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Letter from the Team leaders

July 25, 2022

To,

Minister of Justice Gidon Sa'ar

Bank of Israel Governor Prof. Amir Yaron

Social Equality Minister Merav Cohen

Report of the Team to Formulate a National Program to Increase Financial Inclusion

We are honored to present you with the report of the interministerial team that worked on formulating a national plan to increase financial inclusion.

Financial inclusion means creating **equal access** to financial services for the entire population. Due to the tremendous importance of financial services (payments, credit, savings, insurance, and so forth) to the functioning of a modern economy, financial inclusion is important for both private and overall well-being. Financial inclusion can help create the conditions for individuals get out of poverty, lower inequality, reduce the shadow economy and economic and general crime, and contribute to people's empowerment and creativity. Financial inclusion thereby encourages business opportunities and increases economic growth. While the level of financial inclusion in emerging economies is sometimes quite low, large parts of the population in advanced economies generally have good access to high-quality financial services, and the question of financial inclusion focuses on population segments that have difficulty, for various reasons, in consuming the wide range of financial services conveniently, fairly, and at reasonable cost. The varied and multicultural nature of the Israeli society and economy require a microeconomic view of financial inclusion issues, from the point of view of various population groups. Indeed, the Team's findings show that while the level of financial inclusion in Israel is generally high and similar to that in other advanced economies, it is relatively low in various parts of the population, and prominently so in large parts of Arab society, and there is room to adopt various policy measures to improve it.

The government and financial regulators have in recent years adopted a wide variety of policy measures in order to streamline the financial system, increase competition in it, make it more fair, and adjust it to technological changes that affect many aspects of our lives. Many of these measures have led to increased financial inclusion by enhancing competition and reducing prices, and enacting legislation to regulate the broad provision of financial services (for instance the Compulsory Pension Law) and fairness (for instance the Fair Credit Law). These measures come in addition to regulatory activity and legislation that had already existed beforehand, such as the obligation anchored in the Banking (Customer Service) Law, 5741–1981 to open a bank account for any citizen wishing to do so.

The rapid technological changes of the past few years, such as the rapid penetration and widespread use of payment applications, as well as online services provided by the banks, credit card companies, insurance companies, and pension and savings companies, have led to improved access to financial services and the ability to utilize such services conveniently and easily from any place and at any time. In contrast, the emphasis on providing services online while reducing the human and physical provision of such services has left parts of the population behind, in addition to groups that find it difficult in any case to consume such services for various reasons. As such, the time is right to formulate policy measures for increasing financial inclusion, with a broad look at all the measures taken in the past and developments that are expected in the future.

Until now, the level of financial inclusion in Israel has not been examined in a methodical way, and most of the existing information is based solely on survey data. In order to implement the optimal policy to improve financial inclusion in Israel, we must know what the level of financial inclusion is in the population, and we must map out which population groups have low levels. The Team gathered and analyzed a wide variety of statistical data, a large part of which had not been available until now, and created an in-depth picture of the state of financial inclusion in various population groups. The Team also held broad discussions with various entities of the public sector, the financial system, the private sector, and civil society organizations. Using focus groups, the Team examined the barriers to financial inclusion from the point of view of citizens themselves. Based on all these, the Team formulated recommendations in five main areas, in a way that would lead to the creation of a holistic program to increase financial inclusion in Israel:

A. **Credit to disadvantaged population segments:** A credit facility or loan from a supervised financial institution may help low-income households smooth their consumption (maintain a fixed level of consumption despite temporary income shocks), whether as part of current consumption or the purchase of durable goods, or in large and important transactions such as the purchase of a home. However, there is no law requiring a financial institution to provide credit to a customer, and financial regulators expect supervised entities to use discretion and to properly analyze the risk in providing credit. Despite this, there are many cases in which customers have difficulty repaying credit and therefore encounter significant socioeconomic difficulties.

   The Team identified four main focal points where it would be prudent to act. The first is **housing credit in Arab society**, regarding which the Team (through a subcommittee on financial inclusion in Arab society) formulated recommendations that will enable residents of Arab localities to take out more mortgages through a mechanism that will provide partial State guarantees for bank mortgages in those localities. This is directly connected to various aspects of land registration status, regarding which a team led by the Deputy Attorney General (Civil) recently made recommendations. We hope that after the implementation of those recommendations, alongside the recommendations made in this report regarding how the Israel Lands Authority should act in registering land in tenders it issues, the status and reliability of registration in Arab localities will change for the better. Further, the government has tasked the Director General of the Ministry of Finance with establishing another team led by the Accountant General to further examine the issue of mortgages in Arab localities.

The second focal point is in regard to **population groups excluded from obtaining consumer credit**. The Team found that there are citizens who have difficulty obtaining credit for the first time (for instance, obtaining a credit card), in view of the lack of a credit history, and that there are citizens who have been labeled as having high credit risk, who experience difficulty in recovering and resuming credit consumption. The Team formulated recommendations to examine mechanism that aim to bring excluded customers back into the cycle of credit through a model that will enable issuers to provide a limited short-term credit facility while hedging the risk, as well as by through government and private funds for credit-excluded individuals.

The third focal point concerns **awareness of the Central Credit Register**. The Team found that some citizens are not aware of the implications of the Register. The Team formulated a recommendation that aims to increase awareness of the system and help people use it to their benefit.

The fourth focal point involves **customers encountering difficulties after taking out credit**. The Team recommends setting up mechanisms for human interaction with customers in arrears before sending the debt for collection in legal proceedings, preferring control over enforcement by financial regulators concerning the implementation of directives concerning consumer credit and debt collection, and formulating mechanisms to assist customers in managing their debt. The decision that was recently published by the Bank of Israel, to expand the Central Credit register so that it will also include credit data for corporations as well, will contribute to enlarge the credit supply for small businesses for disadvantaged populations.

B. Increasing access to and use of advanced means of payment. Making a payment is the most basic action in the financial system, and forms the basis for a deeper relationship between a financial institution and its customers—one that also includes credit, savings, and more. In the modern economy, the use of advanced means of payment enables the customer to improve his well-being by increasing his consumption options from the physically accessible sphere to the Internet, where there is a wider variety, better price comparison ability, and more. Advanced means of payment also make it possible to spread out payments, make online person-to-person payments in addition to person-to-merchant payments, and more. The Team found that while the use of advanced means of payment is more common among the general public, large parts of Arab society, as well as among the credit-excluded population, do not use such means. The Team formulated recommendations that will make advanced means of payment accessible more accessible to the public and easier to use, as well as recommendations that will increase the penetration of these means of payment to consumers and merchants in areas where the use of cash is more widespread. These measures in turn support the government's policy to reduce the use of cash and reduce the shadow economy. In addition, advancing legislation on payment services (PSD legislation) should help increase the variety of services offered to the public in this area.

C. **A multiyear plan for financial education in Israel.** Increasing financial literacy is an integral part of greater financial inclusion (Kaiser and Menkhoff (2021); Kaiser et al. (2022)). National financial education programs that concentrate on different population groups (minorities, migrants, and so forth) and stages of life (youth, building a family, purchasing a home, retiring, and so forth) are central to financial inclusion policy measures in many advanced economies. The Team found that in Israel as well, there is a link between financial literacy and financial inclusion, and that financial literacy differs between various population groups. As such, the Team formulated recommendations to institute a national program to increase financial literacy in general, and in Arab society in particular, while anchoring the role of the Capital Market, Insurance, and Savings Authority, as the body with overall responsibility for coordinating financial education in Israel, in leading the effort together with the Bank of Israel and the Israel Securities Authority. One of the elements of the program is the formulation of a portal that will bring together all of the educational materials published by the Israeli financial regulators so that people will have easier access to independent financial information, with extra emphasis placed on linguistic and cultural access for the Arab society.

D. Removing cultural, religious, and linguistic barriers to financial inclusion. Financial services are based on the customer's trust in the financial institution. This trust is based on a sense of belonging and on the customer's ability to understand the conditions involved in consuming a financial product. The sense of belonging may be impaired in a situation where there is a lack of employment diversity in the financial system such that the workforce in financial institutions does not reflect the composition of the population. A customer's ability to understand the conditions depends first and foremost on his level of fluency in the language in which the service is provided. The Team found that these factors have a large impact on the ability and desire of parts of Arab society to utilize services in the financial system. The Team also found that there might be barriers originating in religion that prevent Muslim customers from utilizing some services. Therefore, the Team formulated recommendations to increase employment diversity in the financial system, make primary and common financial content accessible in Arabic, and examine whether there are regulatory barriers to providing "Sharia" compliant financial services that are common in Muslim countries.

E. Other recommendations

1. Financial advising. The Team believes that obtaining financial advice will often help customers obtain better terms, particularly with complex transactions. In contrast, there are financial advisors and agents whose activity is not supervised, and many customers are exposed to misleading advice and sometimes fraud and extortion. The Team recommends a number of alternatives for regulating financial advisors and broadening the powers of the Consumer Protection Authority in this regard.

2. Bank branches in Arab localities. The Team is aware of the changes taking place in banking, with a trend of branch closures and transitioning greater numbers of customers to digital consumption of services. The Team is also aware that in the past decade there has been an increase in the number of bank branches in Arab localities, concurrent with the decline in the number of branches in Jewish localities. However, there are segments of the population that have difficulty in utilizing banking services

digitally, and it is important to note that in Arab society, the digital gap is wider than in Jewish society, creating a greater need for banking services at physical branches. The Team has therefore formulated recommendations that will ensure a basic level of banking service provided in person, according to the type of customers, even if the trend of reducing the number of branches continues.

3. Continued monitoring of the level of financial inclusion and implementation of the recommendations. The vision that the Team has outlined and the recommendations it has formulated are aimed at reducing the disparities in financial inclusion by 2030. In order to examine the effectiveness of the recommendations, the Team recommends that various indices of financial inclusion continue to be quantitatively monitored, and that there be reports of the actions and measures taken by the various authorities.

The Team believes that the implementation of the recommendations in this report will lead to significant improvement in the level of financial inclusion in the economy, and will significantly reduce the disparities between the general public, for which high-quality financial services are largely accessible, and those parts of the population that have difficulty for various reasons in consuming services offered by the financial system.

We would like to thank the members of the Team and their organizations, who gave of their enthusiasm and experience in formulating the recommendations with professionalism and dedication, and special thanks to those who wrote the report.

Sincerely,

Andrew Abir
Deputy Governor of the Bank of Israel

Carmit Yulis
Deputy Attorney General (Civil)

Co-Chairs of the Team

Introduction

On December 30, 2020, the Governor of the Bank of Israel, the Minister of Justice, and the Minister of Social Equality established an interministerial team, led by the Deputy Governor of the Bank of Israel and the Deputy Attorney General (Civil), to formulate a national program to increase financial inclusion. The committee members included representatives of a number of regulatory and enforcement entities, and was co-chaired by Deputy Governor of the Bank of Israel Andrew Abir and Deputy Attorney General (Civil) Erez Kaminitz[1]*, who was followed by Deputy Attorney General (Civil) Carmit Yulis).

In addition to the Co-Chairs, the Team included:

- Yael Mevorah*, Director General of the Ministry of Social Equality (Head of the subcommittee on financial inclusion in Arab society)
- Orit Halevy, Senior Economist, National Economic Council
- Illit Ostrovich-Levy*, Chief of Staff of the Israel Money Laundering and Terror Financing Prohibition Authority
- Yuval Teller, Finance Coordinator, Budget Department, Ministry of Finance
- Oren Cohen*, Deputy Director General for Government and Society, Prime Minister's Office
- Tal Harel Matityahu, Head of Operations, Banking Supervision Department, Bank of Israel
- Amir Davidov, Senior Area Manager, Israel Tax Authority
- Ohad Maoudi, Senior Deputy Commissioner, Capital Market, Insurance and Savings Authority

[1]* Completed his or her term during the period of the Team's work.

In addition to the Team members, there were others who contributed to the writing of this report and to the Team's work. We thank:

- Yoav Soffer, Team Coordinator, Bank of Israel
- Orly Har-Zion, Bank of Israel
- Dr. Maya Haran Rosen, Bank of Israel
- Sefi Bahar, Bank of Israel
- Dorit Markovitz, Bank of Israel
- Ori Altalat, Bank of Israel
- Eylon Binyamin, Bank of Israel
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- Noa Granot, Bank of Israel
- Doron Hershko, Bank of Israel
- Ophir Ben-Sinai, Bank of Israel
- Liron Moutner, Ministry of Justice
- Naomi Avraham, Ministry of Justice
- Roni Neubauer, Ministry of Justice
- Raviv Zayit, Prime Minister's Office
- Michael Ben-Dahan, Budget Department, Ministry of Finance
- Salima Sliman, Minority Sector Economic Development Authority

- Wadia Awad, Capital Market, Insurance and Savings Authority
- Pinhas Nissim, Capital Market, Insurance and Savings Authority
- Sami Lahiani, Minority Sector Economic Development Authority
- Hassan Toafra, Minority Sector Economic Development Authority
- Adham Darawshe, Ministry of Social Equality
- Etti Kaveh, Israel Tax Authority

The following section presents the vision formulated by the Financial Inclusion Team for 2030. Chapter A. of the report presents a background of the issue of financial inclusion. Chapter B. presents the main findings of the qualitative research, which describes various aspects of the state of financial inclusion in Israel. Chapter C. focuses on the reasons for the differences found between various population groups in Israel. Chapter D. presents the broad quantitative findings regarding the level of financial inclusion in Israel. Chapter E. relates to financial inclusion from an international perspective. Finally, chapter F. focuses on policy recommendations formulated by the Team.

Vision

<u>**Financial inclusion in Israel—Vision and Targets for 2030:**</u>

Every adult shall have a payment account, (such as a current account), whether on existing platforms or on those that may be developed in the future, through which he will be able to make and receive payments through traditional or advanced digital means.

- Target – The rate of those holding an account in the subgroups of Israeli society shall be similar to the rate in the general population.
- Target – The rate of those holding and using supervised digital means of payment in the subgroups of Israeli society shall be similar to the rates in the general population.
- Target – Wage payments in cash by employers defined as proprietors will be stopped.

Every adult shall have access to credit when needed, and it shall be provided in an equal and fair manner by responsible and supervised lending institutions.

- Target – The rate of those obtaining mortgages in Arab society will be about half the rate of those obtaining mortgages in overall Israeli society. In addition, when construction is on regulated land according to permits, the rate of mortgage recipients in Arab society will be equal to the rate in Jewish society.
- Target – The Israeli economy shall have credit provision solutions for excluded population groups, taking credit risk into consideration, including "microfinancing" solutions for micro businesses in the relevant sectors, including nonprofits.
- Target – The State shall work to remove barriers to the provision of credit to small and micro businesses, including barriers for nonbank credit providers.

Every adult will have a sufficient level of financial literacy to be able conduct himself with financial responsibility at all stages of his life.

- Target – Operating a system that will provide an infrastructure for financial education within the education system.
- Target – Pooling the information that is relevant at various points of life and relevant decision points (for instance, establishing portals and access in Arabic), including by actively providing information to excluded population groups.
- Target – Creating a strong consumer protection infrastructure for Israeli financial consumers in all financial services.

The financial and regulatory systems will take cultural characteristics and linguistic barriers of population segments into account, and will encourage relationships of trust.

- Target – Making financial content accessible to target populations in languages they understand.
- Target – Encouraging employment diversity for the target population in the financial sector and in the public service as it pertains to these areas.
- Target – Making appropriate financial products accessible to the target populations.

Executive Summary

Introduction

In order to build a practical, comprehensive, and effective work plan to increase financial inclusion in Israel, the Team had to thoroughly examine all aspects of the issue. The team needed to examine how the main components of financial inclusion are reflected in various population groups in Israel, what the barriers to financial inclusion are, and to what population groups are those barriers relevant. As such, the Team gathered a wide variety of data, which provided a holistic picture of the level and characteristics of financial inclusion in Israel. The Team did not suffice with just statistical data, but held broad discussions with various entities in the public sector, the financial system, the private sector, and civil society organizations. Beyond the professional perspectives of these entities, the Team also used focus groups in order to grasp the point of view of relevant segments of the population. Based on a broad survey that the Team conducted, it obtained a clear picture of the state of financial inclusion in Israel, on the basis of which it devised a program to increase financial inclusion in general, and in various population groups in particular.

What is financial inclusion

Financial inclusion means creating **equal access** to financial services[2] **at a reasonable cost** for the entire population. Financial inclusion is very important, and can improve the well-being of citizens in a numerous ways. Financial inclusion may help people get out of poverty, reduce inequality in society, reduce the shadow economy, encourage business opportunities, and stimulate economic growth. Financial inclusion expands access to sources of financing and helps increase economic opportunities for individuals and businesses. However, there are risks to increased financial inclusion without the proper financial literacy. For instance, expanding financial inclusion and the supply of credit

[2] All financial services, including bank accounts, credit and insurance services, digital and mobile means of payment, savings instruments, and so forth.

without increasing people's financial literacy may cause households to take credit in an uninformed manner, and if they then have difficulty repaying that credit, it could lead to financial exclusion due to difficulties they may face in the future in obtaining credit, and the effect this would have effect their access to financial products.

One main way of dealing with this problem is through a long-term financial education program that imparts norms of health financial conduct throughout the population.

The financial inclusion discrepancies between groups in Israeli society – Qualitative findings

Beyond the overall picture, it was important for the Team to map the extent of financial inclusion in all population groups in order to understand the barriers that are relevant to each group. In this context, the Team focused on *Haredi* (ultra-Orthodox) society, Arab society, the elderly, and disadvantaged population groups.

The Team held discussions with nonprofit organizations, entities from the private and public sectors, and civil society activists working in this area. Through these discussions, the Team developed qualitative insights. For example, it found that there are citizens in Arab society who avoid consumption of financial products, partly due to self-perception of discrimination. Some of the aforementioned self-perception comes from a lack of representation of Arab society among employees in financial firms, digitalization gaps, or because the products are not in line with Islamic religious directives. In Ultra-Orthodox society no significant financial inclusion discrepancies were found with regard to certain products, while with others the Ultra-Orthodox society was found to have even more financial inclusion than the general society. Moreover, it was found that in addition to the formal financial institutions, there are others that are unique to Ultra-Orthodox society that are adapted to its needs. However, there appears to be a preference for cash usage over the use of advanced means of payment, and there are digitalization gaps that hamper well-being and restrict their consumption abilities. The Team also found that disadvantaged segments of all population groups may be at risk of having credit heavily endorsed to them by entities that may exploit their lack of financial literacy. A lack of understanding of the implications of taking out credit, for instance, may lead to a deterioration toward financial exclusion, and thereby to social exclusion. Disadvantaged population groups, those with low socioeconomic status, also suffer from a lack of digital literacy and of physical access to digital infrastructure, which makes it difficult for them to consume various financial products.

The Team held discussions with various financial regulators, during which a number of main measures taken in order to enable Israelis to consume financial products were presented. One of the measures presented by the Banking Supervision Department was the Banking (Service to the Customer) Law, 5741–1981, which sets out that a bank is required to open an Israeli currency current account for any customer, unless there is a reasonable cause to refuse. Moreover, Banking Supervision Department directives require banks to offer each customer basic means of payment (debit cards, ATM cards) and access to their bank account through digital means such as a website or various cellular applications.

Some of the measures taken in recent years by the Capital Market, Insurance, and Savings Authority include tools to make financial information in the field of insurance accessible to the public, such as the “Money Mountain” and “Insurance Mountain” websites (in Hebrew). The Authority also publishes service indices of the companies in the insurance and pension industries in order to increase transparency in the field.

In addition to the insights obtained in the discussions with the various regulators, information was also gathered from nonprofits organizations and social activists by a secondary team that was established. These discussions revealed that in all population groups there is some lack of financial literacy. The public is not aware of the implications of its financial actions as derived from the Reducing the Use of Cash Law, 5778–2018 and the Credit Data Law, 5776–2016. A lack of familiarity with the legal arrangements involved in the use of financial products is causing harm to the public. For instance, the Reducing the Use of Cash Law harms the Arab and Ultra-Orthodox public, where the use of cash is more common, and the Credit Data Law makes it possible to accumulate “negative” information on customers, which may catch up with them in the future.

The discussion with activists also revealed that community structure is significant for the Ultra-Orthodox and Arab communities. Therefore, having people of significance in the community transmit financial knowledge that is linguistically and culturally adapted may be more efficient. These agents will be able to actively make the material accessible and bridge the various literacy gaps. The representatives that participated in the conversations discussed the fact that Arab and Ultra-Orthodox societies, as well as population groups in economic distress, must deal daily with existential issues, which is particularly intensive, leading to a lack of significant savings efforts. In addition, these population groups are generally guided by welfare workers to use cash, which they perceive as being a more financially conservative method of conduct.

Mechanisms that affect financial inclusion

In order to explain the reasons for the financial inclusion discrepancies between the various population groups in Israeli society, the mechanisms affecting the level of financial inclusion and the barriers to it were surveyed. The Team found that one of the main barriers is credit risk. For instance, in Arab society there are indications of high credit risks, mainly in localities with low socioeconomic levels, which limits their access to credit. The rate of customers reported to the statistical credit register who have been reported in arrears on loan repayments is about 15 percent, compared with about 6 percent in the non-Ultra-Orthodox Jewish society.

With regard to the quality of mortgage collateral, the Team found that in Arab society, there are property registration barriers, alongside a low level of real estate tradability. These barriers make it difficult to bondage properties, and are some of the reasons for the low rate of mortgage borrowing in Arab society. For instance, the Team found a significant negative correlation between the rate of those aged 18 and over who have a housing loan and the rate of unparcelized land.

Another major barrier is the linguistic barrier. The combination of low Hebrew-language fluency and low access to financial products in Arabic is a barrier to integration of the Arab population in the financial system. Survey respondents in Arab society said that the linguistic barrier prevents them, to a certain extent, from consuming many financial products.

One of the main barriers that was discussed in the focus groups is a low level of digital literacy. Since digitalization of financial services is increasing, population groups that are not familiar with the use of various digital means may be financially excluded. Data gathered from the banking system show that Arab citizens use the banks' websites and applications at a lower rate (21 percent) than Ultra-Orthodox (31 percent) and non-Ultra-Orthodox (44 percent) Jewish citizens. Another possible explanation for the low use of digital means in Arab society may be linguistic barriers.

Some customers in Arab society avoid using financial products for religious reasons. More than 10 percent of respondents said that this barrier affects their consumption of financial products. In Arab society, both the level of financial literacy and confidence in financial literacy are lower than in Jewish society.

Information gathered in the Team's discussions shows that those in the Arab and Ultra-Orthodox communities have a cultural and social preference for using cash. The findings of a survey carried out for the Bank of Israel in 2021 show that more than 50 percent of Arab respondents prefer receiving one-time grants in cash over other means of payment. A survey conducted for the Team's work found that the rate of Arab respondents who avoid holding a payment card due to a preference for cash is higher than the rate among non-Ultra-Orthodox Jews. The rate of those who avoid ownership of a current account for the same reasons is higher among non-Ultra-Orthodox Jews than among Arabs.

Another barrier to financial inclusion is that the conditions are consuming the financial product are not sufficient for the consumer. For instance, a survey conducted for the Team's work found that about half of non-Ultra-Orthodox Jewish respondents that prefer not to take loans from formal financial entities and about 37 percent of the Arab respondents with the same preference, believe that the mortgage\loan terms offered to them by financial entities are not good enough.

Financial inclusion in Israel: The situation based on quantitative data

An international comparison of basic financial inclusion indices shows that the average level of financial inclusion in Israel is high, similar to the levels of countries with similar income levels. However, there are indications of gaps between various population groups within Israel, and within different financial products. Most of the gap in financial inclusion was found to be among the Arab population. In contrast, the Team found that despite the high level of access to and use of the financial system among Ultra-Orthodox society, there are a number of discrepancies relative to non-Ultra-Orthodox Jewish society. For instance, in the Ultra-Orthodox society, the rate of savings was found to be lower in most savings channels than among non-Ultra-Orthodox Jews (other than the use of savings plans).

A prominent finding among Arab society is that there is a relatively high rate of households that do not have a bank account (12 percent), compared with other population groups—including Ultra-Orthodox society where the rate is miniscule. Corresponding to the qualitative findings, Arab society was found to have a low rate of payment card usage. Only about half of Arab households have a payment card.

