito inspections

The unit has a team of inspectors who perform inspections in banks incognito. The members of the team visit branches without identifying themselves, and check the accuracy and extent of information given to customers, and the degree to which the banks fulfill the legal requirements and the Supervisor's directives regarding bank-customer relations.

Examination of banks' fees and standard contracts

As specified in *The Proper Conduct of Banking Business*, banks are required to notify the Supervisor of Banks in advance regarding changes in their fee schedules or the introduction of new fees.

The general position of the Banking Supervision Department is that fees which are not under the supervision of the Price Controller in the Ministry of Industry and Trade should be determined by the banks on the basis of their business considerations, and policy regarding most fees is as far as possible one of nonintervention in this sphere. This policy is reasonable when there is interbank competition, but where this is not the case the Supervisor does intervene in the banks' considerations in order to protect the customers' interests. Thus, for example, rises in fees for "captive" customers of a bank (i.e., customers unable to perform a particular transaction in another bank) were prevented, as were those of fees related to the transfer of accounts from bank to bank, and of fees related to the payment system in the economy.

In the context of this policy, there is a team which examines banking fees (including those not under price supervision) and banks' pricing systems, and systematically checks banks' standard contracts, with the purpose of removing any discriminatory clauses.

From time to time the team also publishes comparisons of the most common fees and of a basket of fees; this has been found to be an effective way of encouraging interbank competition. In 1999 two fees came under price supervision, one on the issue and use of the ATM card for automatic information retrieval, and the other for the cancellation of a direct debit or standing order. As a result, credit card companies must report their fee tariffs to the Supervisor of Banks. During 1999 the mortgage banks were made to cease the collection of double fees on monthly repayments of mortgages which had not been granted as one total sum but in separate amounts.

Regarding standard contracts, summaries were submitted to the Standard Contracts Court about the discriminatory clauses in Bank Leumi's checking account contract. The housing loan agreements of various banks were checked, as was the agreement between banks and the customers of one of the credit card companies. In the light of the growing use of the internet to obtain information and to perform various banking activities, a systematic examination of the relevant agreements between the banks and their customers relating to this was undertaken. Specific clauses in various contracts which raised difficulties were also dealt with.

f. Information and financial reporting

Information and Reporting Unit

The Information and Reporting Unit assembles the information in the Supervision Department, and manages its data bases. As the directives in *The Proper Conduct of Banking Business* are formulated in the department, this unit translates the regulations and constraints into reporting guidelines, constructs the reporting format, and invests resources in developing sophisticated reporting tools (including *inter alia* logical checks that improve the quality of the data received). After the data are absorbed into the system they are processed and cross checked with data from other information systems in the unit. Converting the data into usable and available information is an important part of the unit's function.

Backed by this information, the unit monitors banks' compliance with the limitations of the Banking (Licensing) Law and with *The Proper Conduct of Banking Business*, and follows up on the steps required to be taken by banks in which faults were discovered. Due to the complexity of the Banking Supervision information systems, the units also deals with their assimilation by the banks.

The unit's information is passed on to various outside parties, and the banks receive feedback. The unit handles more than 600 enquiries every year from various economic entities, and publishes (also on the internet) the maximum and the average rate of interest on the "gray" market, used to calculate the fee for early repayment of mortgages to the mortgage banks.

The unit issues several publications: *Annual Information on the Banking Corporations*, containing information covering a five-year period on the banking system in Israel (also on the internet, on the Bank's website www.bankisrael.gov.il, under Publications and Data); *Current Information on the Banking Corporations*, a loose-leaf binder containing updated information on the banking system in Israel; and *Main Data on the Activity of Each Bank*, a quarterly publication (in Hebrew) comparing the different banks, based on information obtained from their financial statements.

The unit, in conjunction with the Financial Statements Unit, examines banks' working papers to check the reliability of the data received. Faults revealed in these inspections prove the need to continue the process of the assimilation of reporting systems in banks.

Financial Statements Unit

This unit's main function is to initiate changes and improvements in the *Guidelines for Preparing Reports for the Public*, and audits financial reports both at the level of the entire banking system, and at the individual bank level.