Another finding that was prominent among Arab society is the higher use of consumer loans alongside low use of housing loans, due to the interchangeability between these products. These findings show a trend that is the opposite of the trend in Jewish society, where the rate of use of consumer loans is low and the rate of use of housing loans is higher. This interchangeability between consumer credit and mortgages is partly due to the complexity of registering a lien on properties in Arab localities and the quality of the collateral, which leads some people in Arab society to take out consumer loans as an alternative to housing loans. It should be clarified that despite the high level of use of consumer loans, the average loan amount in Arab localities is lower than the general average, and the interest on those loans is higher, which may attest to a higher level of risk in Arab society. These findings are in line with data from the statistical credit register and other administrative data, which show either a low payment ethic, or a low supply of credit and a lack of sufficient competition over Arab customers.

While current account lines of credit in Arab localities are lower than the overall average, the utilization of those lines of credit in those localities is higher, which may attest to low financial literacy that could lead to an imbalance between household income and expenses, which may in turn lead to credit risk. The utilization of lines of credit may indicate limitations in obtaining cheaper alternative credit. The issue of low supply in this context is reflected in the fact that people for the Arab society borrow from a small variety of credit sources. In contrast, Ultra-Orthodox society features a relatively broad range of credit sources.

In the area of savings as well, the data show significant gaps in savings volumes between the various population groups. The savings rate in Ultra-Orthodox society is significantly higher than in Arab society in all savings channels, even when looking at groups with similar income levels. The savings rate is highest among non-Ultra-Orthodox Jewish society, which is in line with higher income levels.

Summary of recommendations

1. **Credit to disadvantaged population segments (page 111).** Obtaining a credit facility or loan from a supervised financial institution may help households smooth their consumption, both in terms of current consumption or purchasing durable goods and in terms of large and significant deals such as purchasing a home. The Team devised recommendations that will make it easier to take out a mortgage in Arab society in the short term, as well as recommendations to enable credit excluded individuals to regain access to credit in an informed manner:
    a. In response to the difficulty in property registration and real estate tradability in Arab society, the Team recommends providing partial State guarantees for mortgage loans in the short term, and regulating the registration of new

properties and developing the tradable real estate market in Arab society, in a way that will enable residents of the Arab localities to take out mortgages.

b. In order for excluded customers to regain access to credit, the Team proposes enabling the issuers of means of payment to provide a limited short-term credit line of credit while hedging risks, and the streamlining and improvement of government and private funds for credit excluded individuals.

c. Increasing awareness of the credit data system and its implications for borrowers among particular population groups through focused public information campaigns, taking into account the cultural and linguistic characteristics of each group and the public information channels relevant to it.

d. Arranging mechanisms for personally contacting customers in arrears before the debt is assigned to legal debt collection proceedings, giving preference to control and enforcement by financial regulators concerning the implementation of directives regarding consumer credit and debt collection, and formulating mechanisms to assist customers in managing their debts.

2. **Increasing access to and use of advanced means of payment (page 120).** The Team found that while the use of advanced means of payment is widespread among the general public, a considerable part of Arab society and among those who are credit-excluded do not use such means. The Team formulated a set of recommendations with the aim of increasing the use of advanced means of payment:
   a. Recommendations that will make advanced means of payment more accessible to the public and make it easier to use them in general, and debit cards in particular.
   b. Recommendations that will increase the penetration of these means of payment among customers and merchants in areas that are characterized by a low level of financial inclusion.
   c. A recommendation that would require merchants to have advanced means of accepting payments.

d. In order to minimize the payment of wages in cash, the Team recommends examining amendments to the Wage Protection Law, which would minimize the payment of wages in cash and provide the possibility payment through advanced means.

3. **Multiyear financial education plan (page 131).** By implementing a national financial education program that concentrates on the differences between various population groups and adapts to various stages of life (youth, establishing a family, purchasing a home, retirement, and more) it will be possible to increase financial literacy in Israel. The Team formulated recommendations that aim to instill financial education in the optimal manner:
   a. Anchoring the function of the Capital Market, Insurance, and Savings Authority as the body with overall responsibility for financial education in Israel, which will lead the effort together with the Bank of Israel and the Israel Securities Authority.
   b. Putting special emphasis on Arab society by establishing a designated team that will be coordinated by the Bank of Israel and lead together by Capital Market, Insurance, and Savings Authority, Israel Securities Authority and the Minorities Authority that will lead the financial education effort in that society.
   c. Establishing a national portal that will concentrate all of the educational materials published by the Israeli financial regulators so that people will have easier access to impartial financial information, with an emphasis placed on linguistic and cultural access for the Arab society.
   d. The team recommends that the financial education plan be included in the education system.
   e. In order to control the various financial education initiatives, the Team recommends that success indicators be formulated to examine the inclusion of financial education and the level of financial literacy.
4. **Removing cultural, religious, and linguistic barriers to financial inclusion (page 136).** Trust in the financial system may be impaired when there is a lack of employment

diversity in the financial system, such that manpower in the financial institutions does not reflect the composition of the population. The extent of the customer's fluency in the language in which the service is provided has an impact on his understanding of the service he will be consuming. In addition, the Team found that there may be religious barriers preventing Muslim customers from consuming some services. These factors have a large effect on parts of Arab society in their consumption of services form the financial system.

a. In order to make financial products more accessible to Arab citizens who are not highly fluent in Hebrew, the Team recommends that financial regulators instruct the institutions under their supervision that essential documents that have consumer significance, as well as essential explanatory documents on the institution's website be accessible in Arabic, without the customer needing to make an active request. The regulators will instruct the supervised institutions to provide basic common services on various platforms in Arabic. Finally, the financial regulators' public enquiries units will respond to those wishing to make enquiries in Arabic, even if the final answer is provided in Hebrew.

b. In order to increase employment diversity in the financial system, the Team recommends that the financial regulators examine ways to encourage the supervised institutions to publish information on employment diversity in the financial institutions.

c. The Team recommends that the financial regulators publish a public consultation to examine whether there are regulatory barriers to providing Shari'a-compliant financial services that are common in Muslim countries, and to examine whether any such barriers can be overcome.

5. **Additional recommendations (page 138).**

a. **Financial advising** – There are financial advisors and agents whose activity is not supervised, and many customers are exposed to misleading advice and sometimes even to fraud and extortion. The Team recommends a number of alternatives for regulating financial consultants and broadening the powers of the Consumer Protection Authority in this regard.

b. **Bank branches in Arab localities** – The digital gap is greater in the Arab community than in Jewish society, and there is greater need to consume services at bank branches. The team therefore recommends that the provision of services at bank branches and manpower at the branches be in line with the cultural and social characteristics of the customers. The Team recommends that the Banking Supervision Department issue instructions that as part of its branching policy, each bank will be required to concern itself with how services are provided and bringing them in line with the quantity and spread of its customers by residential location. In addition, the Team recommends that during the next two years, no branches should be closed in Arab localities without an appropriate alternative within the locality or nearby at the Banking Supervision Department's discretion.

c. **Continued monitoring of the level of financial inclusion and implementation of the recommendations** – In order to examine how the Team's vision and targets are being met and the effectiveness of the policy measures implemented due to the recommendations, the Team recommends that various indices of financial inclusion continue to be quantitatively monitored in selected measurable areas.

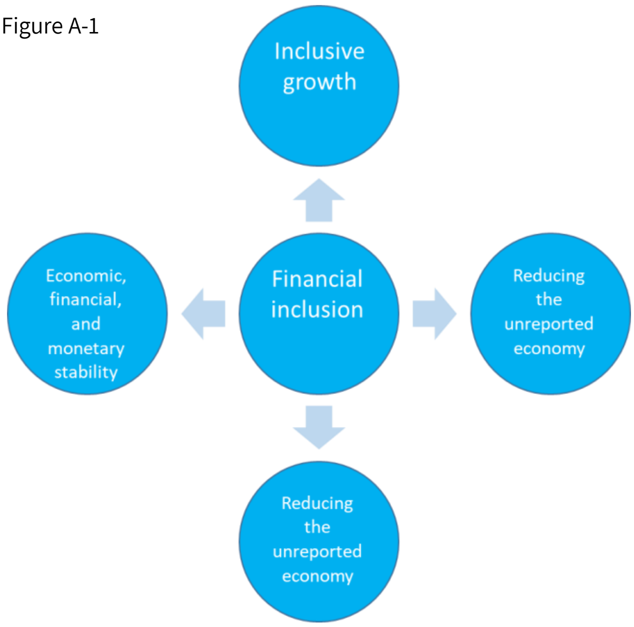
WHAT IS FINANCIAL INCLUSION?

A. What is financial inclusion

A.1. Background

Financial inclusion means creating **equal access** to financial services[3] for the entire population **at a reasonable cost**. Financial inclusion is important both for the well-being of individuals and for the stability of the financial and political systems (Campbell et al. (2011); World Bank (2014); Zingales (2015); Cihak et al (2016)). Financial inclusion can help create conditions for getting individuals onto a path out of poverty, reduce inequality, reduce the unreported economy, contribute to people's empowerment and creativity, encourage business opportunities, and advance economic growth (Figure 1.1) (Townsend and Ueda (2003); Levine (2005)). It can also contribute to moderating the business cycle—shortening troughs in the cycle and extending peak periods (Claessens et al (2013, 2014)). Various national and international agencies therefore see increased financial inclusion as a main element in advancing the economy. Financial inclusion is particularly essential in advancing the UN's sustainable development goals (SDGs) for 2030. Central banks in many countries, together with other financial regulators, are a major factor in leading national programs to advance financial inclusion among their populations.

Figure A-1



[3] All financial services, including bank accounts, credit and insurance services, digital and mobile means of payment, savings instruments, and so forth.

The importance of financial inclusion is partly due to the fact that it expands access to sources of finance (Barajas, Beck, Belhai, and Ben Nacuer (2020)) and thereby supports the allocation of capital to manufacturing uses, the efficiency of commercial transactions, the diversification and management of various risks, and more. Increased financial inclusion can also be the result of the diversification and expansion of the types and number of entities offering financial services, and is therefore also linked to the issue of financial development—expanding the quantity and quality of the financial markets operating in a country (Chami et al (2010); Beck (2012)).

A central element in the literature focuses on inclusion discrepancies that are mainly caused by market frictions and the need to reduce the effect of those frictions. One main frictional variable is information gaps. The public suffers from information gaps when it makes financial decisions, so the creation of policy tools that will help the public reduce those gaps—such as the establishment of a credit data register, and open banking—can help expand the public's access to credit.

Similarly, greater financial literacy on the part of the public can also help narrow information gaps. Other frictional variables include increased enforcement capability over fairness and information transparency in contracts, increased competition, and more. The literature tends to divide the frictional variables into those having to do with market structure and the supply side of credit and those having to do with the demand side of credit.

Some of the differences in financial inclusion are due to **structural conditions**. There are costs involved in making financial services accessible to the entire population, and therefore, with all other things remaining constant, financial inclusion will be greater among population groups for whom conditions allow the provision of financial services at lower costs and in a way that will be feasible for the providers of those services. One of the main structural conditions is the customers' income level. It is more worthwhile for financial institutions to provide services to customers with high income levels, those that can provide greater income to the institutions, while the cost of supplying services to customers includes fixed elements that are not dependent on the income level derived from providing them.

Other structural conditions include population size and density, and demographic factors such as the age composition of the population. The larger the population in a given area is, the lower the cost of providing services to customers will be. (For instance, it is more efficient to deploy ATMs for a more densely populated area.) In Israel, Arab society and the Haredi sector are population groups with relatively low income levels and small proportions of the population (21 percent and 11 percent of the population respectively), particularly if we take into account their age composition. (Both groups have a high rate of children, which, in general, do not consume financial services.) These characteristics reduce the economic feasibility of providing dedicated financial services to these groups. These two groups differ from each other in terms of population density (Arab society generally features small and rural localities, while the Haredi population generally lives in densely-populated urban concentrations) and in other characteristics such as fluency in Hebrew, religious preferences, and so forth.

Another structural factor that may influence the extent of financial inclusion is the intensity of competition in the financial system. When there is little competition, the financial institutions may focus on providing services to customers that create high profit margins, and avoid investing in offering financial products to disadvantaged customers. In contrast, competitive pressure that is not accompanied by close supervision and an appropriate level of financial literacy may lead to a situation where customers are offered products that are not appropriate for them.

A lack of appropriate financial literacy may on its own create risks in increased financial inclusion. For instance, expanding financial inclusion and increasing the supply of credit, and particularly of consumer credit, might lead households to encounter stress and difficulty in repaying credit, which may in turn lead to financial exclusion due to difficulties in obtaining further credit or access to means of payment. Beyond the negative implications on the household level, this may also create risk to financial stability if a large number of households experience such difficulties concurrently. In addition, increased financial inclusion may create tension with the AML/CFT[4] regime.

The literature on financial inclusion has generally examined the differences between countries or between regions within a country, but has not sufficiently examined the differences between minority groups within a country, and can also include variance in financial inclusion relative to various population groups, such as:

- Variance between age groups – older and younger
- Gender variance – men and women

Religious-based variance is prominent in Israel. As such, the collection of statistical information for the Team's work was based on a division of localities by their religious identification. The insights mainly focused on measuring the differences in financial inclusion between the following three groups:

- Non-Ultra-Orthodox Jews
- Arabs
- Ultra-Orthodox Jewish population

Where the dimensions of the examination permit, the insights will relate to other divisions as well.

A.2. Financial inclusion, financial literacy, and financial education

The literature on financial inclusion has, in the past, focused on physical access to financial services, particularly in the emerging economies. In recent years, the emphasis has shifted to advancing digital infrastructure, digital literacy (which will enable the use of the new infrastructure), diversification, and the quality and price of the services provided to

[4] Anti-money laundering and combating the financing of terrorism.

disadvantaged population groups, including in advanced economies. Another important area is advancing **financial literacy** (Bachas et al. (2012); Radcliffe et al. (2018)).

The OECD has defined financial literacy as, "a combination of awareness, knowledge, skill, attitude and behavior necessary to make sound financial decisions and ultimately achieve individual financial wellbeing."[5] Financial literacy does not relate only to the acquisition of financial knowledge, but also to the expansion of financial ability and the building of tools and behavior ability that will make it possible to make proper financial decisions. A high level of financial literacy may help people make better decisions, develop trust in the financial system in general, and lead to an increase in the informed use of financial products and services. Thus, a high level of financial literacy will improve **the level of financial inclusion** among the public.

One of the policy tools through which to improve the public's financial literacy is increased **financial education.** Financial education is the act of transmitting financial knowledge and insights through curricula that may be long-term or short-term. The OECD defines financial education as, "the process by which financial consumers/investors improve their understanding of financial products and concepts and, through information, instruction, and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being."[6] Financial education programs emphasize the transmission of knowledge in a way that is adapted to the various population groups and their needs, at various stages in the lives of the individuals that make up the public, including the education system, military service, and adult life.

[5] 2018 OECD/INFE Financial Literacy Measurement Toolkit.

[6] OECD (2005). *Improving Financial Literacy: Analysis of Issues and Policies,* OECD Publishing.

DISCREPANCIES IN FINANCIAL INCLUSION IN ISRAEL: QUALITATIVE FINDINGS

B. The financial inclusion discrepancies between groups in Israeli society – Qualitative findings

B.1. Introduction

This chapter summarizes the qualitative insights[7] formulated during the Team's discussions and during the accompanying research. The chapter details the main information presented during the Team's meetings, findings of research conducted using focus groups among relevant population groups, and insights obtained as part of discussions that the Team held with civil society organizations and activists working in the field.

B.2. Main points of the information presented in the Team's meetings

The Team's starting point was to examine the question of financial inclusion in relation to defined population groups: the Arab community, the Ultra-Orthodox community, and the Jewish population with low socioeconomic status.

Regarding the Arab community, evidence brought to the Team showed that a significant barrier to its financial inclusion is their sense of discrimination when asking for services, to the point where most of them avoid seeking financial services out of concern of discrimination. The financial system and the regulatory system must therefore know how to act with sensitivity and to create a subjective sense for these customers that they are not discriminated against. For instance, in order to consider religious and cultural characteristics, there should be adequate representation of this population group among the system's employees, confidence-building steps should be taken, and so forth.

Most of the discrepancy among Arab society is concentrated in small businesses and households, while medium businesses' access to financial services is generally adequate. There are discrepancies in how Arab society uses digital services, which are gradually closing

[7] As opposed to the insights formulated based on statistical findings, which are detailed in Chapter D.

over time. The banking system has relatively few branches in Arab society, but physical branches are becoming less significant over time. However, between 2005 and 2015 there was actually a significant upward trend in the number of branches in Arab localities, in parallel with a reduction in the number of branches in Jewish localities. It is only in the past two years that there has been a moderate net downward trend in the number of branches in Arab localities. While objective indices point to higher credit risk among Arab society[8], there are actually parameters in Arab society that should work to reduce the risk, such as relatively low residential and workplace mobility.

In regard to Ultra-Orthodox Jewish society, the Team's findings show that in general, there is no significant financial inclusion discrepancy. Not only are the rates of bank account ownership, savings, and those with health insurance not low, a large part of this community receives financial services through tracks outside the financial system as well. Beyond the high level of access to loans through free-loan societies, there are also community-organized mutual life insurance programs and other community services. While the lack of supervision over these organizations may lead to the realization of risks from various domains, the fact is that Ultra-Orthodox Jewish society features efficient financial service in addition to the service it receives from the regulated financial system. However, Ultra-Orthodox Jewish society is not homogenous, and financial conduct varies among the various groups within this community, as does the extent of conservatism and preparedness to adopt various financial and digital tools. Despite the lack of a significant discrepancy in financial inclusion among Ultra-Orthodox Jewish society, there are a number of financial behavior patterns in the community that must be addressed. First, there is a preference for cash over the use of advanced means of payment. Such behavior is not necessarily due to the lack of financial literacy, but it does make it more difficult for people in Ultra-Orthodox Jewish society to conduct themselves financially in certain ways. Second, as will be detailed below, there is a low level of pension savings among the Ultra-Orthodox Jewish population,

[8] In this context, see Section C.1.3.

for cultural reasons. Third, digitization discrepancies in Ultra-Orthodox Jewish society prevent them from diversifying their consumption and consuming more financial products.

In general, disadvantaged population groups tend to have difficulty dealing with complex financial products, and some of them therefore avoid using such products, while others provide fruitful ground for the aggressive marketing of credit, while lacking knowledge or understanding of the implications of such credit. In recent years, traditional savings channels have not created sufficient incentive for savings, which becomes even more the case for population groups without knowledge of or access to more advanced options. In addition, there are population groups that suffer from digital discrepancies and have difficulty adopting the digital tools that the financial system offers—senior citizens with physical or cognitive difficulties, those who have difficulty with the Hebrew language (immigrants, minorities), and others.

The issue of credit exclusion is complex, since it is difficult to distinguish a situation where credit is not provided due to exclusion from a situation in which the customer's risk characteristics do not justify the provision of credit. According to social organizations that operate in this field, credit exclusion generally describes those who have no bank account, whose income is low, who lack financial literacy, and for whom there is mutual distrust with the financial system. Such situations could lead to their credit rating improperly reflecting their default risk, which would lead to a worsening of their financial situation (due to the lack of access to credit or due to taking out expensive credit from unregulated entities), which in turn worsens their credit exclusion. For instance, a lack of understanding of the significance of a credit facility and the implications of exceeding it could lead to high late payment charges, and so forth. Civil society organizations have launched several initiatives, some in conjunction with the government, to make credit more accessible to micro businesses, although the monetary volumes of such initiatives are apparently far from meeting the demand. In terms of households, the fund for credit excluded individuals that was supposed to be set up under the Credit Data Law has still not begun operating, since the terms in the tender turned out to be unattractive for bank credit providers. A new tender was recently published and includes nonbank entities.

Relevant insights and aspects concerning the work of regulators who were part of the Team:

<u>Banking Supervision Department, Bank of Israel:</u>

The Banking (Service to the Customer) Law, 5741–1981 sets out that a bank must open a current account in Israeli currency with no credit facility for any customer, unless there is a reasonable reason to refuse. This is a significant starting point that forms the basis for broad financial inclusion in the Israeli economy. Enforcement of this obligation is a top priority for the Bank of Israel's Public Enquiries Unit. Supervisory directives obligate the banks[9] to offer every customer basic means of payment (a debit card), a cash withdrawal card, access to information concerning the account through the Bank's website, access to making transactions through digital channels and the telephone call center, and more.

The Banking Supervision Department offers the public a variety of tools that enable customers to consume banking services in an informed and efficient manner, including a banking ID that clearly presents all transactions made in the account in a transparent manner that makes comparison easy; the fee tracks reform that took effect in 2014 and that includes the "tracks service" that is intended to simplify and lower the pricing of common bank services; the bank mobility reform that took effect in 2021 and enables customers to move from one bank to another online easily, conveniently, securely, and without cost, within seven business days; and the Open Banking reform that will mostly take effect in 2022 and will enable customers to make informed use of their banking information and advance secure innovation in the financial realm.

The main challenges identified by the Banking Supervision Department in this area are:

[9] The banks may set restrictions.

- Public passiveness in informed financial conduct: For various reasons, large parts of the public do not efficiently use the tools available to them. For instance, only a low rate of customers have actively joined low-cost banking tracks, despite the many efforts to create greater public awareness of this option. The Banking Supervision department therefore intervened on behalf of certain population groups and obligated the banks to proactively subscribe small businesses, senior citizens, and customers with difficulties to this service.

- The trend of reducing the number of bank branches and transitioning customers to digital banking is a challenge mainly for senior citizens. The Banking Supervision Department instructed the banks to make sure that there would be continued access to banking services after the closure of branches. It also led a broad nation-wide effort to provide guidance and digital education to senior citizens as part of a multiyear program to provide financial education content to various population groups (youth, soldiers, and more). In 2022, efforts are being directed to the Arab community.

As a prime example of its work in this field, the Banking Supervision Department identified the distress of women victims of violence who are in shelters and half-way houses, and launched the "Banking Availability Covenant" in conjunction with the banking system. The Covenant created infrastructure to assist those women in embarking on a new and independent financial path.

Capital Market, Insurance, and Savings Authority, Ministry of Finance:

In recent years, the Capital Market, Insurance, and Savings Authority has developed various tools to increase the transparency of and access to financial information for the public, and to thereby enable the public to compare products and make informed decisions, and to identify cases of double insurance. Examples of this include the "Insurance Mountain" and "Money Mountain" websites and the pension clearinghouse. Insurance calculators were developed to enable the public to compare the prices of various insurance products (compulsory vehicle, health, life, home), and to provide them with insurance company service index scores regarding each product. There are also provident fund and pension calculators and the Insurance-Net website, which enable the public to monitor yields achieved by the institutional investors through various products and investment tracks.

The Authority publishes services index readings for companies in the various insurance and pension savings fields. The indices provide transparency for savers and insured clients, with the aim of increasing competition in the area of service to the customer. They also help the public make decisions when purchasing particular products, provide an incentive for institutional investors to improve their service, and help the public exercise its rights.

The Authority also engages in actions to advance financial inclusion. A tender for selected pension funds enables worthwhile pension savings alternatives at a fair price for nonunionized savers. The process lowered the average management fees on assets and deposits, and strengthens smaller pension providers. It is also worth noting a number of regulatory actions in the area of pension savings and insurance, such as age-dependent savings tracks, Jewish law and Sharia compliant savings tracks, investment provident funds, consolidation of inactive accounts, withdrawal of small amounts from inactive provident fund accounts, risk insurance on mortgages for those with disabilities, pro bono pension consulting, Capital Market Authority measures to assist senior citizens, and making the compulsory vehicle insurance pool more accessible.

B.3. Insights obtained in discussions with nonprofit organizations and social activists

As part of the mapping of disparities in financial inclusion in Israel, a subcommittee was established that held discussions with representatives of nonprofit organizations working among various population groups, particularly the Ultra-Orthodox public, the Arab public, and disadvantaged population groups. The discussions focused on understanding the situation regarding basic financial products (opening and managing a basic current account with no credit facility, access to information and executing transactions through direct channels, and pension). With that, the participants in the discussions also dealt with additional issues and financial products (for instance, credit).

The main insights from these discussions included:

- **Lack of knowledge and financial literacy** – One of the main points broadly raised both in relation to the general public and in regards to specific population groups was that there is a very great lack of knowledge regarding financial products, and of understanding regarding the significance and implications of choices made regarding financial products and services. There is a broad phenomenon among various population groups of insufficient understanding of financial products and the terms offered with those products, which makes it difficult to make informed decisions regarding those products.

- In particular, **the public is not aware of legal arrangements** that may have an impact on their day-to-day financial conduct, specifically the Reducing the Use of Cash Law, 5778–2018 and the Credit Data Law, 5776–2016. The Reducing the Use of Cash Law makes it a criminal offense for someone to use large amounts of cash that exceed the ceilings set out in the law. Arab and Ultra-Orthodox communities make significant use of cash, and during the discussion it was pointed out that large parts of these communities are not aware of the prohibitions or their details. The Credit Data Law has an impact on every citizen, and on his or her ability to obtain credit. The first interaction with the Law takes place when a person requests credit and is refused due to a negative credit history, while the person is not even aware that such information is even being collected in an itemized and identifiable manner. A person must manage his affairs and build a credit record before requiring credit. It is thus very important to bring this issue to the public's knowledge in an effective manner.

- **Human intermediation within the community**. Alongside the understanding that a lack of financial knowledge is one of the main barriers to financial inclusion, it was mentioned that the emphasis does not need to be on making the information itself accessible, but on how it is made accessible. In today's day and age, there is theoretical access to a large amount of information: calculators, usage guides, articles, etc. However, it came up in the discussion that in order for the access to the information to be effective, human intermediation is necessary for various population groups, and it is preferable that this intermediation be done through people from within the community. There are a number of aspects of the need for such intermediation. First, people have a tendency to be passive, and proactive approaches are necessary. Second, making the information accessible through people from within the community makes it possible to overcome linguistic and cultural differences, as well as suspicion and lack of trust in the financial system. Third, the use of human intermediation can provide a response in places where there is a lack of digital accessibility (in the context of population groups in the geographic and social periphery).

In terms of the linguistic barrier in the Arab community, the existing financial information is not sufficiently accessible in Arabic. Since the linguistic barrier exists among young people as well—contrary to the widespread perception that this barrier exists only in the older population—the need for linguistic accessibility of financial content is brought into sharper relief. Cooperation with local government and with relevant organizations working within the relevant populations groups is very important. Some representatives in the discussions noted that it is worth focusing on young people in the various population groups, since their willingness and desire to learn are greater, and using them as agents of change will create waves among the broader population, including among older age groups. At the same time, it should be noted that not all financial consulting and agency roles are currently regulated, such that there is not necessarily any binding professional standard for working in these fields, and using unlicensed financial agents may expose the public, in certain cases, to financial damage, exploitation, and fraud.

- **Digital accessibility as a key to financial accessibility.** Digital literacy in Arab society, Ultra-Orthodox Jewish society, and older age groups is lower than in the general population, particularly in relation to more advanced skills (beyond the use of email and basic web browsing). In addition, there is a lack of infrastructure and physical accessibility to digital services. Digital access is required in order to enable financial accessibility, particularly in view of the financial system's transition to providing services through digital channels.

- **Various arguments were raised toward the banking system** and how it sometimes behaves, mainly concerning the provision of credit. There were also claims that the banking system operates by "pushing credit" that is not appropriate for their customers, and that is beyond their customers' financial capabilities, without the customers understanding the terms of the credit, the alternatives that are available to them, the costs of the credit, and the significance of failing to repay loans that are offered to them. There were also claims that the system exploits customers' lack of information, and that they behave aggressively toward debtor customers. In many cases, the intervention of organizations that work on behalf of debtor customers helps them spread out payments with better interest terms, but there was concern expressed in relation to customers that are not being helped by these organizations. Another claim was raised that there is a failure in the provision of basic banking services to customers in default, and that the Banking Supervision Department's guidelines in this context are not being enforced. Debtors who are near the end of the process of arranging their debts, and even those who have already completed it, are having difficulty in rehabilitating themselves financially, since the banking system prevents them from receiving services. This makes it difficult for them reintegrate into proper financial behavior (for instance, difficulties in obtaining checkbooks makes it difficult for them to rent a dwelling).

- **The lack of employment diversity in the financial system** – A number of the people who participated in the discussions noted that there is low representation of population groups from various sectors in the financial system, and that employment diversity can bridge linguistic and cultural gaps, reduce the level of suspicion, and increase the level of trust in the system. In addition, it will enable the financial system to take customers from all population segments into consideration when developing their products and making them more accessible.

- **Financial exclusion leads to social exclusion** – Financial exclusion leads to people turning to illegal markets and to deterioration of both their financial state and their personal security. Turning to the gray market leads people to crime and to a life under stress and threats.

- **Savings and pension** – The representatives who participated in the conversation discussed the fact that in Arab and Ultra-Orthodox Jewish society, as well as among population groups under financial stress, people have to deal on a day-to-day basis with major issues, and do not sufficiently deal with savings for the future. Specifically regarding pensions, the perception both in Arab society and in Ultra-Orthodox Jewish society is that the adults will be supported in the future by their families and communities. However, in view of the increased life expectancy and higher cost of living, it is doubtful whether this model will be sustainable in the future. It was noted in the discussions that in Ultra-Orthodox Jewish society, due to the social characteristic of entering the labor market at a later age, pension savings begin very late. In terms of the general population as well, it was noted that individuals do not maintain their rights (for instance, in terms of maintaining insurance continuity), until later ages (around age 40). It was also noted that many self-employed individuals in the Arab and Ultra-Orthodox communities do not make pension deductions, since such deductions impact their disposable income in the present, and are considered by many to be a form of "tax".

- In another context having to do with pensions, there is **a significant lack of objective pension advice** around the time of retirement age, and it was argued in the discussion that this lack, and the resulting uninformed decision-making, lead to significant financial damage.

MECHANISMS THAT AFFECT FINANCIAL INCLUSION

C. Mechanisms that affect financial inclusion

This chapter outlines and analyzes various barriers that may have an impact on differences in the level of financial inclusion of various population groups in Israel. The examination in this section shows that the barriers that have such an impact are credit risk levels; language and digitization discrepancies; religious barriers; low financial literacy; barriers concerning the quality of collateral and tradability of real estate assets; and other cultural barriers. The analysis shows that all these barriers have an impact, and that there is no single barrier that can explain all of the discrepancies between the population groups. The following are the main findings regarding the barriers that affect financial inclusion.

- Financial literacy – There are barriers in Arab and Ultra-Orthodox Jewish society that are due to a low level of financial literacy, but the barriers are stronger in the Arab community.

- Language barriers – The combination of low fluency in Hebrew and low accessibility to financial products in Arabic constitutes a barrier to integration in the financial system.

- Cultural barriers – There is a clear preference in Ultra-Orthodox Jewish society, and even more so in Arab society, for the use of cash in current financial transactions. This preference is partly due to a lack of trust in the various financial institutions and instruments.

- Preference for the use of case and concern over consumer protection issues – The preference for cash in Arab and Ultra-Orthodox Jewish communities is accompanied by concern over consumer protection issues.

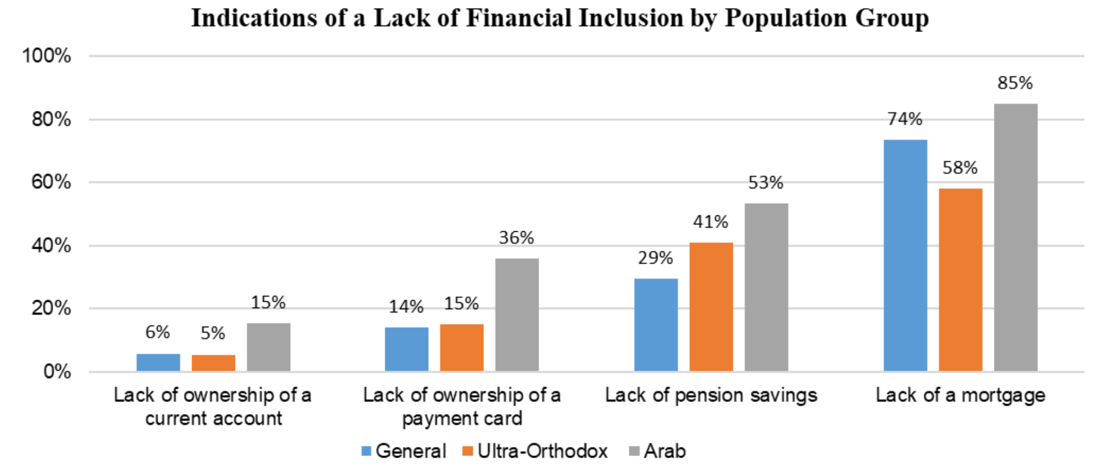
- Digital barriers – Digital literacy in Ultra-Orthodox Jewish society is low, and it is even lower in Arab society. One of the explanations for the low level among the Arab population may partly have to do with language barriers.

- Religious barriers – There are barriers in both the Arab and Ultra-Orthodox Jewish societies that have to do with religion, but the barriers in the Arab community are stronger.
- Risk level – There are indications in the Arab community of high credit risk levels, mainly in localities with low socioeconomic standing relative to non-Arab localities with low socioeconomic standing.
- Barriers that are unique to the real estate market (licensing and properties as collateral) – There are licensing and collateral barriers in the Arab community, but neither these nor the high risk level are responsible for all the discrepancies in mortgage borrowing between Arab and Jewish society.
- Terms that are not favorable for the consumer, and low bargaining capability – Some customers avoid consuming various financial services because in their perception, the terms that the financial institutions offer are not favorable.

C.1. Examining the possible reasons for the discrepancies in the use of financial products

As part of the Team's work, the Bank of Israel carried out a special survey to examine the various factors in the financial inclusion discrepancies between population groups. The examination focused on discrepancies in the use of various financial products: holding a current account, holding a payment card, mortgage borrowing, and pension savings. Figure C-1 shows the discrepancies in the use of the various financial products by population group. These discrepancies are similar to those presented in the previous chapter regarding differences in the level of financial inclusion. This survey makes it possible to examine the reasons for the discrepancies by looking at the responses of those who answered that they do not use a particular financial product, when asked about the reasons they don't use it.

Figure C-1

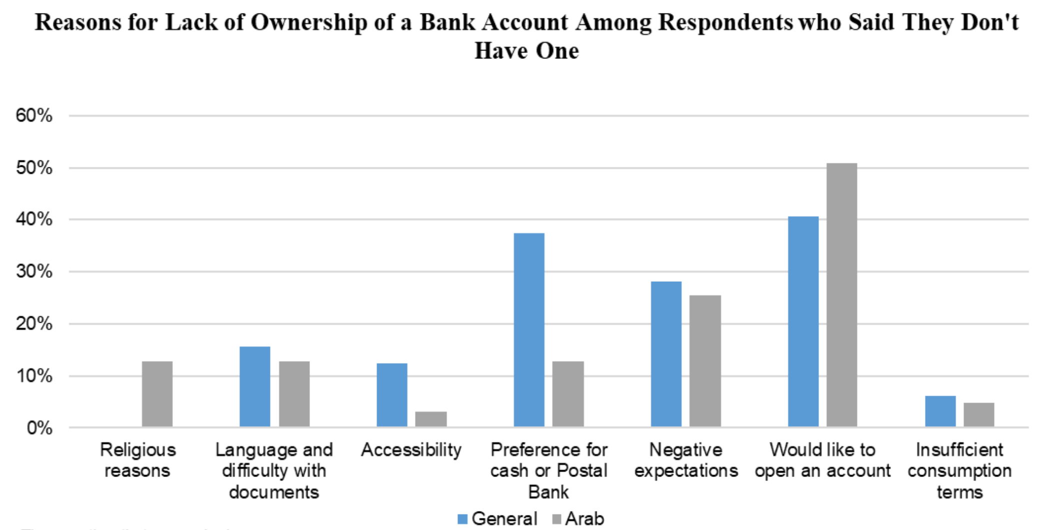


The questions that were asked:
- Do you currently have a bank account at one of the banks?
- Do you currently have a payment card (credit card, debit card, or prepaid card)?
- Are you currently repaying a mortgage that you took from one of the banks or a large financial company (credit card company or pension company)?
- Do you currently have pension savings (managers' insurance, provident fund, or pension fund), with one of the large pension companies?

SOURCE: Survey conducted for the Bank of Israel, 2022.

An analysis of the responses in Figures C2–C5 shows that there are different barriers that might have an impact on the level of use of each financial product among various population groups. In the Arab community, a greater share of the population indicates barriers that are consistently more acute than in other groups, for all questions. We will therefore focus on that group.[10]

Figure C-2



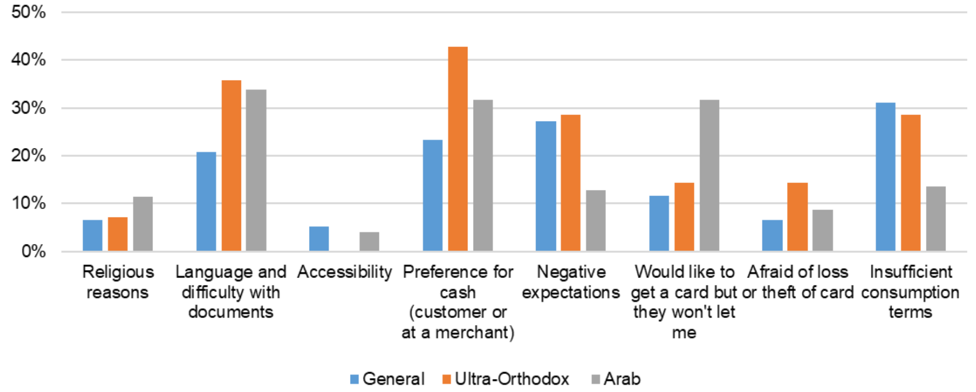
The question that was asked:
Please mark from the following list, what are the reasons you are not intereseted in opening a bank account at one of the banks.
Excluding the *Haredi* population due to few observations.

SOURCE: Survey conducted for the Bank of Israel, 2022.

[10] We were unable to separate those who were only uninterested in taking out a loan from a financial institution from those who were only uninterested in taking out a mortgage, due to the size of the sample.

Figure C-3

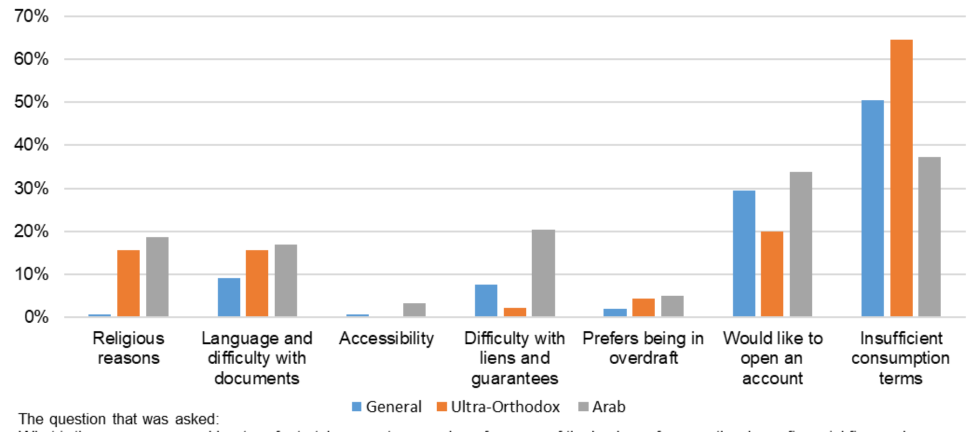
Reasons for Lack of Ownership of a Payment Card Among Respondents who Said They Don't Have One



The question that was asked:
For those who indicated that they **are** interested in getting a payment card in the next two years: Please mark from the following list, what are the reasons you currently do not have a payment card.
For those who indicated that they **are not** interested in getting a payment card in the next two years: Please mark from the following list, what are the reasons you are not interested in getting a payment card.
SOURCE: Survey conducted for the Bank of Israel, 2022.

Figure C-4

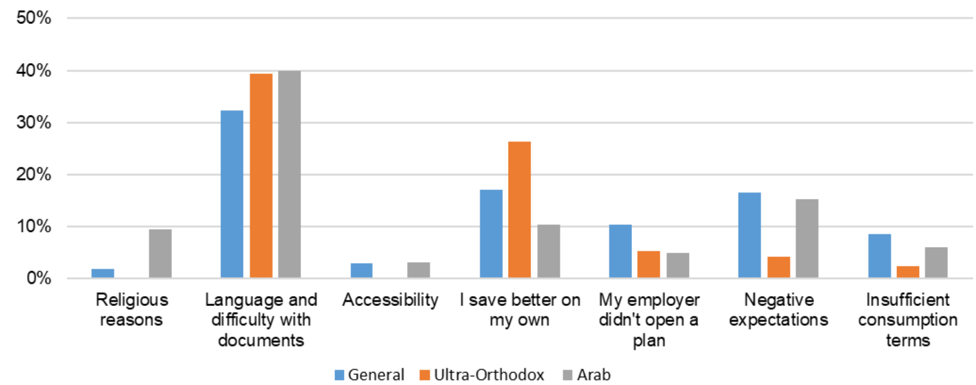
Reasons for Preferring Not to Take a Mortgage or Loan from Financial Institutions Among Respondents who Said This was Their Preference



The question that was asked:
What is the reason you would not prefer to take a mortgage or loan from one of the banks or from another large financial firm such as a credit card company or pension company?
SOURCE: Survey conducted for the Bank of Israel, 2022.

Figure C-5

Reasons for a Lack of Pension Savings Among Respondents who Said They Don't Have Any



The question that was asked:
For those who indicated that they **are** considering opening a pension savings account in the next two years: Please mark from the following list, what are the reasons you currently do not have pension savings (managers insurance/provident fund/pension fund).
For those who indicated that they **are not** considering opening a pension savings account in the next two years: Please mark from the following list, what are the reasons you are not interested in opening a pension savings account (managers insurance/provident fund/pension fund).
SOURCE: Survey conducted for the Bank of Israel, 2022.

C.1.1 Religious barriers

Product consumption restrictions due to an individual's religious beliefs appear mainly in Arab society, with regard to all sorts of products (current accounts, payment cards, credit, and pension savings; Figure C6). Jewish or Muslim religious prohibitions on charging interest may drive customers away from using products that involve the payment or receipt of interest. The Islamic religion absolutely prohibits making transactions that carry interest, as it considers interest as profiting on the exploitation of another person's weakness. As such, a bank operating on the basis of pure Islamic religious foundations cannot utilize an interest mechanism, but must operate on the basis of voluntary Islamic sources. In Islamic countries, there is a well-developed financial system that operates according to Islamic law (Shari'a). Judaism contains a similar prohibition (against charging interest to Jews only), but the financial system has adopted a Jewish legal solution in order to charge interest from Jews ("Transaction Permit"), while no similar Islamic solution has been adopted.

Even though the survey showed that this is a greater barrier for Arab society, only 19 percent of those who do not prefer to take a mortgage or loan from a financial institution responded that this issue is a barrier for them. In other words, most respondents did not state a religious barrier as the reason for not using this financial product, but rather indicated other barriers. With regard to other financial products, religious barriers prove to be even lower, ranging from 10 to 13 percent of respondents, depending on the type of financial product (figure C-6).

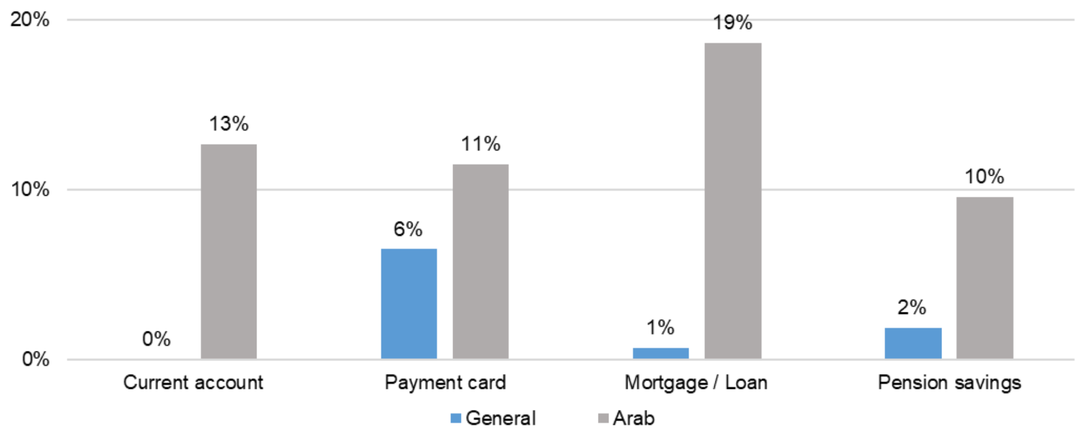
There is evidence from the savings field that this is not a significant barrier. One of the solutions to religious barriers is the creation of a designated financial product with a religious permission, which bypasses the difficulty in paying or receiving interest. The "Saving for Every Child" program gives parents the ability to actively choose a Shari'a-compliant track. Studies have shown that in Arab society, most parents chose to hold their savings in the banks (which pay interest), rather than in this track (Haran-Rosen and Sadeh

(2021); Greenstein, Weiss, et al. (2019)). In contrast, a high rate of people in the Ultra-Orthodox community chose a "kosher" investment track.

It should be noted that a qualitative study conducted in Arab localities on population groups that had no access to surveys conducted over the Internet, and where financial inclusion levels were lower, shows that the religious barrier may be greater than what the Internet study shows.

Figure C-6

Rate of Respondents who Avoid Consuming Financial Products for Religious Reasons



The question concerning mortgages/loans relates to the rate of respondents that do not prefer to take out a mortgage or loan **from financial institutions**. The other questions relate to the rate of respondents that do not consume the financial product **at all**.

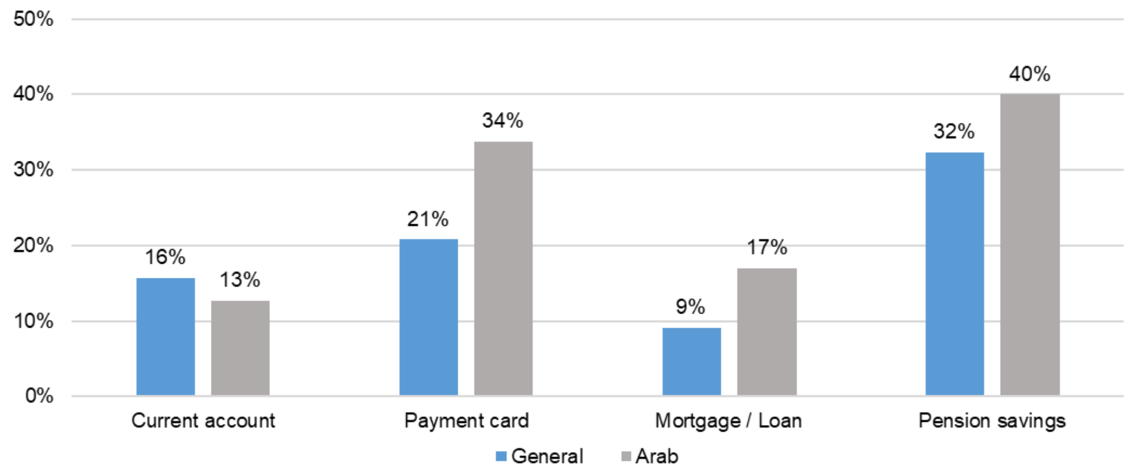
SOURCE: Survey conducted for the Bank of Israel, 2022.

C.1.2 Linguistic barriers and difficulties understanding documents

Language barriers and difficulties in understanding documents are more significant in Arab society than in the other population groups when using the various financial services (Figure C-7). About 17 percent of those who prefer not to take mortgages or loans from a financial institution stated that this was because of a linguistic barrier and difficulty understanding the documents. This rate changes with regard to other financial products, ranging from 13 to 40 percent of those who avoided consuming financial products in Arab society, depending on the question. This barrier is due to a combination of low reading and writing fluency in the Hebrew language among Arab society, and the fact that most financial products and service channels are accessible only in Hebrew. This difficulty leads to an impaired ability to understand financial contracts, and prevents individuals from making broad use of the financial system. Below, in Section C.1.10, there is an analysis that shows that the linguistic barrier also has an impact on the use of digital communication channels.