In 1999 checks were performed in the accounting area covering issues such as disclosure of the minimum capital ratio in the directors' report and of housing loans in commercial banks, and the weighting of problem loans in the minimum capital ratio of the mortgage banks.

New directives in the *Guidelines* related to urgent topics which were deferred from 1998 because the focus was on preparedness for the new millennium, among others:

- Directives regarding "Accounting related to derivatives and hedging activities."²²
- Provisional directives relating to disclosure of the banks' preparedness for the year 2000²³ and the method of calculating and presenting net interest margins taking into account the effect of derivatives which are not used for hedging.
- Provisional directives on "A qualitative report on exposure to market risks and methods of managing them" and on the regulation of disclosure of housing loans activity by commercial banks were issued, including the implementation of the method of making provision according to the depth of arrears.

²² Directive no. 1992-06 dated 17.01.00.

²³ See Appendix to this chapter.

g. The payments system

The activity of the Payments System Unit concentrates on all the regulatory and supervisory aspects of the payments system in Israel, including credit cards and clearing. Its activity also covers aspects related to bank-customer relations as manifested in the clearing process.

Two significant developments affected Israel's payments system in 1999, one was the shake-up which occurred in the credit card market, and the other was the increase in foreign involvement in the foreign-exchange market in Israel, and hence in the payments system, *inter alia* due to the abolition of foreign-exchange control in mid-1998. This involvement increased credit risks in Israel's payments system.

Credit cards

Alpha Card's entry into Israel's credit card market in the second half of 1998 as a clearing house and issuer resulted in basic changes in that market (see Box 6.1).

The credit card companies are auxiliary corporations under the control and supervision of the Supervisor of Banks. In 1999 and at the beginning of 2000 the Banking Supervision Department was engaged in the preparation and issue of directives regulating the activities of these companies. In 1999 a directive was issued regarding the obligation to report on credit risks, and work is being done on regulation in the areas of activity of the companies and regarding full disclosure by them.

The clearing house

Since the second half of 1999 the clearing house has been clearing checks in foreign currency: a time was determined for the debit/credit of checks in foreign currency drawn by residents and others on their foreign-currency accounts in the Israeli banking corporations. This arrangement is similar to that regarding local-currency checks, and enables payments in foreign currency to be made, ensuring that the credit and the debit are implemented at the same time. If the use of foreign-currency checks expands, the possibility of computerized clearing will be considered. Should that occur, only checks in US dollars would be cleared in the same way as checks in NIS (credited on the same day).

The Clearing House Committee decided to extend the authority of the Clarification Committee in cases of disputes between clearing-house member banks related to the clearing of drafts. Decisions were also taken regarding the way to combat the severe problem of stolen checks, from the aspect of interbank relations and also from the aspect of bank-customer relations.

The large-payments system:

Globalization of the money and capital markets has spurred many countries to construct a system for clearing large sums of money in real time. Membership of the euro bloc, which is conditional on having such a system, would also enable Israel to integrate into the TARGET system which serves the members of the bloc.

The Governor of the Bank of Israel has appointed a committee consisting of three members of the Bank's management to examine the question of the establishment of a large-payments system.

h. Special activities

Checks without cover

This section, in cooperation with the commercial banks, operates a complex computerized system for dealing with persons issuing checks without cover. The system is based on the provisions of the Checks Without Cover Law, 5741–1981, which was last amended in 1992. In 1994 and 1995 the authority to restrict banks' customers was extended in a series of new laws, which apply also to customers with files against them in the Execution Office, those who refuse to grant their spouses divorces despite court orders to do so, and bankruptcies.

All the above notwithstanding, most restricted customers (77,000 at the end of 1999, 82,000 at the end of 1998) were issuers of checks without cover. At the end of 1999 the number included about 6,800 with files against them in the Execution Office and those who refuse to divorce their spouses.

The section deals with about 5,000 new customers a month on average who have been reported to the Bank of Israel following the restriction of about 7,500 checking accounts due to the issue of checks which were returned because of lack of cover.