Figure C-7

Rate of Respondents who Avoid Consuming Financial Products due to Language Barriers and Difficulty Understanding Documents



The question concerning mortgages/loans relates to the rate of respondents that do not prefer to take out a mortgage or loan **from financial institutions**. The other questions relate to the rate of respondents that do not consume the financial product **at all**.

SOURCE: Survey conducted for the Bank of Israel, 2022.

C.1.3 Financial literacy

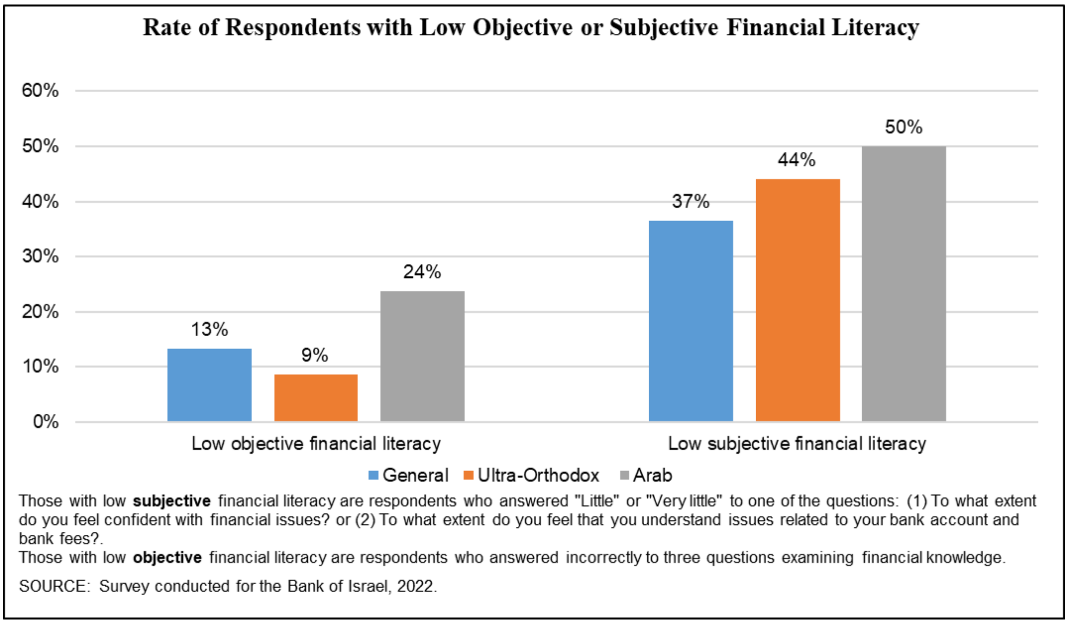
Difficulty in understanding documents is also linked to the level of financial literacy. Financial literacy is the ability to understand financial terms and conduct activity with financial content, which is the basis for making informed financial decisions. Studies by Haran Rosen and Sadeh[11] show that it is not only objective financial literacy—the level of individuals' objective financial knowledge as it is—that has an impact on financial behavior, but subjective financial literacy—the level of confidence that an individual feels regarding his knowledge of financial issues—also has an impact on such behavior.

A survey conducted by the Bank of Israel, based on questions that were validated by academic research as indicators of a person's level of financial knowledge, found that from both objective and subjective standpoints, financial literacy in the Arab community is lower than in the general population (Figure C-8). When asked three financial knowledge

[11] 2017 study - https://www.boi.org.il/en/Research/Pages/dp201710e.aspx;

2021 study - https://www.boi.org.il/en/Research/Pages/dp202121e.aspx questions, 24 percent of respondents in Arab society answered incorrectly, compared with 13 percent in the general population and just 9 percent in Ultra-Orthodox Jewish society. About 50 percent of respondents in Arab society said that they don't understand financial topics, compared with 44 percent in Ultra-Orthodox Jewish society and 37 percent in the general public.[12]

Figure C-8



The survey, as well as earlier findings in the professional literature, show a correlation between a low level of financial literacy and low financial inclusion. Among respondents who do not have a current account, 50 percent answered the three knowledge questions in the survey incorrectly. The rate grows to 63 percent if we examine those who do not have a current account and who also have low subjective financial orientation (Figure C-9). The survey examined correlations between financial literacy and other indicators of low financial inclusion, and found similar links—low financial literacy is connected with a lower level of financial inclusion.

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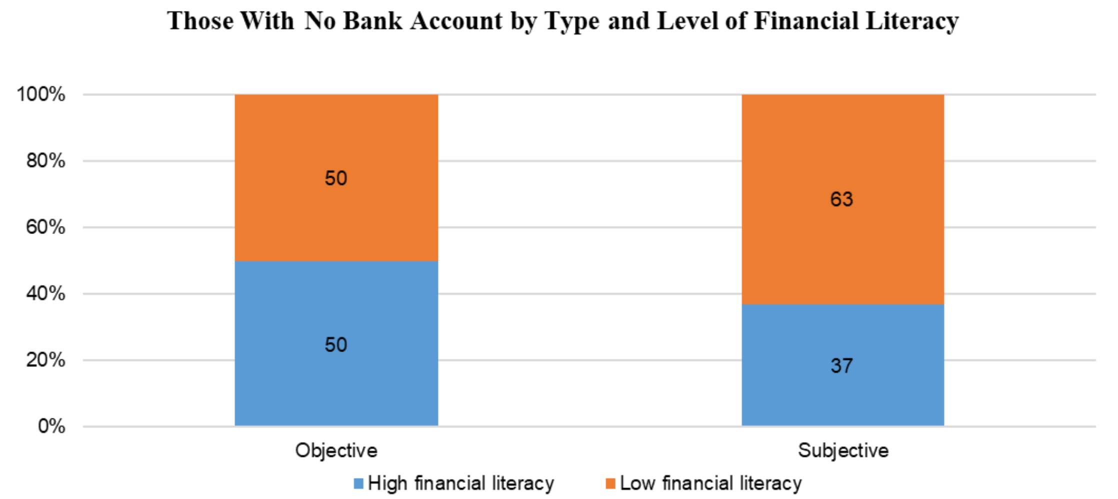
[12] Divided by gender, the findings were similar to what is found in the literature (Lusardi and Mitchell (2014); Bucher-Koenen et al. (2017). Women's objective, but mainly subjective, financial literacy is lower than that of men. In particular, it was found that high rates of women in *Ultra-orthodox Jewish society* and in Arab society stated that they do not understand financial topics. The survey shows that there is a link between objective or subjective financial literacy and financial inclusion.

Figure C-9



Those with low **subjective** financial literacy are respondents who answered "Little" or "Very little" to one of the questions: (1) To what extent do you feel confident with financial issues? or (2) To what extent do you feel that you understand issues related to your bank account and bank fees?.
Those with low **objective** financial literacy are respondents who answered incorrectly to three questions examining financial knowledge.
SOURCE: Survey conducted for the Bank of Israel, 2022.

In addition to the theoretical statistics, the Team carried out regressions (not shown) that show that subjective financial literacy and a level of confidence in financial knowledge have a positive effect on financial inclusion. The regression shows that even after controlling for socioeconomic variables (education, income, age, gender) and sectoral attribution in the regression, higher financial literacy is correlated with greater financial inclusion, and that this is reflected in an individual’s greater likelihood of owning a current account, holding a payment card, taking out a mortgage, and saving for pension.

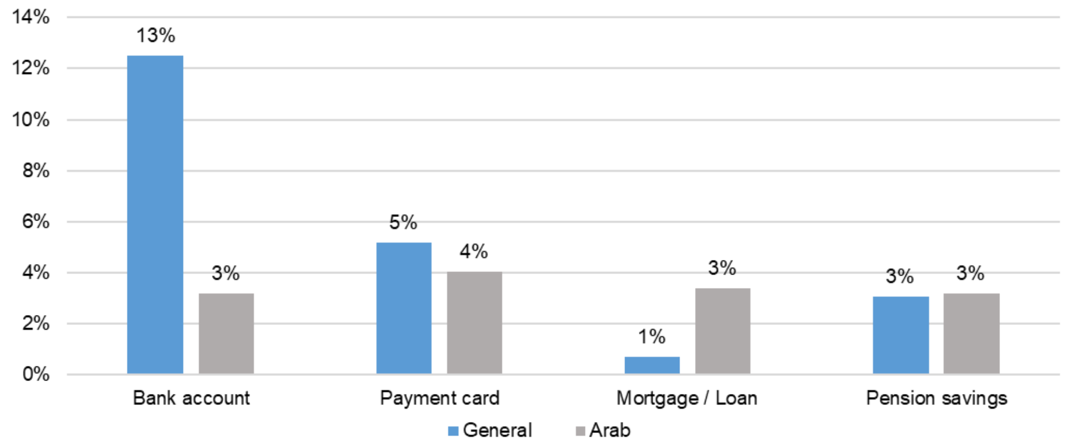
It is worth noting that a qualitative study carried out in Arab localities regarding the population groups that has no access to surveys conducted over the Internet, and who have a lower level of financial inclusion, shows that the linguistic barrier and difficulties understanding documents may be greater than what is shown by the Internet survey.

C.1.4 Physical accessibility

The literature that deals mainly with emerging economies provides another explanation for a low level of financial inclusion: low physical accessibility and lack of proximity to financial service providers. The survey shows that this barrier is actually more significant for the general Jewish population, but is not a major barrier for the other communities (Figure C-10). The rate of respondents in Arab society who noted this barrier ranges from 3–4 percent depending on the type of financial product.

Figure C-10

Rate of Respondents Who Avoid Consuming Financial Products Because They are Not Accessible to Them



The question concerning mortgages/loans relates to the rate of respondents that do not prefer to take out a mortgage or loan **from financial institutions**. The other questions relate to the rate of respondents that do not consume the financial product **at all**.

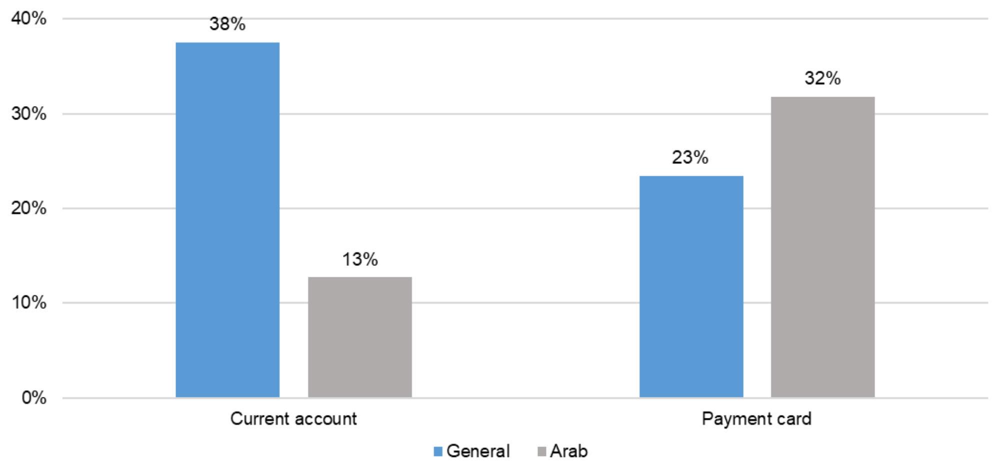
SOURCE: Survey conducted for the Bank of Israel, 2022.

C.1.5 Preference for cash and concern over loss or theft of cards

The preference for the use of cash can explain the discrepancies in the use of payment cards in Arab society and among the general population. The rate of those listing this barrier as a reason for not using payment cards is 32 percent in Arab society and 23 percent among the general public. Another survey conducted for the Bank of Israel on the use of means of payment found that there is a preference in Arab society for cash, and an avoidance of receiving money through bank transfers or smartphone payment apps (Figure C-12). In Ultra-Orthodox Jewish society, a similar avoidance of receiving payment through applications over smartphone was found, but it is interesting to note that there was a relatively high preference for receiving money via bank transfers. It should be noted that the survey's questions on actual behavior show similar findings. These findings show a low level of use of digital means of communication for both population groups, as detailed in Section C.1.10 below. The fact that there is a high rate of respondents who say they are concerns about the loss or theft of credit cards shows that consumer protection is very important to the general population, particularly to the Arab and Ultra-Orthodox population groups. This concern may be due to a perception that cash can be divided and that in day-to-day life individuals do not walk around with all of their money on them. Thus, if cash is stolen or lost, the individual does only loses a small amount of money. In contrast, if an individual walks around with his credit card, he may feel unease that if it is lost, he may lose a much larger amount of his money.

Figure C-11

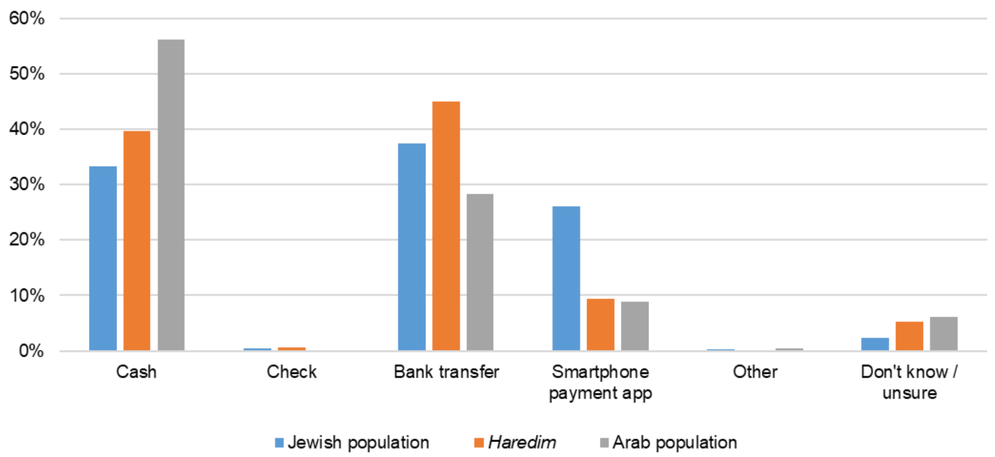
Rate of Respondents Who Avoid Consuming Financial Products Because They Prefer Using Cash



SOURCE: Survey conducted for the Bank of Israel, 2022.

Figure C-12

If you were offered NIS 1000 right now, how would you choose to receive it?



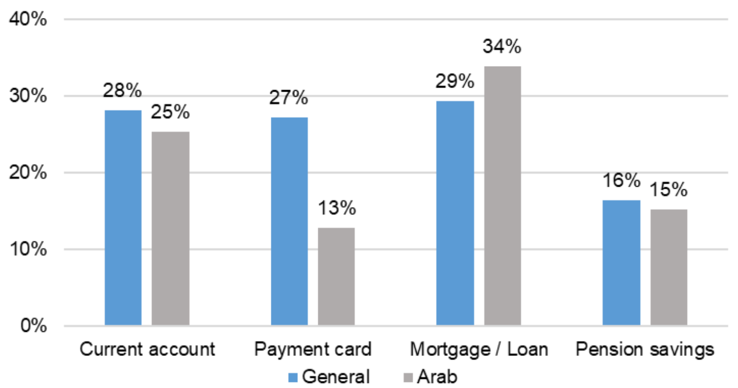
SOURCE: Survey conducted for the Bank of Israel, 2022.

C.1.6 Expectations

The rate of those who responded regarding barriers having to do with negative expectations of the interaction with the financial institution—those who think that a request will not be approved or that the terms they will receive will not be favorable—is high in Arab society (13–34 percent depending on the type of financial product), but is not higher than in other population groups (Figure C-13). This barrier may attest to increased risk, as detailed in Section C.1.9 below, or it may show a subjective sense that may be due to low financial literacy (mainly the self-confidence component), low level of trust, or other reasons. In contrast, the rate of those in Arab society who do not have a financial product and whose request to consume that product was rejected by the financial institution is significantly higher than in the general population (Figure C-14).

Figure C-13

Rate of Respondents who Avoid Consuming Financial Products due to Negative Expectations

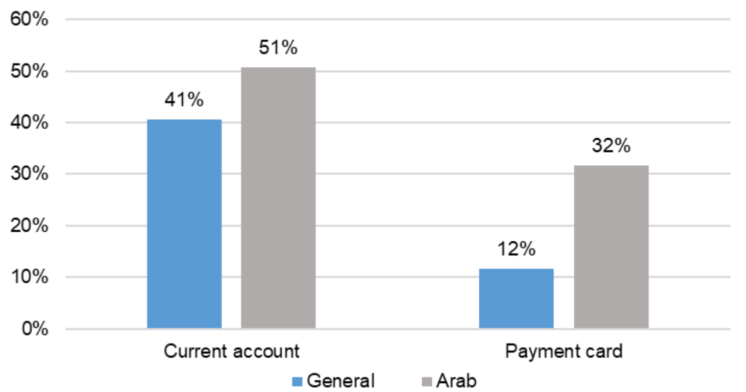


The question concerning mortgages/loans relates to the rate of respondents that do not prefer to take out a mortgage or loan **from financial institutions**. The other questions relate to the rate of respondents that do not consume the financial product **at all**.

SOURCE: Survey conducted for the Bank of Israel, 2022.

Figure C-14

Rate of Respondents who Avoid Consuming Financial Products Because they Don't Get Approved for Them



The questions relate to the rate of respondents that do not consume the financial product **at all**.

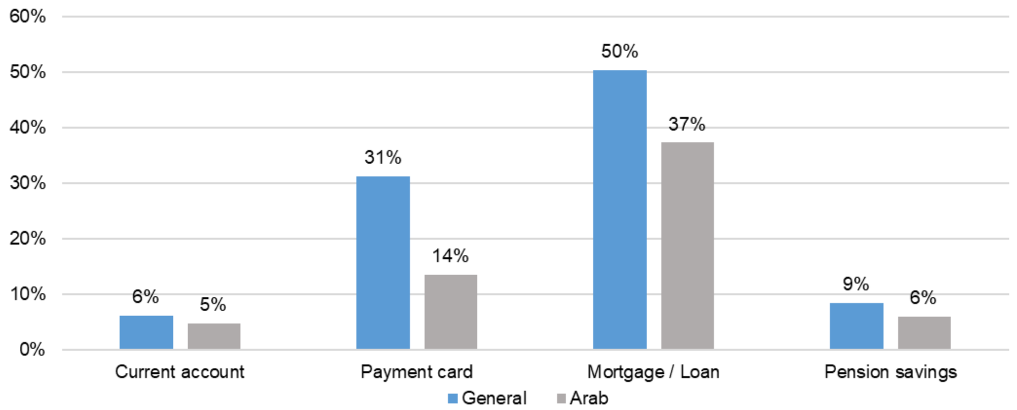
SOURCE: Survey conducted for the Bank of Israel, 2022.

C.1.7 Conditions for consuming financial products

The survey shows that a major barrier for the consumption of financial products has to do with customers' perceptions about the conditions involved in consuming those products. These conditions are reflected in interest rates and high fees, the provision of small credit facilities to customers, and high management fees. About 37 percent of respondents in Arab society and about half of those in the general public noted that they prefer not to take out a mortgage or loan from the official financial institutions due to this barrier. This barrier was also found to be more significant for the general population than for the Arab community with regard to other financial products.

Figure C-15

Rate of Respondents Who Avoid Consuming Financial Products Because the Terms of Consuming the Product are not Good for Them



The question concerning mortgages/loans relates to the rate of respondents that do not prefer to take out a mortgage or loan **from financial institutions**. The other questions relate to the rate of respondents that do not consume the financial product **at all**.

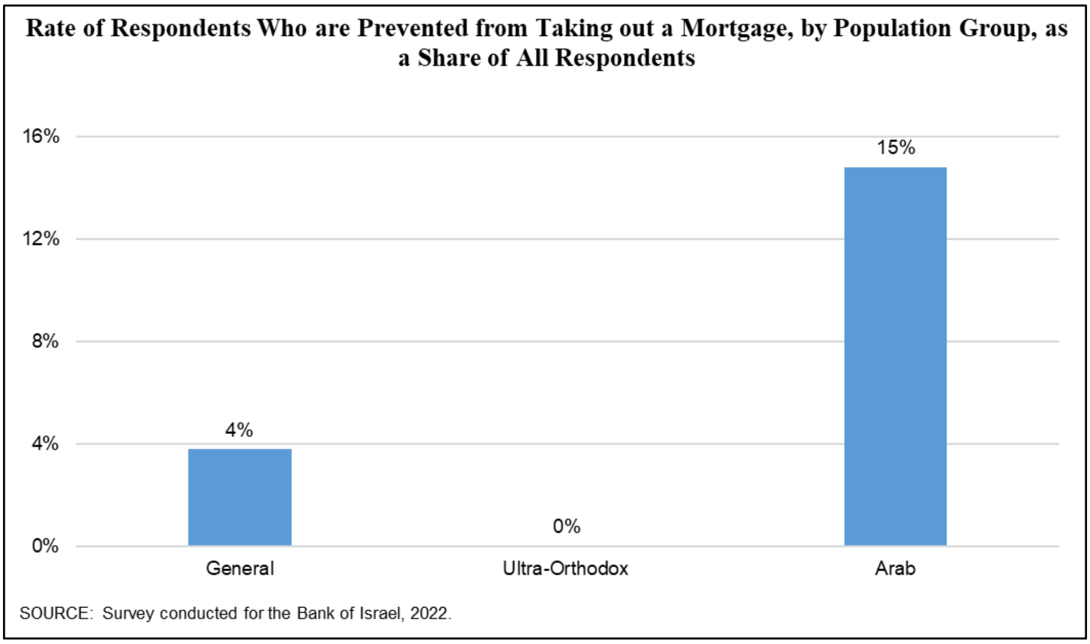
SOURCE: Survey conducted for the Bank of Israel, 2022.

C.1.8 Quality of mortgage collateral

The quality of mortgage collateral poses a barrier that is unique to the Arab community, since there is a widespread phenomenon in Arab localities whereby there is no proper registration of properties, which leads to an inability to provide collateral for housing loans.

The survey shows that a relatively high rate of people in Arab society who indicate this barrier as being relevant, and that about 15 percent say they would want to take out a mortgage, but they are prevented from doing so (Figure C-16). The latter response apparently includes barriers in terms of the quality of collateral and the ability to encumber a property. Since this matter is essential and widespread, there is more discussion of it in Section C.2, but this unique barrier also turns up in the survey.

Figure C-16



Regressions on the data from the Bank of Israel's survey (not shown) show the complexity throughout the above analysis. As expected, the variables showing the existence of barriers arising from personal socioeconomic characteristics (education and income) have a statistically significant effect, but even after controlling for those variables, there were additional barriers. Variables showing barriers arising from low financial literacy also have a statistically significant impact, but in addition, belonging to Arab society was found to have a statistically significant effect on all financial inclusion indicators. In other words, there are additional unobserved characteristics. These barriers may be tied to the barriers mentioned above—religion, language, avoidance of the use of noncash means of payment, concern over consumer protection issues—but these may be due to differences in risk level (a topic that we expand upon below) or other cultural or administrative barriers, as shown in the mortgage market and in consumer expectations.[13]

[13] In contrast, the regressions show that belonging to the *Ultra-Orthodox* community has a statistically significant negative impact on pension savings, but that this is not the case for other financial inclusion indicators. In other words, there are cultural barriers that are unique to *Ultra-orthodox Jewish society* that lead to discrepancies in the volume of pension savings and not in financial inclusion in the general sense.

Further to the survey's findings, the following section expands on the unique barriers that require further detail: credit risk level; barriers to the use of digital communication channels' and an expanded analysis of barriers in the mortgage market.

C.1.9 Level of credit risk

One of the potential causes of a low level of financial inclusion is a high level of borrower risk. For a financial contract (for instance the provision of credit or a loan) to be valid, the lender must reach an assessment of a certain likelihood that the borrower will meet the terms of the financial contract. If the lender's assessment is that there is a high risk of not meeting the repayment terms, it could raise the interest rate on the financial service, and if the risk level is too high, it could simply not offer the financial contract at all. Another effect of a high risk level is that in the absence of information on the borrower, the lender may base its assessment of the borrower's risk similar to the risk level of the population group to which the borrower belongs, which would influence the supply and price of services to borrowers from various groups.