In 1999 the downward trend of the number of restricted customers and accounts which had started in 1998 continued. In annual terms the reduction is about 8 percent. This is the result of banks tightening their control systems, reflected in stricter enforcement of credit limits and preventing customers from deviating from them. This may be the banks' response to the rise in credit risks due to the economic slowdown.

Table 6.7
Restricted Customers and Accounts, 1995–99

						(End-of-year)
	1995	1996	1997	1998	1999	Rate of change in 1999 (%)
Restricted accounts	151,836	160,258	162,486	150,447	138,754	–7
<i>of which</i> For checks returned ^a	94,769	96,805	113,533	106,389	97,390	
Restricted customers	77,097	81,668	87,510	82,621	77,365	–6
<i>of which</i> Restricted in aggravated circumstances	36,457	38,625	44,285	40,862	36,470	–8
Special restrictions	763	1,588	2,725	4,177	6,765	
Percent of those restricted in aggravated circumstances	48	49	54	55	56	

^a The difference represents accounts restricted due to restriction in aggravated circumstances in another account.

The computerized systems dealing with this population are highly sophisticated. Most of the section's work load therefore consists of guiding the banking system in controlling events in the system and handling deviations from the norms and complaints. Some 3,000 written requests for clarifications or other action were received from the public and others in 1999, of which 1,500 were appeals lodged in the courts (1,300 in 1998). This number does not include telephone requests (about 10,000) for clarification and information. Towards the end of the year a computerized answering machine was installed on a trial basis to deal with the most common approaches from restricted customers. About 500 a month of those making enquiries by telephone (estimated to be about half of the total number of phone enquiries) are dealt with via the automatic answering service.

Readiness for emergencies

The management of banking activity in an emergency situation is vested in the Supervisor of Banks in the framework of the emergency economy system. Banking is part of the general economy, but due to the industry's relatively large size, special arrangements relating to banking have been formulated. In 1999 there were no external events that required attention within that framework, and the Banking Supervision confined itself to maintaining the framework and procedures. Towards the end of the year, in the context of the general preparations regarding the millennium bug, the interbank arrangement re reciprocal honoring of checks in the period of an emergency was updated.

APPENDIX 6.1

Activities of the Banking Supervision Department in 1999

- | | |
|------------|--|
| 1 February | Provisional directives relating to disclosure of the banks' preparedness for the year 2000 were introduced in <i>The Guidelines for Preparing Reports to the Public</i> , and a new format of disclosure was set, based on the new disclosure rules defined in the directives of the US supervision authorities.
In the context of credit risks entailed in the transition to the year 2000, procedures for identifying the population at risk and the action required were defined. Management of banking corporations were required to report to the board of directors at the end of every quarter on the implications of the millennium risks for the bank's customers. |
| 10 March | A directive raised the minimum capital ratio for banking corporations from 8 percent to 9 percent. |
| 14 March | Amendments to the directives relating to financing the purchase of controlling interest in corporations were published. The amendments imposed limitations on the balance of credit granted to a corporation for |

the purchase of the controlling interest in another banking corporation in cases where the ratio of finance for the purchase to the total cost of the purchase exceeds 50 percent.

- 26 April To ensure that the issue of the millennium bug was completely covered, the banking corporations were asked to examine the risk aspects detailed in the document published by the Year 2000 Coordination Committee of the Bank for International Settlements (BIS). The document sets out another framework for assessing the appropriateness and completeness of all the preparations undertaken in the approach to the year 2000 from the aspect of business risk management.
- 28 April Following the amendments to the directives relating to financing the purchase of controlling interest in corporations and the limitations on the indebtedness of single borrowers and groups of borrowers, the directive on the additional loan-loss provision was amended. The main amendment was that deviations from the limitations on the purchase of the controlling interest in corporations (including banking corporations) requires an additional loan-loss provision of 4 percent of the excess indebtedness.
- As part of the preparedness for the transition to the year 2000, a provisional directive was issued requiring banking corporations to close their offices to the public on Friday December 31, 1999, Saturday, January 1, 2000, and Sunday, January 2, 2000. The corporations had to notify their customers about this closure by means of a notice at the entrance to their offices and in the press. The notice could be made either by the Association of Banks, or by a banking corporation, or by an individual bank.
- 31 May Banking corporations were required to include their estimates of the effect of theoretical changes in the exchange rate on their profit and loss statements in their monthly returns (on an individual bank basis) and in their quarterly returns (both on an individual bank basis and on a consolidated basis) to the Banking Supervision.
- 1 June In the context of the policy of liberalization regarding the supply of banking services other than in the branches of the banking corporations, the Governor of the Bank of Israel, accordance with his powers under Section 28 of the Banking (Licensing) Law, issued two additional permits:
1. A general permit allowing banks to issue credit cards and to get customers to sign a request for the issue of such a card, also by mailing the contract to the customer and receiving it back from the