The main finding in this section is that the level of credit risk in Arab society is higher than in the other population groups, based on a large number of risk indicators.

The first indicator in examining borrower risk is the rate of those aged 18 and over who, in the past 12 months, were reported in arrears[14] in repayment a loan (of any type) or as exceeding their credit facilities. Data from the statistical credit database show that the rate of arrears and exceeding credit limits is significantly higher in non-Jewish localities than in Jewish ones (Figure C-17). These findings also held after comparing localities belonging to similar socioeconomic clusters, but the differences narrowed in the higher clusters.

[14] Arrears – At least 30 days have passed from when the debt was created, and the debt in arrears is above NIS 200. If the credit provider is an authorized source, at least 60 days have passed from the date on which the debt was created, and the debt in arrears is above NIS 500. SOURCE: First Addendum to the Credit Data Regulations, 5778–2017.

Figure C-17

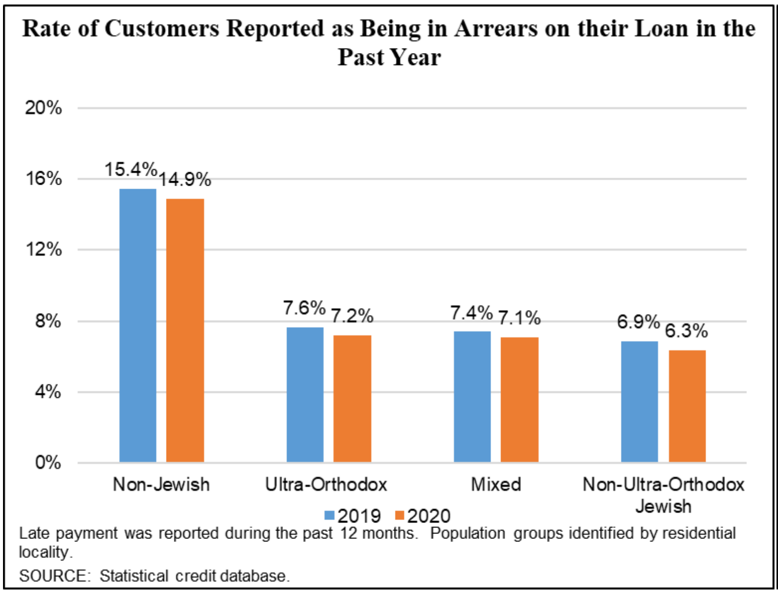
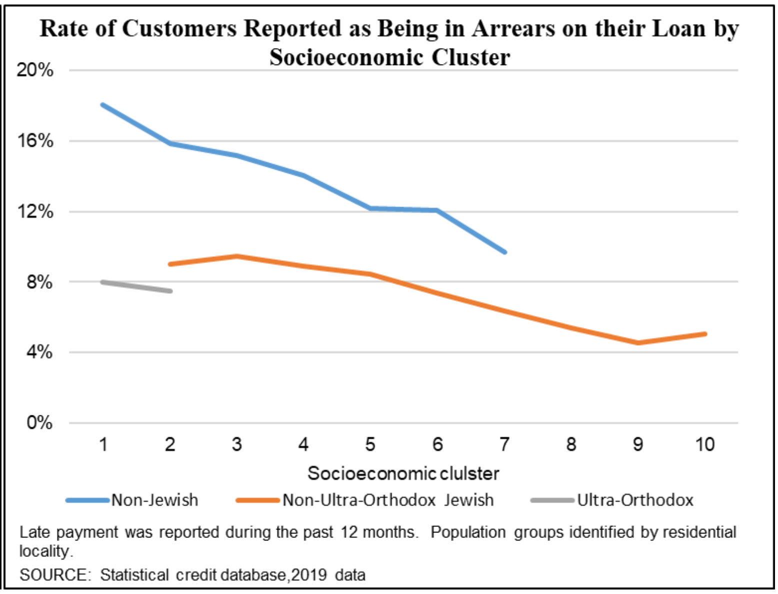


Figure C-18



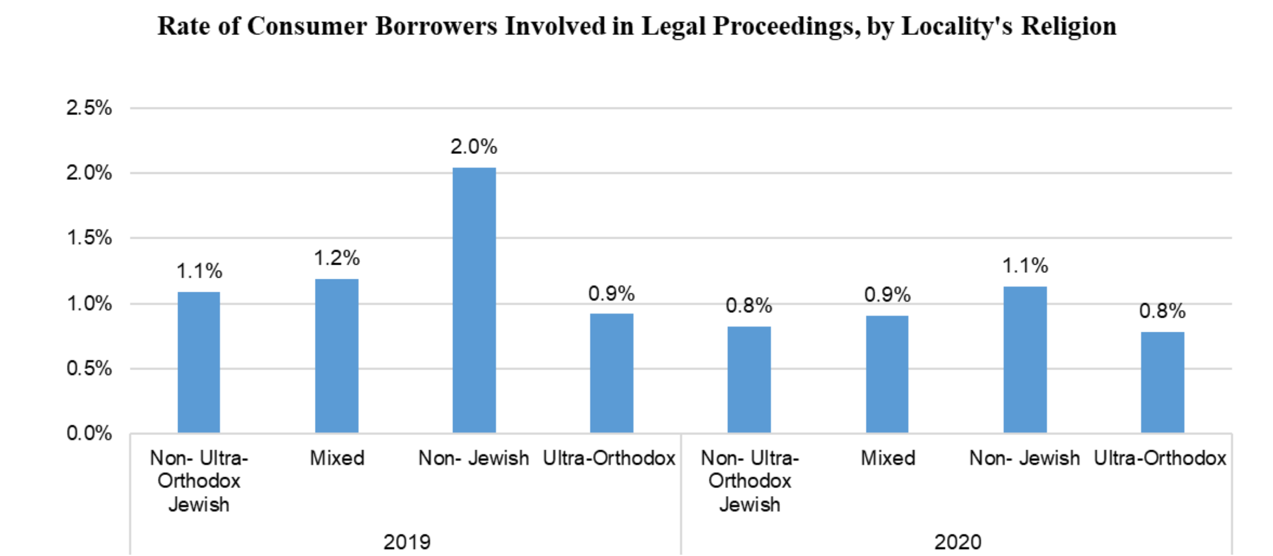
Another indicator that we examined is the volume of loans for which reports were made to the Credit Data Register that the lenders began legal proceedings to collect the debt.[15,16] A comparison of this indicator shows that the rate of borrowers in non-Jewish localities against whom legal proceedings had been initiated, for both consumer and housing loans[17], is significantly higher than the rate for localities in the comparison groups (Figures C-19 and C-20). These discrepancies remained even after comparing by communities in similar socioeconomic clusters.

[15] Pursuant to Sections 3 and 4 of the Credit Data Regulations, 5778–2017, one of the figures that clearly shows that the customer is not meeting his debt repayments is the existence of a debt to a banking corporation, credit card issuer, or information source, where the amount of the debt is over NIS 10,000, and where legal proceedings have been initiated.

[16] Including restricted accounts, enforcement and collections proceedings above NIS 5,000, and default proceedings.

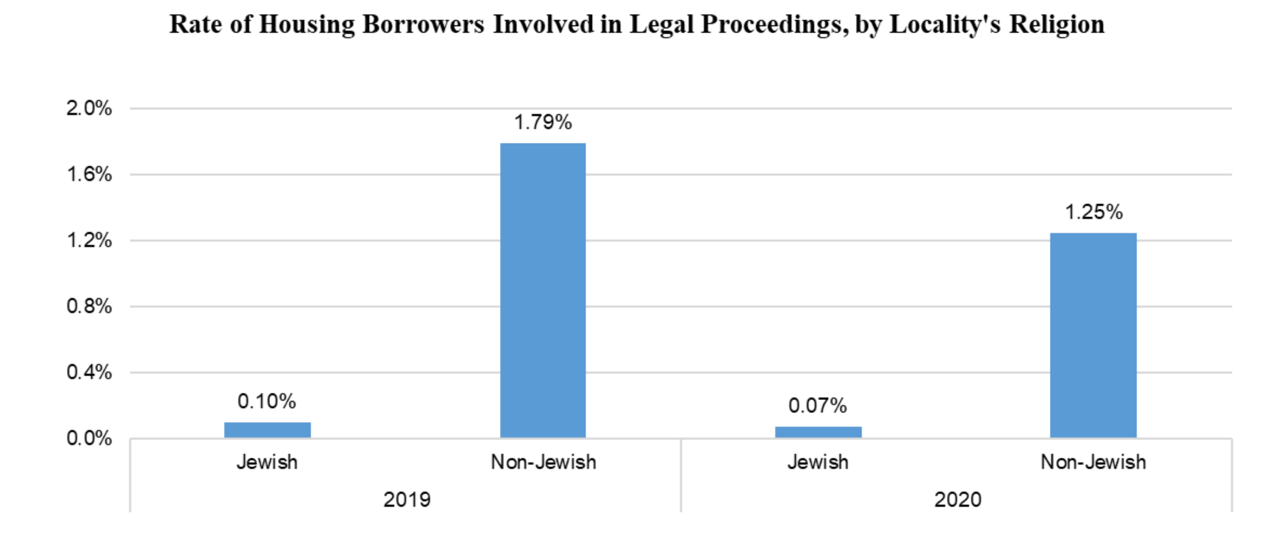
[17] Due to data confidentiality restrictions, the examination of housing loan data did not distinguish between *Ultra-Orthodox* and Jewish non-ultra-orthodox localities.

Figure C-19



Legal proceedings regarding consumer loans were reported during the past 12 months. Population groups identified by residential locality.
SOURCE: Statistical credit database.

Figure C-20



Legal proceedings regarding housing loans were reported during the past 12 months. Population groups identified by residential locality.
SOURCE: Statistical credit database.

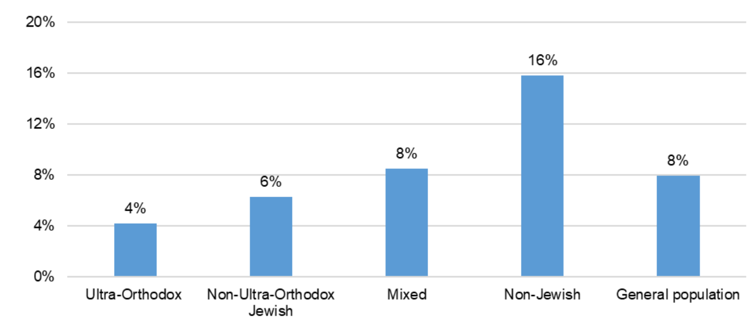
Another finding is that most of the discrepancy between the sectors in consumer loans occurred in 2019, while there was a significant decline in the volume of legal proceedings in non-Jewish localities in 2020, possible as part of the leniencies due to the COVID-19 crisis (stopping account restrictions, special tracks to open enforcement and collections files without reports, the debt deferral program, and more.)

The indicators that have so far been presented provide information on the “flow” of borrowers with credit risk problems. (The analysis focused on the past 12 months). The next indicators will try to examine borrower risk by “inventory” data, based on Enforcement and Collections Authority files, bankruptcies of individuals, and variance in the number of restricted account. The disadvantage of using these indicators is that they cannot distinguish between proceedings initiated due to the use of financial products and those that may be due to broader contexts.

Data from the Enforcement and Collections Authority and from the Supervisor of Defaults and Economic Rehabilitation for 2019 show that the rate of those aged 18 and over with Enforcement and Collections Authority files and with bankruptcies is significantly higher in the non-Jewish localities. And examination of the variance by the Central Bureau of Statistics socioeconomic rating shows that the discrepancies remain when comparing by socioeconomic profile.

Figure C-21

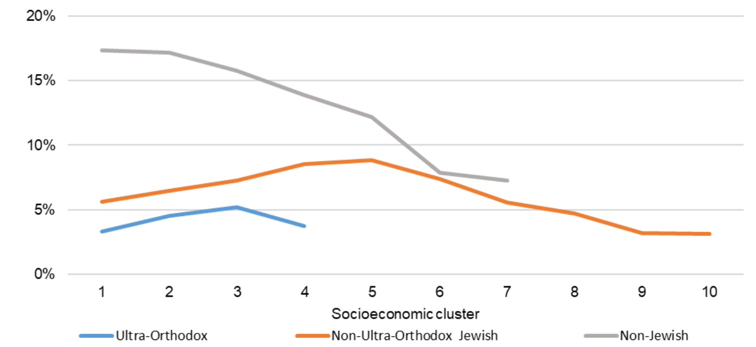
Rate of Borrowers with Enforcement and Collections Files Relative to those Aged 18+ by Locality



Population groups identified by residential locality.
SOURCE: Official Receiver and Population Authority, 2019 data.

Figure C-22

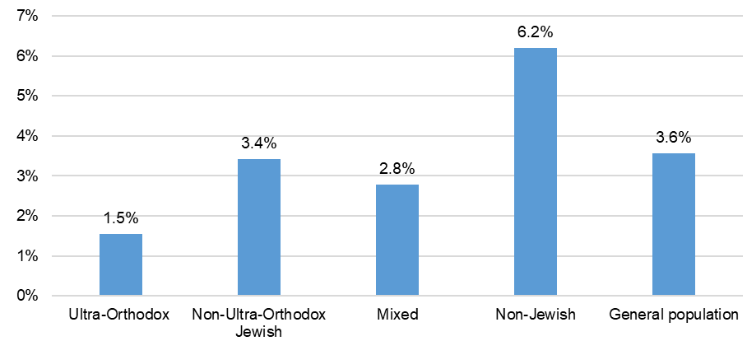
Rate of Citizens with Enforcement and Collections Files by Socioeconomic Cluster



Number of active Enforcement and Collections files relative to number of people aged 18+ in the locality, divided into socioeconomic clusters. Population grousp identified by residential locality.
SOURCE: Official Receiver and Population Authority, 2019 data.

Figure C-23

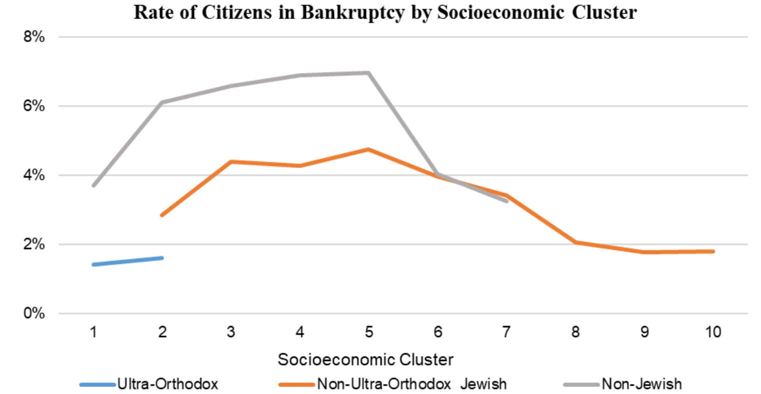
Rate of Citizens in Bankruptcy



Number of active Official Receiver files relative to number of people aged 18+ in the locality. Population groups identified by residential locality.
SOURCE: Official Receiver and Population Authority, 2019 data.

Figure C-24

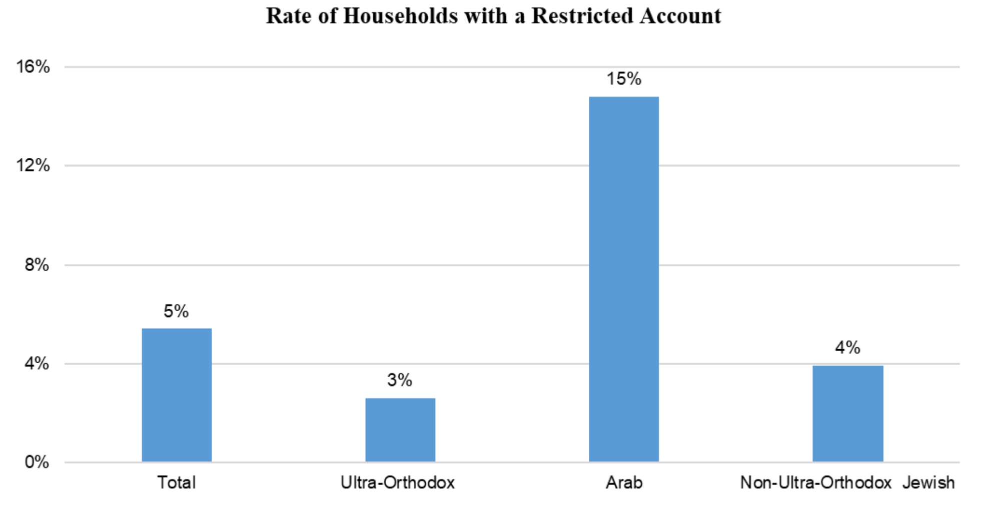
Rate of Citizens in Bankruptcy by Socioeconomic Cluster



Number of active Official Receiver files relative to number of people aged 18+ in the locality, divided into socioeconomic clusters. Population groups identified by residential locality.
SOURCE: Official Receiver and Population Authority, 2019 data.

Another figure that shows the variance between population groups is the volume of restricted account. A long-term survey by the Central Bureau of Statistics (2018) shows the

Figure C-25



SOURCE: Central Bureau of Statistics Long-Term Survey, 2018 data.

variance based on self-reporting, and that the phenomenon is greater among households in the Arab community. It should be noted that the number of restricted account is generally around 260,000 customers (about 500,000 accounts) during normal times, of which about 14,000 are due to checks without cover and the rest have had restrictions imposed by outside sources, such as the Enforcement and Collections Authority, the Official Receiver, the Center for Fines, and the Rabbinic courts.

C.1.10 Digital communication channels and linguistic barriers

Another dimension of financial inclusion is the use of digital means and channels to consume services in the financial system. The importance of remote consumption of services increased due to the trend of downsizing the deployment of branches in the banking system in recent years, and due to movement restrictions during the COVID-19 period.

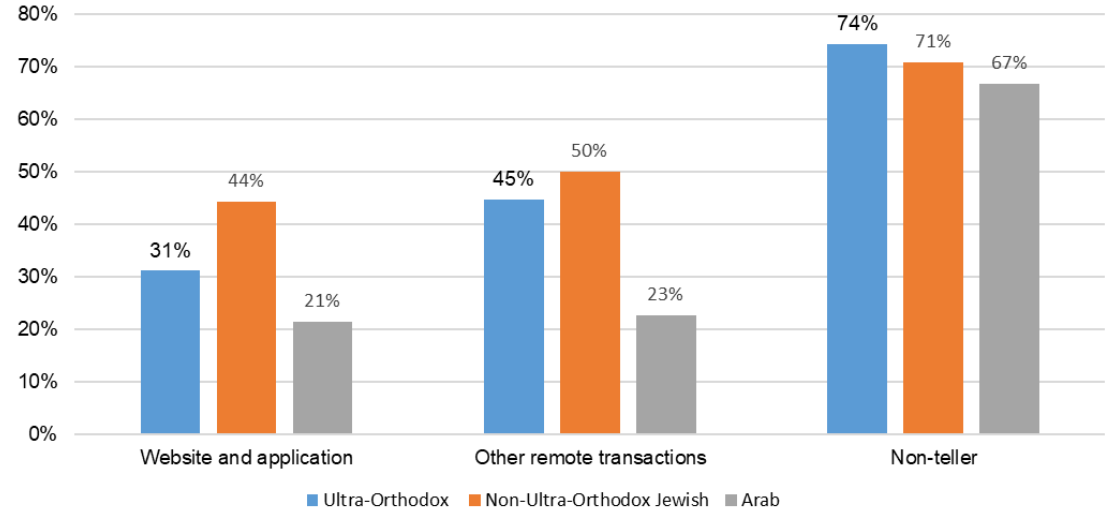
Since many communication channels, particularly digital channels, in Israel are only accessible in Hebrew, the language barrier can be significant in regard to these channels. From the standpoint of the rate of banking transactions done through websites and applications that are accessible only in Hebrew, there are significant gaps between usage patterns in the Arab and Ultra-Orthodox Jewish societies and those in the non-Ultra-Orthodox Jewish society, the latter of which have recently been making greater use of these channels (Figure C-26). The gaps between the Ultra-Orthodox and non-Ultra-Orthodox Jewish societies have narrowed significantly when examining all remote communication channels combined (meaning, if we add phone and SMS services—most of these channels are accessible in Hebrew only, and Arabic-language service is provided over some of them, but at lower quality than in Hebrew). However, the gaps compared with Arab society have remained, or have even become wider. If we include automatic machines at the bank branches in the equation, the gaps between all population groups narrow significantly. In other words, it seems that the use of means other than physically going to the branch, particularly the use of advanced digital means, in Arab society is limited compared with the rest of the population.

There are similar trends found in data provided by the Central Bureau of Statistics Social Survey for 2020. Respondents to that survey were asked whether they used the Internet in order to receive digital bank services. While 70 percent of the non-Ultra-Orthodox Jewish population made transactions using digital banking channels, just 40 percent of Ultra-Orthodox and Arab respondents said that they had done so. There were similar gaps between the population groups in relation to more advanced transactions, such as paying bills and transferring money using payment applications.

The Bank of Israel Annual Report for 2021 contains an analysis that deals with barriers that may explain these discrepancies—including the lack of supportive infrastructure such as Internet connections, the lack of digital literacy, and the lack of Arabic-language service, alongside low Hebrew-language fluency in Arab society. This analysis shows that the rate of those connected to the Internet in Arab society is similar to the rate in non-Ultra-Orthodox Jewish society, and the lack of digital literacy cannot explain the nonuse of additional communication channels such as banking by phone. The findings of the analysis show that most communication channels in the banking system are not accessible in Arabic, and the use of these channels is high among those who are fluent in Hebrew. For more information, see Chapter 8 of the Bank of Israel Annual Report for 2021.

Figure C-26

Use of the Banking System by Activity Channel and Population Group



Remote transactions include all online banking channels, excluding ATMs. Non-teller transactions include ATMs. All indices were calculated relative to all transactions made by that population group. Populations groups are identified by mailing address recorded at the bank.

SOURCE: Based on the banking system, 2020 data.

Another examination was based on usage data from the Postal Bank's website, which is another channel for conducting current account transactions. In order to make transactions on the site, customers must sign an approval of access to the website, but less than one-third of customers have signed such an approval. An examination of the variance between societal groups shows that only about 20 percent of Arab society has access to the Internet, compared with about 40 percent in the overall population and in Ultra-Orthodox Jewish society. An examination of actual use of the site (during the past 12 months) shows that about 2 percent of Arab society used the site, compared with about 10 percent of Jewish society.

C.2. An expansion on barriers to taking out mortgages

The mortgage market provides a particularly interesting test case. Beyond the barriers mentioned above that have an impact on borrowing (risk, financial literacy, religious barriers, language barriers, and digital barriers), and in view of the barriers on the ability to encumber a property in a mortgage, there are unique barriers that were discussed in the

Team's work in regard to mortgages. The discussions included an analysis of the issues of land registration in Arab localities.

C.2.1 Unique social barriers

In the Team's work and the examination of the qualities research, as well as its discussions with professional entities in the field, it was identified the perception of mortgages in Arab society as "problematic" and something that should be avoided, as having a mortgage is not a desired situation. Accordingly, publicly available mortgage data in the Land Rights Registry (Tabu) leads to fear of mortgage borrowing.

C.2.2 Barriers at the collateral level

There is a significant discrepancy in Arab localities between identification of ownership, as it appears in the land registry, and the actual state of ownership. This contradicts the main function of the land registry, which is to reflect the true state of ownership. This discrepancy creates numerous difficulties, in that it weakens a material right, does not create sufficient certainty for the owners themselves, and prevents full tradability of land, including its provision as collateral for a mortgage. The following is a review of the barriers linked to an absence of land registry:

1. Parcelization

   a. The multiplicity of land partnerships[18] - the lack of regulation and of clear parcelization of land that is jointly owned;

   b. Lack of land regulation and lack of land registration in the Land Rights Registration Authority (Tabu);

   c. The multiplicity of unregistered transactions and inheritances, which creates a rolling incompatibility between those holding the land and its registered owners;

[18] Joint ownership of a land property.

d. The absence of registration has a negative impact on certainty and tradability, makes transactions more expensive, and provides an incentive for stagnation.

2. Planning barriers

a. Difficulty in infrastructure planning and construction (multiplicity of owners, making it necessary to prepare complex unification and parcelization plans);

b. A lack of parcelization plans due to a lack of financing and a lack of local planning and building committees;

c. Limited realization of construction rights in view of the lack of infrastructure and diminished capacity of the existing fabric;

d. Lack of building permits

3. Other barriers

a. Lack of registration of joint residences – a situation of joint construction and joint permits has developed, which creates a forced guarantee for a mortgage between the joint owners;

b. Group building (including ILA tenders), where the property is not divided, the group members depend on each other with regard to the pace of construction, and the group members depend on other when taking out a mortgages, which torpedoes the advancement of a mortgage for construction;

c. The process of registering the land in TABU involves many expenses relative to the household's income;

d. The real estate market in Arab society generally lacks tradability. An analysis of the Israel Tax Authority's real estate database shows that between 2018 and 2020, there were only about 100 second-hand transactions each year. The lack of tradability can be attributed partly to the clan structure of some localities, and to the fact that a lender may encounter difficulties in foreclosing a property, even if it is properly registered, in view of the unique social nature of these localities.

As this section shows, the gaps between Arab and Jewish societies in the rate of mortgage borrowing are partly derived from the significant volume of unregulated construction in Arab society, the undeveloped real estate market, and the borrower risk to banks.

To examine the effect of the various factors on the volume of mortgage borrowing, Chapter 8 of the Bank of Israel Annual Report contains an analysis of the correlation between land regulation, borrower risk, and the rate of mortgage borrowers in the locality. Figure 8.12 in the Report, which presents the correlation relative to land regulation, shows that land regulation is negatively correlated with the rate of all mortgage borrowers in the locality (the downward spread of the dots, without relating to their color), but the correlation in each of the population groups—non-Ultra-Orthodox Jews, Ultra-Orthodox Jews, Muslims, Beduin, and so forth—is low (the spread of dots by group color). A similar picture emerges regarding the risk indicator (Figure 8.13 in the Report)—a negative correlation over the entire sample, but a high spread of the rates of those who have debts to the Enforcement and Collections Authority in each population group, indicating a very low correlation with the overall rate of mortgage borrowers in the locality.

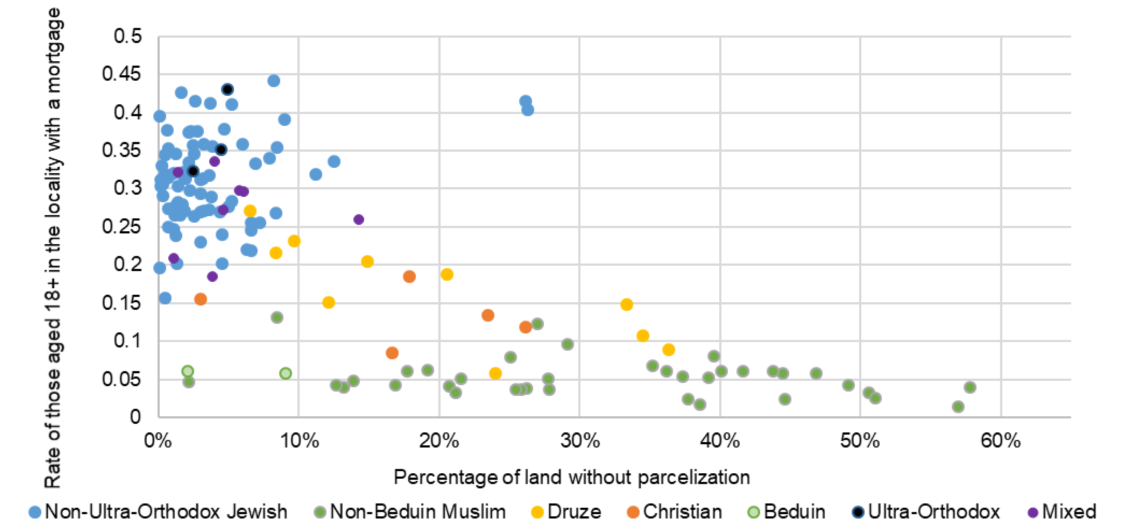
It therefore seems that borrower risk and the lack of land registration do not explain the phenomenon in its entirety, and that there are other factors influencing the low rate of mortgage borrowing in Arab society. Those factors include the discrepancy in financial literacy between Arab society and the rest of the population[19], the lack of access to services, the absence of financial information on borrowers[20], the difficulty in foreclosing properties, which would enable lenders to provide significant amounts of credit, and cultural differences that are reflected in a low amount of trade in land in Arab society.

[19] Maya Haran-Rosen and Orly Sade (2021). "The Disparate Effect of Nudges on Minority Groups", Bank of Israel Research Department, Discussion Papers Series 2021.21

[20] Financial information includes: details of reported income, payment ethic, and household conduct.

Figure C-27

The Correlation between the Rate of Unregulated Land and the Rate of Those Aged 18+ with Mortgages



The estimated rate of unregulated land is according to the Israel Mapping Center's GIS layer relative to the locality's urban fabric.
SOURCE: Based on Israel Mapping Center, Statistical Credit Register, and Central Bureau of Statistics, 2019 data.

Figure C-28

The Correlation between the Rate of Private Debtors with Enforcement and Collections Files and the Rate of Mortgages in the Locality

The horizontal axis shows the number of Enforcement and Collections Files of private debtors in the locality relative to the number of people aged 18+ in the locality. The vertical axis shows the number of mortgage borrowers in the locality relative to the number of those aged 18+ in the locality.
SOURCE: Based on Enforcement and Collections Authority and the Statistical Credit Register,2019 data.

Not treating the root problems in the real estate market in Arab society and the financing limitations in that market will lead to a worsening of the barriers noted above, a crisis of trust, and the development of alternatives that are damaging to individuals. This is because, due to the demographic growth that is leading to excess demand over supply, and due to the limited access to housing loans and the lack of a developed rental market, households in Arab society have adopted other solutions to deal with the problem. One of those solutions is utilizing building rights in family compounds. A long-term survey shows that 12 percent of households in Arab society live in a dwelling that is owned by a relative, compared to about 2.5 percent households in Jewish society. This solution increases the problem of a lack of collateral, since the property rights of all households who live in the same property are not well-defined, building expansions are not all done legally, and the lender has difficulty putting a lien on a joint property that includes a number of borrowers.

Another solution is the use of alternative financing products, particularly consumer loans, whether in an adjusted track[21], or through a large number of simple consumer loans. It seems that the banks have, in recent years, been trying to create tracks that bypass the need for collateral in order to provide mortgages by way of "designated housing loans". One such product that is being offered, for instance, is a housing loan of up to NIS 400,000 for 25 years against a building permit. The Team's work shows that such products provide a partial response, since they are provided at some banks through digital channels, which are less common among customers from Arab society, interest rates on such loans are higher than on mortgages, and the volume of credit is smaller than what is provided through mortgages with a property as collateral.

The multiplicity of consumer loans leads to a situation where the average interest rate that a household pays is higher, the monthly repayment is higher, and customers encounter bureaucratic difficulties involved in servicing a large number of loans, all of which increase the risk that a household may encounter delays in repaying the loans. In order to examine this argument, we looked at how the difference in the number of consumer loans affects the interest that household pays relative to the various population groups.[22] Data from the

[21] Some of the banks offer loan tracks of between NIS 400,000 and NIS 600,000 for 10 years as an alternative financing solution to mortgages. The cost of these loans is higher than that of mortgages, and the repayment period is shorter, which is reflected in higher monthly payments.

[22] Late payment – At least 30 days have passed from when the debt was created, and the debt in arrears is above NIS 200. If the credit provider is an authorized source, at least 60 days have passed from the date on which the

statistical credit database show that in non-Jewish localities, there are more consumer loans in general, and there are more loans per individual from the various groups. Figure C-28 shows that the amount of such loans is higher than the amount borrowed in Jewish localities, despite the income gaps between the two groups. Figure C-29 shows that in both groups, as the number of loans grows, the rate of late payments also grows, but in all groups, there is a greater late payment rate in the non-Jewish localities. The interest rate given on loans in Jewish localities is lower in all borrower groups, and the largest discrepancy is among those for which the interest rate increases. In Arab localities, the cost of capital declines moderately as the number of loans increases. This difference in the interest path may show that the bank considers these customers as low-risk and is prepared to provide a large number of loans at a lower cost. The effect of a late payment reported in the credit database leads to a higher interest rate for individuals in all groups, while resulting the interest gap is greater among Jewish society.

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debt was created, and the debt in arrears is above NIS 500. SOURCE: First Addendum to the Credit Data Regulations, 5778–2017.

Figures C29–C32 show the characteristics of consumer loans as dependent on the individual's number of loans.

Figure C-29

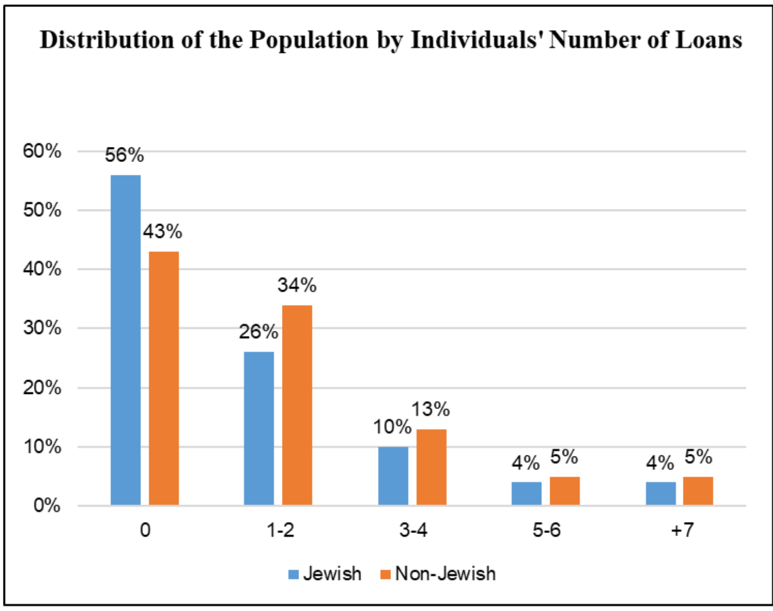


Figure C-30

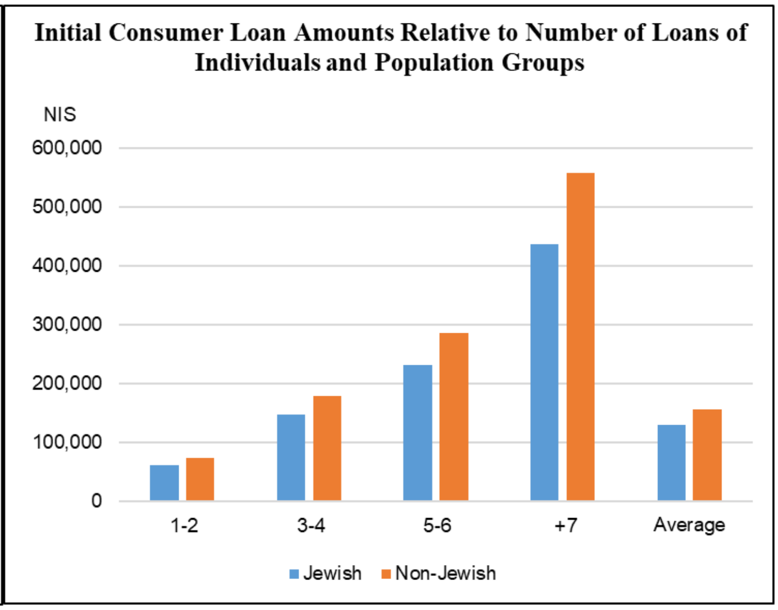


Figure C-31

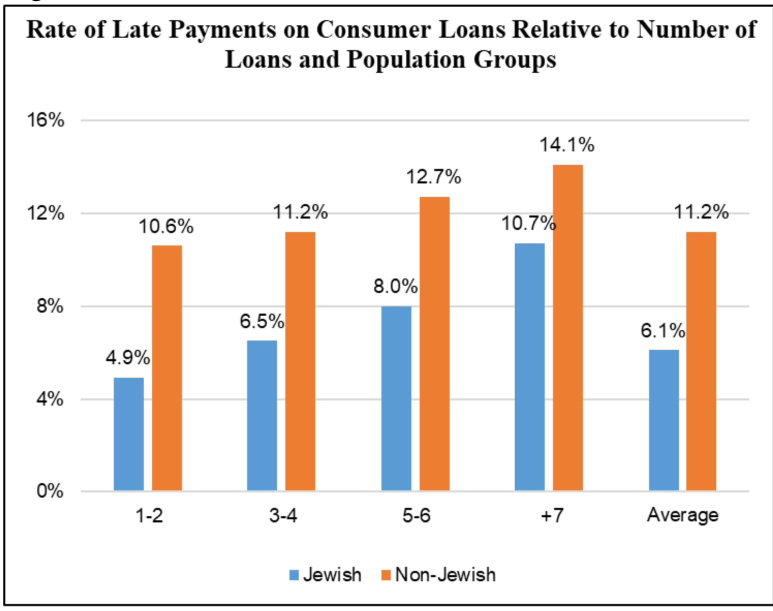
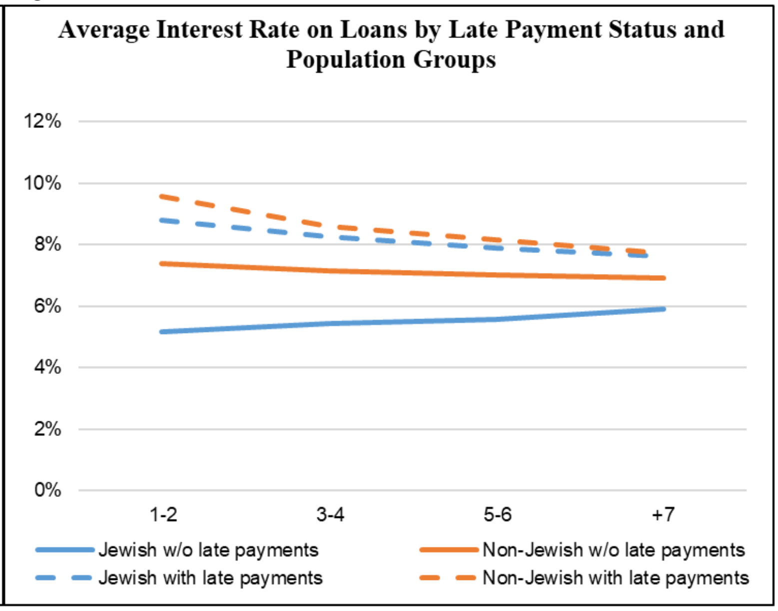


Figure C-32



The graphs show various characteristics of the population groups and the number of consumer loans borrowed by individuals that are reported to the Credit Data Register. Due to limitations posed by the anonymization of the data, a group analysis and equivalization of the population groups is in relation to the number reporting to the Credit Data Register. In Figure C32, the interest rate is equivalized to the loan level of each individual, and calculated as the simple average within each grouping of the number of loans.

SOURCE: Credit Data Register, 2019 data.

FINANCIAL INCLUSION IN ISRAEL: QUANTITATIVE DATA

D. Financial inclusion in Israel: The situation based on quantitative data

This chapter presents quantitative data on the state of financial inclusion in Israel in general, and among relevant population groups. The chapter discusses the existing level of financial inclusion in Israel compared with other countries, as well as the level of financial inclusion among groups that are unique to Israeli society, as far as they can be identified from the data sources available to the Team.

D.1. Main findings

An international comparison of basic financial inclusion indices shows that the average level of financial inclusion in Israel is high, similar to the level of countries with similar income levels. However, there are indications of gaps between various population groups within Israel, and regarding some financial products. Most of the financial inclusion discrepancy is among Arab society. In contrast, the Team's findings suggest that despite the high level of accessibility and use of the financial system among Ultra-Orthodox Jewish society, there are a number of significant gaps relative to non-Ultra-Orthodox Jewish society. For instance, the savings rate in Ultra-Orthodox Jewish society is lower in most savings channels than among non-Ultra-Orthodox Jewish society (except for the use of savings plans at banks).

Even though the use of cash is preferred in both Arab and Ultra-Orthodox Jewish societies, there is a relatively high rate of households in Arab society that do not have a bank account (12 percent), while this rate is miniscule in the other population groups, including among Ultra-Orthodox Jewish population. Unsurprisingly, and in complementary fashion, the use of payment cards was found to be low in Arab society, where only about half the people have a payment card.

It was also found that credit card facilities are lower among Arab society, even after comparing between localities with similar socioeconomic profiles—a difference that may indicate discrepancies in terms of demand for financial products, such as low financial literacy and a lack of trust in the system, and discrepancies in terms of supply of financial services, such as limited access and less willingness on the part of the financial system to offer credit facilities.

Another finding that is prominent among Arab society is the greater use of consumer loans, alongside the lower use of housing loans, due to the substitutability between these products. This substitutability between consumer credit and mortgages is partly due to difficulties having to do with the complexity of registering a lien on properties in Arab localities. It should be clarified that, despite the high level of use of consumer loans, the average loan in Arab localities is lower than the overall overage, and the interest on those loans is higher, which may suggest a low credit supply and insufficient competition over customers in Arab society, or a higher risk level in Arab society, as shown by data from the statistical credit database and other administrative data that show a low level of loan repayment.

While credit facilities in bank accounts in Arab localities are lower than the overall average, the utilization of facilities in these localities is higher, which may suggest a higher risk level or limitations in obtaining cheaper credit alternatives. The issue of low supply in this context is reflected in the fact that there is a smaller variety of credit sources in Arab society than in Ultra-Orthodox Jewish society.

There are also significant discrepancies in the level of use of savings and investment products and in the volume of savings between the various population groups. A comparison of Ultra-Orthodox and Arab groups with similar income levels shows that the savings rate among Ultra-Orthodox Jewish population is significantly higher than among Arabs. This difference suggests that the gaps in Arab society are not solely due to income levels. The savings and investment rate is the highest among non-Ultra-Orthodox Jewish society, which is in line with their higher income levels.

D.2. Financial inclusion in Israel compared to other countries

The rate of bank account ownership in various population groups in Israel is similar to the rate in the same or similar groups in other countries with high incomes (Figure D-1). However, the data show that the largest gap between Israel and the comparison countries, in most groups, is among those who do not participate in the labor market. The data also indicate that among the poorest 40 percent and among those who live outside urban areas, the level of bank account ownership is lower than the average in the comparison countries. A comparison of the public's different uses of bank accounts shows that Israelis make relatively little use of their bank accounts to make payments, while the rate of Israelis who use their bank accounts to receive payments (wages or otherwise) is higher than in the comparison countries (Figure D-2). In addition, Israelis make fewer Internet payments and fewer digital entries to their accounts, which may indicate discrepancies in financial and digital literacy.

It should be remembered that these comparative findings are from the period prior to the outbreak of the COVID-19 pandemic, which served as a significant catalyst for expanded use of digital services in Israeli society and around the world.

Figure D-1

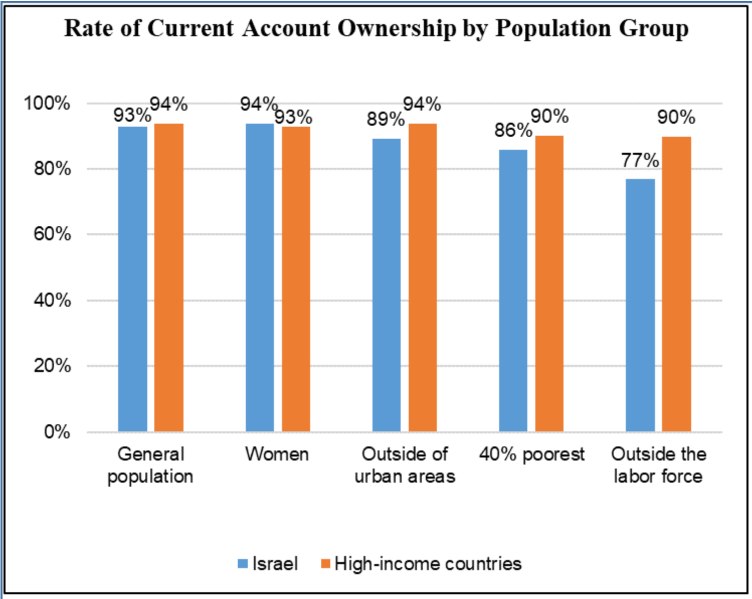
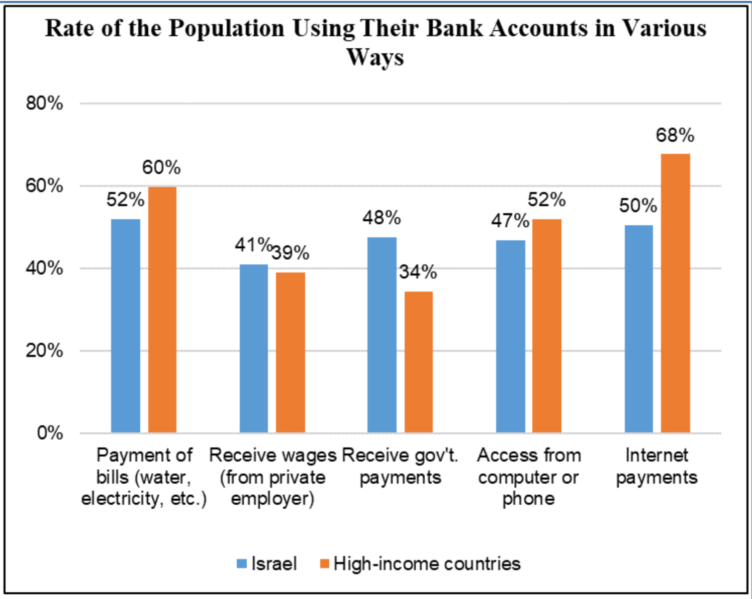


Figure D-2



SOURCE: The Little Data Book on Financial Inclusion 2018, World Bank

Another comparison deals with accessibility of the banking system. A comparison of the number of bank branches per 100,000 population shows that there are about 35 percent fewer branches in Israel than in the comparison countries (Figure D-3). This may be due to the high geographic concentration of the population. For instance, the number of bank ATMs per 100,000 population is about 45 percent higher than in the comparison group. This may also indicate the high use of cash in Israel compared with other countries.