- customer by mail, duly signed, or by getting the customer to sign in the presence of a member of the bank's staff in locations designated by the bank.
2. A general permit allowing credit to be granted via the customer's employer at the workplace, and not necessarily by a member of the bank's staff. The amount of such credit was limited to NIS 35,000, and repayment was by deduction from the employee's salary. The ratio of the monthly repayment to the employee's salary was also limited. It was also specified who of the employer's staff is authorized to deal with the granting of this credit.
- 8 July The directive on direct debits was amended. The main changes were:
1. A bank receiving a request to debit an account by authorization (direct debit) must give a positive or negative reply within seven business days from the date it received the request. If the reply is negative, the bank must also advise the customer, and give reasons for replying in the negative.
 2. If an account is debited despite the customer having rescinded the authorization, the amount debited must be repaid to the customer at its value on the date of the debit.
- 7 September Two changes were made in the list of banking corporations: the name of Israel General Bank Ltd was changed to Investec Clali Bank Ltd, and American Israel Bank Ltd is in the process of merging with Bank Hapoalim B.M.
- 19 October The license of American Israel Bank Ltd was revoked. Citibank N.A. was granted a license as a foreign bank, and a permit to open a branch.
- 14 November Various amendments to the *Guidelines for Preparing Reports to the Public* were issued. The main ones were:
1. Banking corporations are now required to disclose their total balance of problem loans.
 2. Banking corporations must include in the explanatory notes to their financial statements the effects of new legislation etc. regarding provident funds, quantitative disclosure (or a reference to such disclosure) on the activity of the banking corporation in these spheres and its results in the period of the statement and in the previous period.
 3. The requirement regarding disclosure of income from management fees, commissions from insurance was extended.

- 15 November Due to the increase in foreign-currency credit to Israeli borrowers and in the risks inherent in such credit, the directive regarding the procedures for granting credit which the banks must follow was amended. The amendments determined what must be included in the customer's collateral portfolio, including the customer's exposure to foreign-currency credit, and the possible effect of an extreme change in the exchange rate on the quality of credit. The file of a customer whose foreign-currency indebtedness exceeds the amount set must include information on the sources which reduce or may reduce the credit risks arising from the customer's exposure to changes in the exchange rate.
- 18 November Republic National Bank of New York (Suisse) S.A. was granted a license as a foreign bank, and a permit to open a branch.
- 15 December In the light of changes in the general environment in which the banking system operates, banking corporations' potential exposure to market risks has increased. In line with the recommendations of the Basle Committee, a directive was issued requiring banking corporations to allocate capital against their exposure to market risks. It was made clear that this allocation is on top of the requirement to hold capital against credit risks. The directive enables a banking corporation to choose one of two alternative methods of estimating exposure to market risks and allocating capital against it: it can either adopt one or more of several standard methods for estimating each market risk separately, or it can use an internal model—and the bank has freedom in choosing or constructing the model—subject to the approval of the Supervisor of Banks.
As a result of the amendment regarding the allocation of capital for the exposure to market risks, the directive on the minimum capital ratio was also amended. The main change was setting and defining tertiary (tier-3) capital to be used to cover only market risks.
- 27 December A permit was granted to the holders of the controlling interests of Union Bank of Israel Ltd, following which they purchased 19.55 percent of the controlling interest held by the state (by M.I. Holdings Ltd), increasing their holding to 85.79 percent of the controlling interest.
- 30 December The financial institution license of the Investment Corporation of the United Mizrahi Bank Ltd was revoked.

The Banking Supervision Department-Organizational Structure