Figure D-3

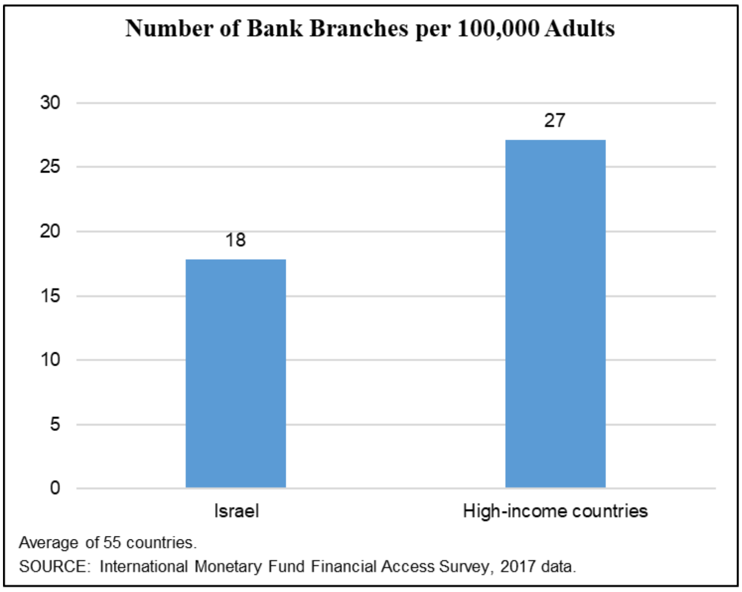
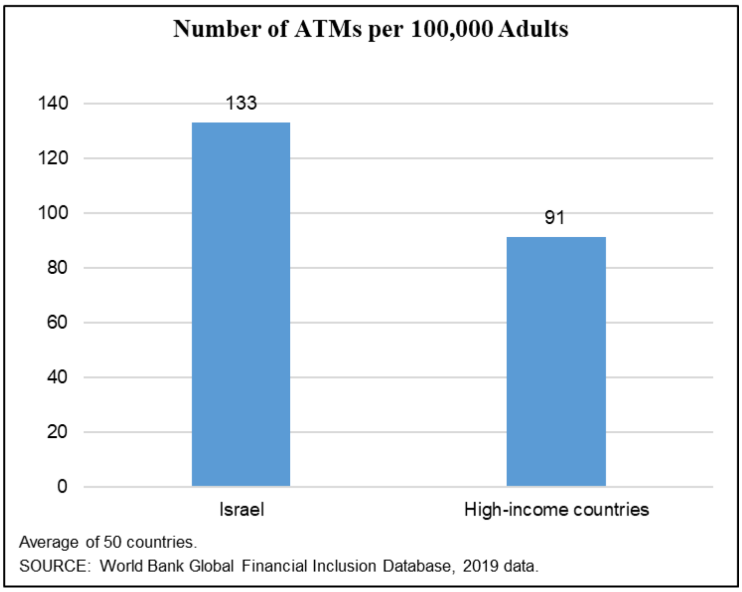
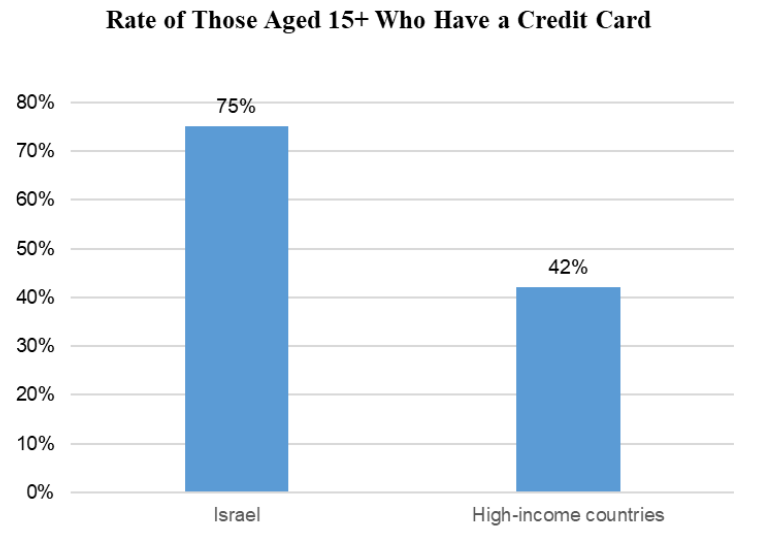


Figure D-4



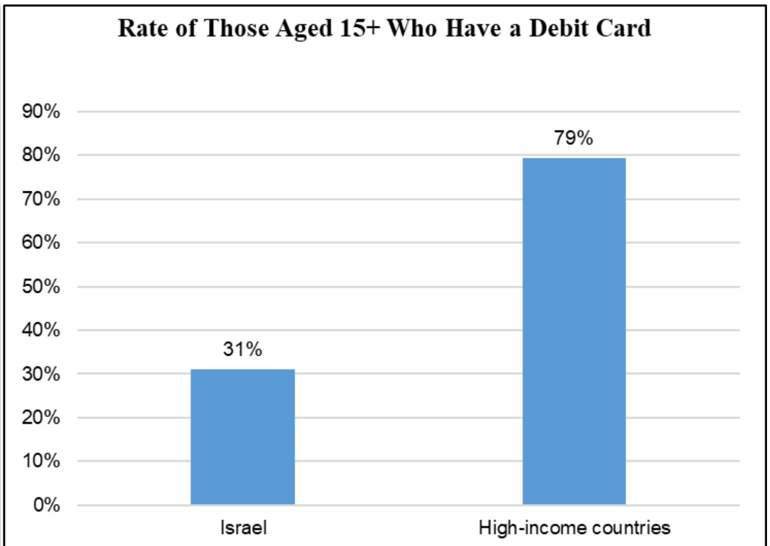
In terms of ownership of different types of payment cards, Israel is similar to the comparison countries, but there are different preferences. In Israel, use of credit cards (deferred debit cards), which enable consumers to obtain free intramonth credit, is common (Figures D-5 and D-6). Immediate debit cards are therefore less popular in Israel than in other countries.

Figure D-5



Average of 48 countries.
SOURCE: World Bank Global Financial Inclusion Database, 2017 data.

Figure D-6



Average of 48 countries.
SOURCE: World Bank Global Financial Inclusion Database, 2017 data.

D.3. Financial inclusion of groups within Israeli society

D.3.1 Data sources

In order to provide a holistic picture of the various financial inclusion indices beyond what emerges from the international comparison, we gathered data from various sources in Israel, in addition to dedicated surveys conducted as part of the Team's work. The data collection also made it possible to create tracking indices for the future regarding the level of financial inclusion in Israeli society. Consolidating the data from various sources helps distinguish between population groups or geographic areas with low financial inclusion levels, and to identify the areas in which it is reflected.

Since the statistical data do not generally identify individuals according to the various population groups—non-Ultra-Orthodox Jewish, Ultra-Orthodox, Arab—identification within the collected data is based on the homogeneity of these population groups in various localities and geographic areas. Therefore, most of the data were collected and processed at the locality level (or group of localities in the case of small localities). This level of details allows us to identify subgroups in the Israeli population while maintaining confidentiality of the individual's information or that of the business entity that provided the information.

The following is a list of the information sources used by the Committee:

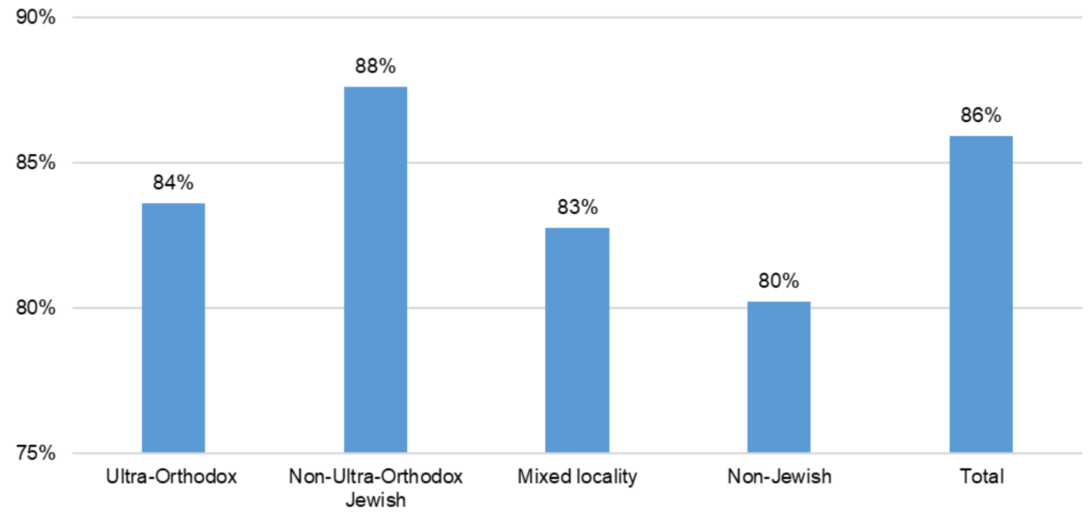
- **World Bank data**, particularly from **Global Findex**. These data are based on an international survey that is conducted every few years. The survey is conducted through personal interviews involving 1000 participants comprising a representative sample of the Israeli population. Participants are asked about their use of the financial system. Population groups are identified in these data through respondents' answers regarding their religion and religious level. This report presents data from the most recent survey, conducted in 2017.
- **Central Bureau of Statistics long-term survey.** An annual survey conducted by the CBS, which includes a chapter on ownership of financial assets. Participants in the survey are asked about their household's ownership of financial assets. Population groups are identified in the data by respondents' answers regarding their household's nationality and religious level. This report uses data from the 2018 survey, the most recent one to include questions from the financial chapter.
- **Banking Supervision Department data.** Aggregate data on bank branch activity in various localities. Population groups are identified by locality groups where bank branches operate. Due to commercial secrecy limitations, all branches in Israel were grouped into 82 groups, of which 60 are in non-Ultra-Orthodox Jewish localities, 3 are in Ultra-Orthodox localities, 14 are in non-Jewish localities, and 5 are in mixed localities.
- **Data from surveys conducted by the Bank of Israel Currency Department and by the Bank of Israel Payment and Settlement Systems Department, and a dedicated survey conducted for the Team's work.**
- **The Statistical household credit database.** A Bank of Israel database that is based on the Central Credit Register, with the data having been anonymized and cleansed of identifying details regarding customers. The statistical database contains itemized information on all credit transactions made by individuals above age 18 who are Israeli citizens and residents, as reported by the credit providers. The database contains

information on all new transactions completed from 2016 onward, as well as active transactions during the current year. The data are reported at a monthly frequency, and include information on credit transaction amounts, credit history, and payment ethic of borrowing households, while combining three main dimensions: the entity participating in the transaction, details of the transaction, and collateral. The information sources that report the data to the system are mainly credit providers, such as banks, credit card companies, or nonbank credit providers, as well as various public authorities such as the Official Receiver, the Enforcement and Collections Authority, and the Restricted Accounts Section at the Bank of Israel. Population groups are identified by the individual's residential locality as reported by the credit provider, excluding localities with less than 2,000 residents.[23] A comparison of the representation rates of the population groups (Figure D-7) identified in the database relative to data from the Population Authority shows that the identification rate ranges from 80 to 88 percent in the various population groups. As a result, the estimates of financial inclusion calculated on the bases if the statistical credit database are expected to be biased upward (thus indicating greater financial inclusion than is actually the case), since they are calculated only on the basis of the population reported to the Central Credit Register, and not in relation to the general population.

[23] The data do not include localities with less than 2,000 residents for reasons of privacy protection. As a result, the estimates may indicate higher than actual levels of financial inclusion.

Figure D-7

Population's Representation in the Central Credit Register



Division of the groups identified in the Statistical Credit Register relative to those aged 18+ in the various population groups.
SOURCE: Statistical Credit Register and Population Registry, 2019 data.

- **Postal Bank data.** Data received from the Postal Bank regarding individual's ownership and use of Postal Bank accounts. Population groups are identified through a combination of information from the Postal Bank's "Know Your Customer" process and the individual's residential locality.

- **Data from the Israel Electric Company.** Data obtained from the Electric Company regarding the means of payment used to make payments in various localities. Population groups are identified by the residential locality in which the electricity contract is registered.

Additional information files:

  - **Central Bureau of Statistics Local Authorities File for 2018.** A file that contains information on the 255 local authorities in Israel, including the size of the population aged 15+.

  - **Central Bureau of Statistics Socioeconomic Index.** An index that measures the socioeconomic level of various localities. This report uses the index for 2017 in its March 2021 version.

- **Population Registry files of localities' populations for various years.** A comprehensive file that includes information on the quantity of the population aged 18+ in various localities in Israel.

D.3.2 Use of bank accounts

A basic index of financial inclusion is access to, and the extent of use of, a bank account.

D.3.2.1 Owning a current account

As stated, ownership of a current account is the fundamental element of participation in the financial system. The banks in Israel are required to open a bank account (with no credit facility) for anyone requesting it[24], but the data show that there are still discrepancies between groups concerning the rate of bank account ownership.[25] World Bank data regarding Israel show that only about 83 percent of those who define themselves as Muslim[26] have a bank account, compared with about 95 percent among the Jewish population groups (Figure D-8). The discrepancies between the groups also appeared in a Central Bureau of Statistics survey that examined the rates of household ownership (assuming that not every individual in a household requires a separate bank account), according to which 12 percent of households in Arab society do not have a bank account, while the rate among the Jewish population groups is negligible (Figure D-9).

[24] The Banking (Service to the Customer) Law, 5741–1981 sets out that a banking corporation shall not unreasonably refuse to open a bank account with no credit facility for a customer. This obligation was brought into sharper relief in Proper Conduct of Banking Business Directive 422 – "Opening and Managing a Current Account with No Credit Facility", which was first published in May 2014.

[25] We cannot know whether survey respondents who have a Postal Bank account responded affirmatively to this question, meaning whether they are included among those who have a bank account according to the survey.

[26] Population groups were identified in the World Bank data according to the respondent's religion (for instance, Muslim) and religious level (for instance, *Ultra-Orthodox* (ultra-Orthodox)), and not by nationality (for instance, Arab). In contrast, identification in the Central Bureau of Statistics long-term survey was by the respondent's declaration of nationality.

Figure D-8

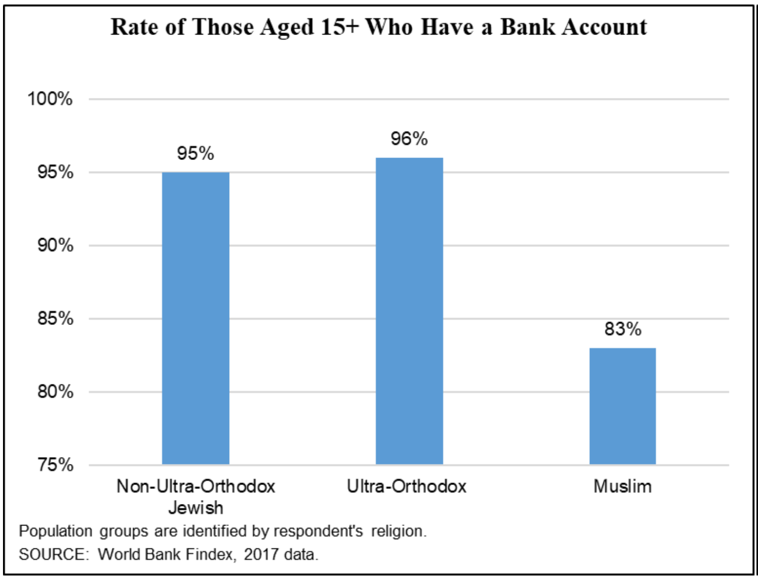
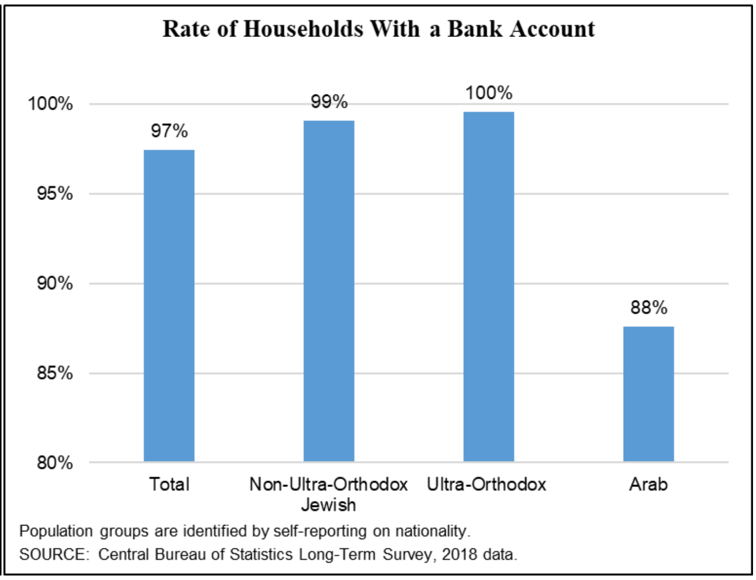


Figure D-9



Another estimate of the rate of individuals without a bank account was made according to administrative data on how the 2020 Grant to Every Citizen, which was sent automatically to the bank accounts of all eligible individuals, was received. About 95 percent of those eligible for the grant received it through a bank account in their name. If the National Insurance Institute did not have up-to-date bank account details, eligible individuals were sent to the post office to receive the grant amount in cash. An examination of the variance between population groups shows that the National Insurance Institute could not find bank accounts for about 10 percent of residents in non-Jewish localities, and about 9 percent in Ultra-Orthodox localities, compared with about 3 percent in the non-Ultra-Orthodox Jewish society (Figure D-10). An examination of the various by age group shows that the main discrepancy in the Ultra-Orthodox Jewish society is among the 18–25 age group, and that from age 25 up, the rate of grant payment to a bank account was similar to the rate in the non-Ultra-Orthodox Jewish society (Figure D11). Among residents of non-Jewish localities, the level remained high in all age groups, and was higher at the edges (the 18–25 and 50+ age groups).

Figure D-10

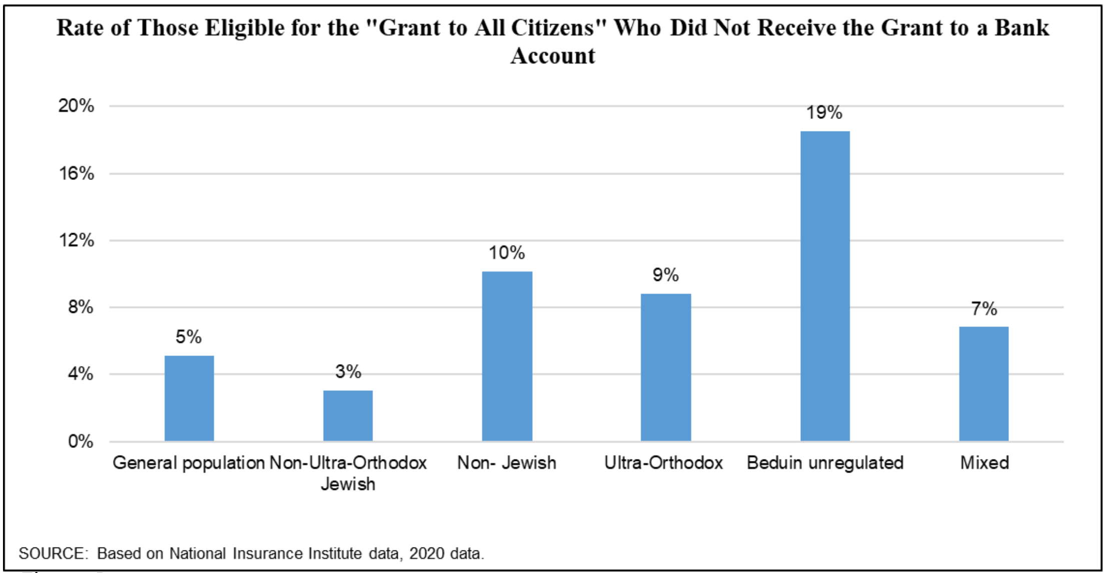
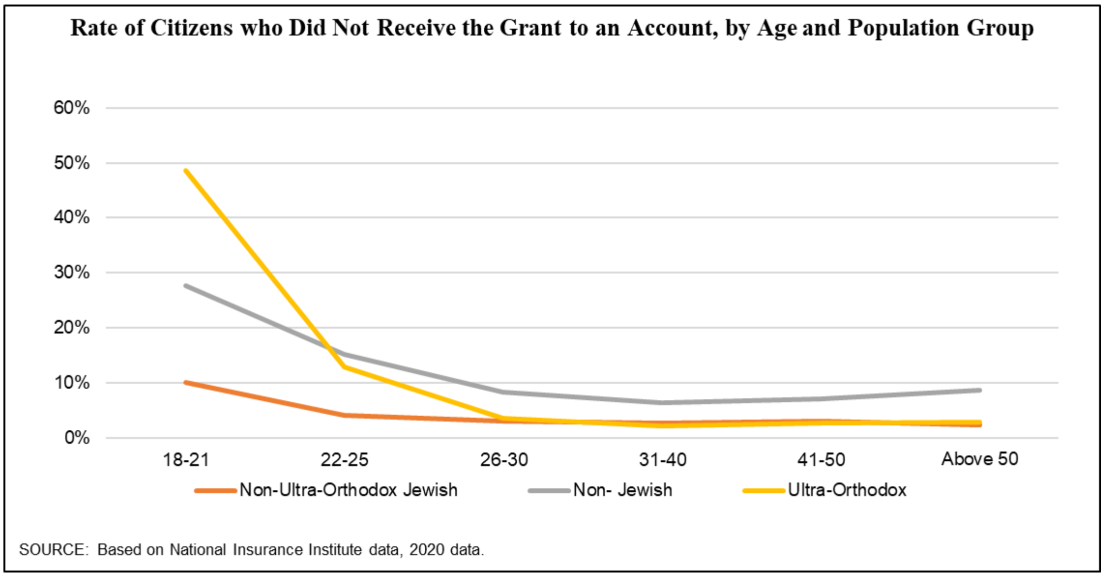


Figure D-11

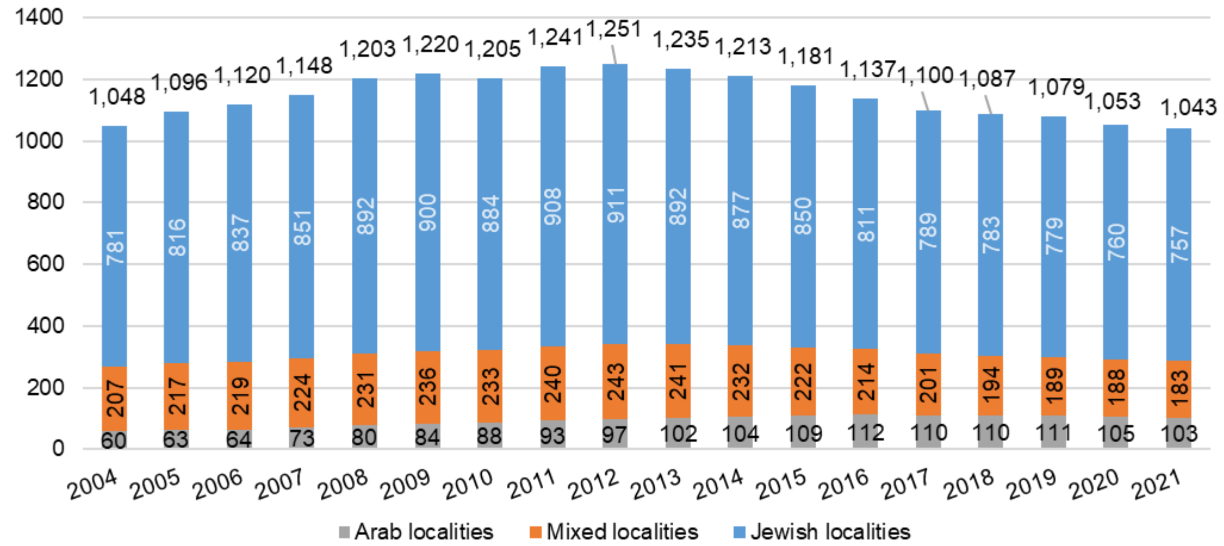


D.3.2.2 Access to bank branches

According to Banking Supervision Department data for 2021 (which do not include the Postal Bank), there are 1,043 bank branches in Israel, spread across the country. Until 2019, there was an upward trend in the number of branches in Arab localities, compared with a decline in the number of branches in Jewish society. Since 2019, there appears to be a moderate decline in the net number of branches in Arab localities as well (Figure D-12).

Figure D-12

Deployment of Branches in the Total Banking System, by Population Sector



Mixed localities: Jerusalem, Tel Aviv, Haifa, Lod, Ramle, Acco, Nof Hagalil, and Ma'alot-Tarshiha. Any place where there is mention of the Arab sector, the reference is to the "Non-Jewish" sector according to the Central Bureau of Statistics definition. This calculation includes branches and extensions.

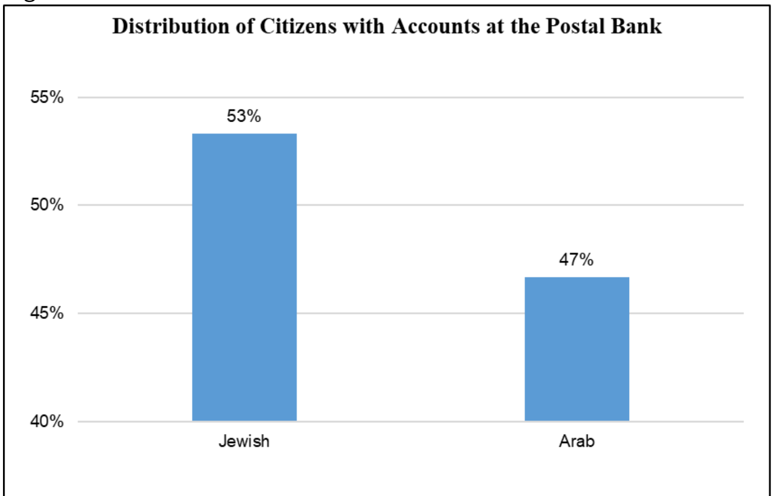
SOURCE: Banking Supervision Department calculations based on reports by the banks.

D.3.2.3 Activity with the Postal Bank

The Postal Bank is a subsidiary company of Israel Post, and provides basic financial services through post office branches across the country. The services it provides include making and receiving payments (bills, taxes, fees, receipt of benefit payments and government transfer payments, and more); management of a current account with no credit facility, including issuing checkbooks, debit cards, and foreign exchange services. It is important to note that in recent years, Postal Bank services have been available digitally—on their website and through a mobile application. Managing a current account at the Postal Bank does not carry a regular payment, although some transactions that the banks provide for free or as part of a fee basket are subject to a separate payment at the Postal Bank. Postal Bank branches are much more accessible than those of commercial branches, since service can be obtained at most post office branches across Israel (about 700 branches). The Postal Bank's strategy alongside large deployment and low account management costs have historically positioned the Postal Bank as a main option for managing a current account among disadvantaged population groups.

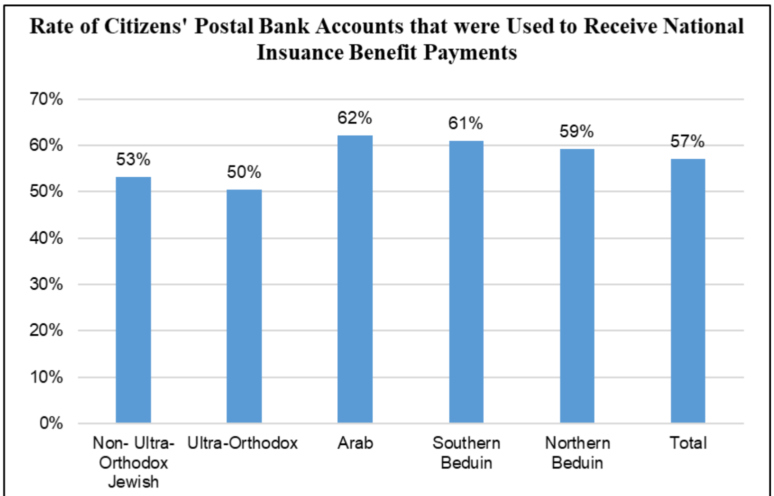
Among the various population groups, Arab society is over-represented among Postal Bank customers (excluding foreign citizens), with about half of all Postal Bank customers coming from Arab society (Figure D-13). For many of these customers, a Postal Bank account is an alternative to the commercial banking system. In addition, Postal Bank customers are, for the most part, supported by benefits from the National Insurance Institute (Figure D-14). More than half of Postal Bank customers chose to have these benefits deposited in an account at the Postal Bank, with the high representation among Arab society being most prevalent. The Postal Bank also makes it possible for customers without an account to receive National Insurance Institute benefit payments in cash.

Figure D-13



Population groups are identified by residential locality ("Jewish" includes "*Haredi*").
SOURCE: Postal Bank, 2019 data.

Figure D-14



Population groups are identified by residential locality.
SOURCE: Postal Bank, 2019 data.

D.3.3 Access to credit

Obtaining a credit facility or loan from a supervised financial institution may help low-income households smooth their consumption, either through current consumption or the purchase of durable goods or through large significant transactions such as the purchase of a home. However, there is also a phenomenon of "pushing credit" to disadvantaged population groups with low financial literacy. This section tries to map access to credit for various population groups. A population group is considered more included if the rate of access to credit in the group is higher (the supply side). In this context, we examine the existence of current account credit facilities, consumer loans, mortgages, and the extent of diversification of credit sources. In the background, we note that an international comparison of the volume of credit issued by the financial and banking systems to the private sector (businesses and households) shows that the volume of credit issued in Israel is significantly lower than in the comparison countries, and that its diversification is low, meaning the weight of bank credit as a share of total credit is particularly high.[27] The explanations for this low level are mainly the low number of nonbank credit providers, which is partly due to high financing costs; a low level of development of financial markets, which includes lack of a developed securitization market; and regulation on housing credit.

D.3.3.1 Current account credit facilities

A current account credit facility reflects the bank's willingness to enable its customer to create a negative balance in the account up to a certain amount. While the Banking (Service to the Customer) Law, 5741–1981 prohibits a bank from unreasonably refusing to open an account with no credit facility, the bank is not obligated to provide a credit facility in an account, and having such a credit facility can be expected to show a higher level of inclusion for the customer, since it enables access to available and immediate credit when needed. It should be noted that the interest on overdrafts from the credit facility is generally higher than the interest on consumer loans, although in certain cases, for instance as part of customer recruitment campaigns, banks do make it possible to obtain limited credit facilities at low interest or with no interest.

[27] See Chapter 4 of the Bank of Israel Annual Report for 2019, and "Four Recommended Pillars of Strategic Government Action to Accelerate Economic Growth and A Fiscal Framework for Financing Them".

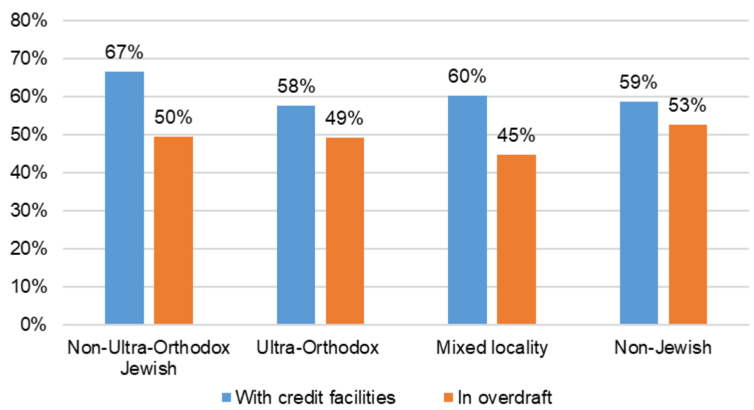
Data from the statistical credit database show that in non-Ultra-Orthodox Jewish localities, there is a higher rate of individuals with current account credit facilities than in other groups, and that among the other groups there is no significant difference in this rate (Figure D-15).

An examination of customers with credit facilities by their localities' socioeconomic rating shows that in non-Jewish localities in the low socioeconomic clusters, the rate of such customers is lower than in Jewish localities from the same type of cluster, including localities in Ultra-Orthodox Jewish society. This may indicate a low level of financial inclusion in these localities. In contrast, in localities belonging to the middle clusters (4–7), the rate of those with a credit facility is higher (Figure D-16).

Beyond the actual existence of the credit facilities, we also examined the extent of its use. Figure D-17 presents the rate of those who have bank accounts with credit facilities and who utilized the facility, broken down by socioeconomic cluster. The Figure shows that in non-Jewish localities, the utilization rate of the credit facilities is higher in all clusters. This indicates the variance between population groups. Utilization of the credit facility may indicate customers' low financial literacy, since it generally involves the use of high-cost credit and if the household utilizes it for a prolonged period, it may indicate an imbalance between income and expenses, and a high level of credit risk among the population. However, in the absence of access to other credit, overdrafts are an accessible alternative for obtaining credit quickly and conveniently, even if it comes at a high cost.

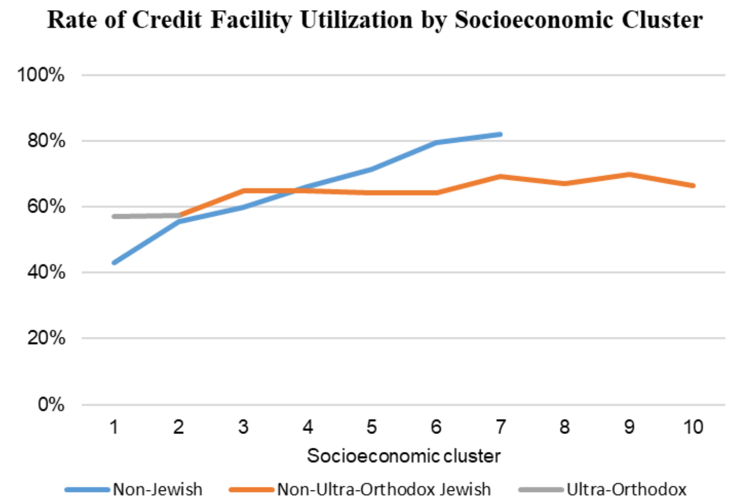
Figure D-15

Rate of Customers with Credit Facilities and Accounts in Overdraft



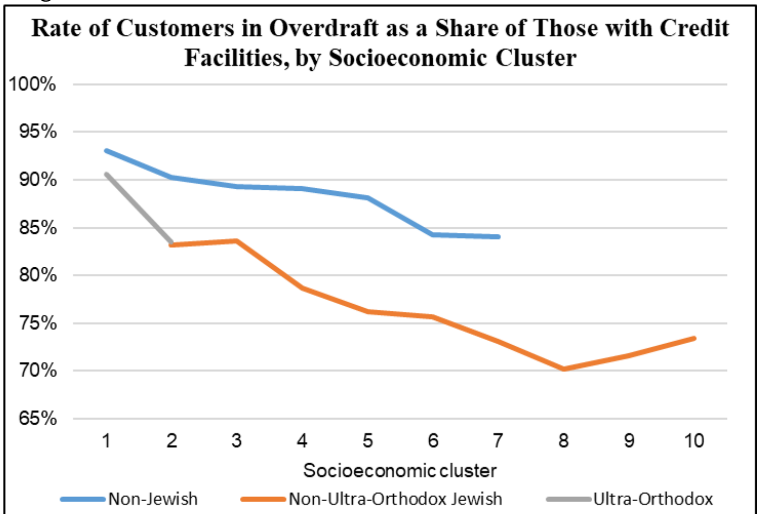
Customers with credit facilities in their current accounts, and accounts where the facility was utilized in the past 12 months, as a share of all customers reporting to the credit data register.
SOURCE: Statistical Credit Register, 2019 data.

Figure D-16



Customers with credit facilities in their current accounts, and accounts where the facility was utilized in the past 12 months, as a share of all customers reporting to the credit data register.
SOURCE: Statistical Credit Register, 2019 data.

Figure D-17

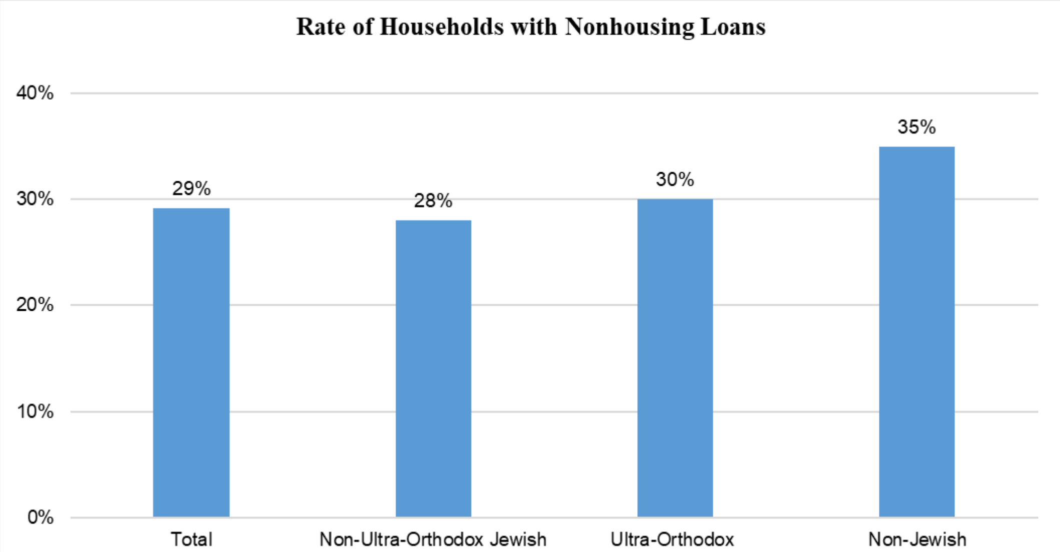


Customers with credit facilities in their current accounts, and accounts where the facility was utilized in the past 12 months, as a share of all customers reporting to the credit data register.
SOURCE: Statistical Credit Register,2019 data.

D.3.3.2 Consumer loans

A consumer (nonhousing) loan is generally cheaper than the credit facility in a bank account, but it is less accessible. It is necessary to actively ask for the loan and to explain what it is for. An analysis of the rate of those who have a consumer loan, by breakdown of localities, shows that both at the household level (Figure D-18) and at the individual level (Figure D-19), there is a higher rate of use of such loans in the non-Jewish localities. This gap exists over all socioeconomic clusters (Figure D-20).

Figure D-18



SOURCE: Central Bureau of Statistics Long-Term Survey,2018

Figure D-19

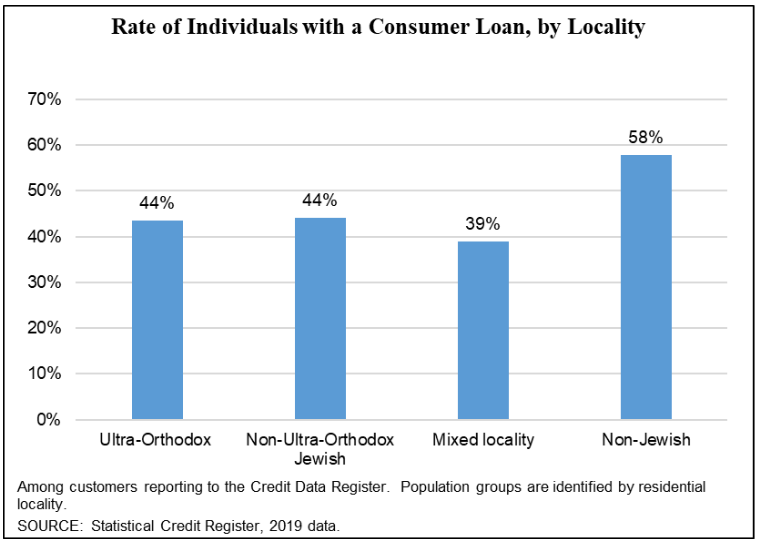
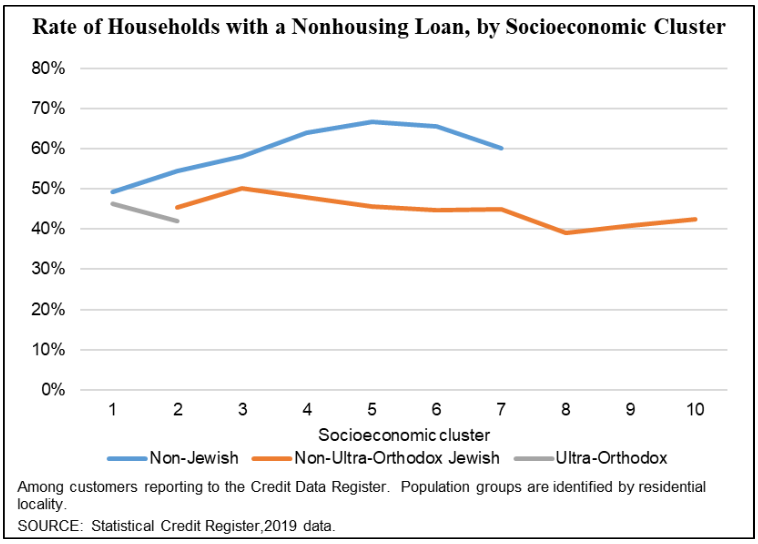


Figure D-20



While this indicator may show a high level of access to consumer credit, the Team's discussions showed that there is substitution between mortgages and consumer loans, due to unique problems that exist in the housing market in Arab society, such that the access to credit must be analyzed in view of this finding as well.

In order to examine the variance between population groups, we must look not only at the level of access to consumer loans, but also at the differences in the loan characteristics, particularly in view of the fact that some loans in Arab society are taken out for housing purposes. Therefore, this section examines loan duration, loan amount, and interest.

Loan duration in Ultra-Orthodox Jewish society is greater than in the other groups (Figure D-21). The amount of the average consumer loan is lowest in Ultra-Orthodox Jewish society, while there is no significant difference between the amounts of consumer loans issued in non-Jewish localities and those issued in non-Ultra-Orthodox Jewish localities (Figure D-22).

Figure D-21

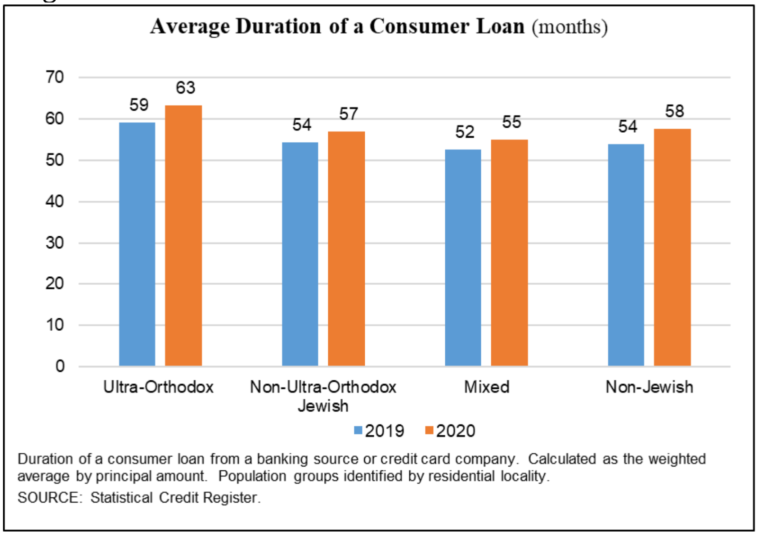
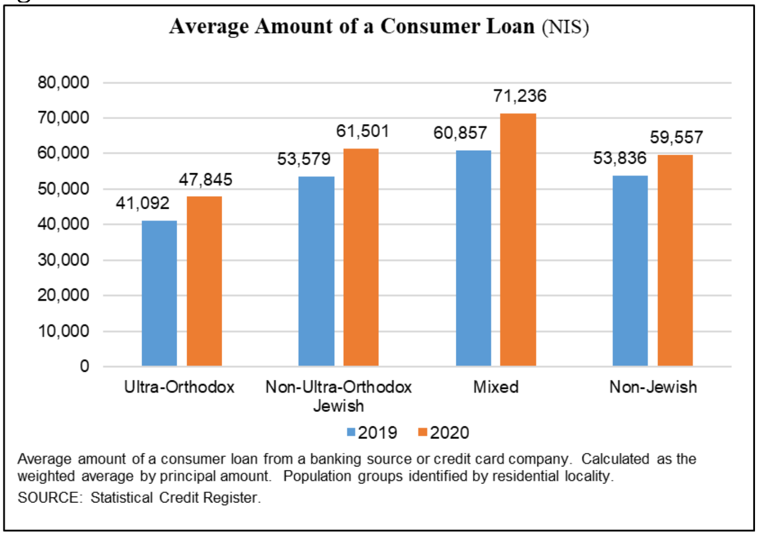
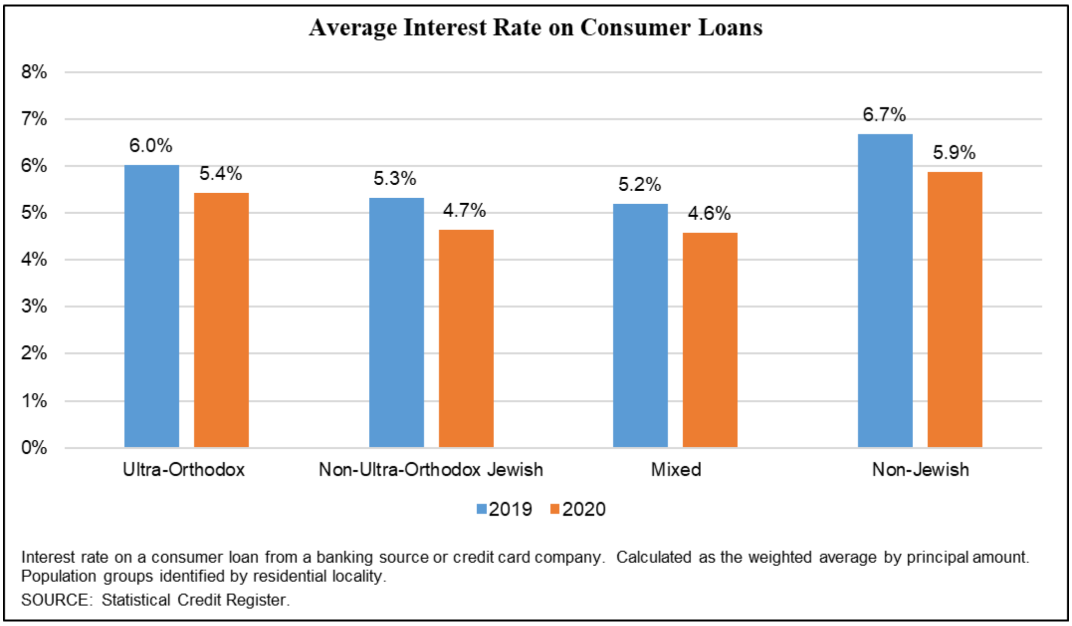


Figure D-22



The average interest rate for consumer loans in Arab localities is higher than in non-Ultra-Orthodox and Ultra-Orthodox Jewish communities (Figure D-23).

Figure D-23

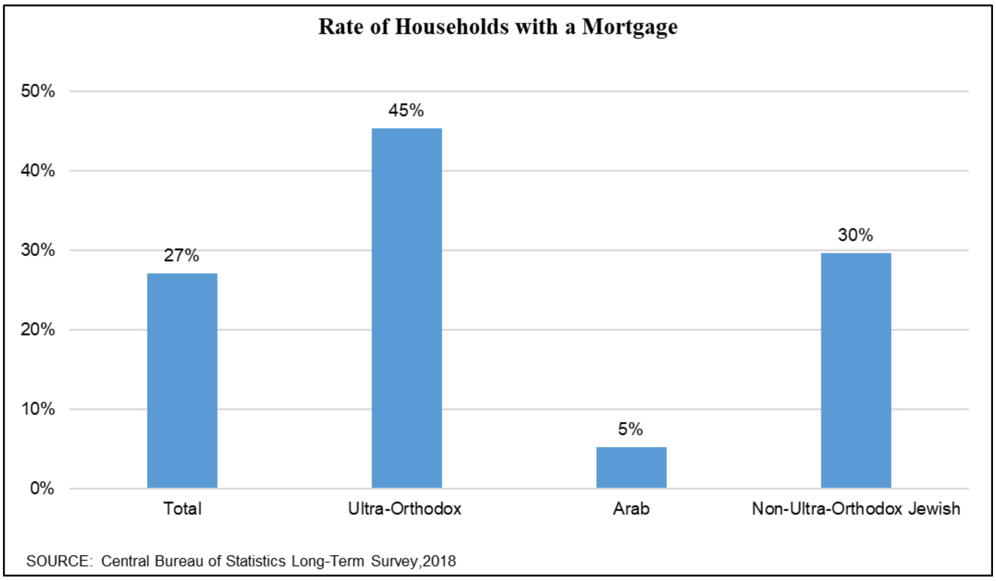


This variance in loan characteristics between Ultra-Orthodox localities and non-Jewish localities with similar socioeconomic profiles may indicate discrepancies in financial literacy levels between these population groups. The lower level of credit and longer term to repayment in Ultra-Orthodox Jewish society lead to a lower payment to income ratio than in the non-Jewish localities. In addition, the high average interest rate in non-Jewish localities indicates a lower level of competition, but in view of the higher payment to income ratio and differences in payment ethic (which in turn may be due to discrepancies in financial literacy – see Section C.1.3), a large part of the interest rate gap is apparently due to the higher level of risk.

D.3.3.3 Housing loans

A housing loan is one of the most important financial transactions in the life of a household. The rate of households that have mortgages differs greatly between the population groups

Figure D-24



(Figures D-24 and D-25). The level of those who have mortgages in Arab society is significantly lower than in the other population groups, and is highest in the Ultra-Orthodox localities. The discrepancies in the rate of those who have mortgages remain in comparisons by socioeconomic cluster (Figure D-26).

Figure D-25

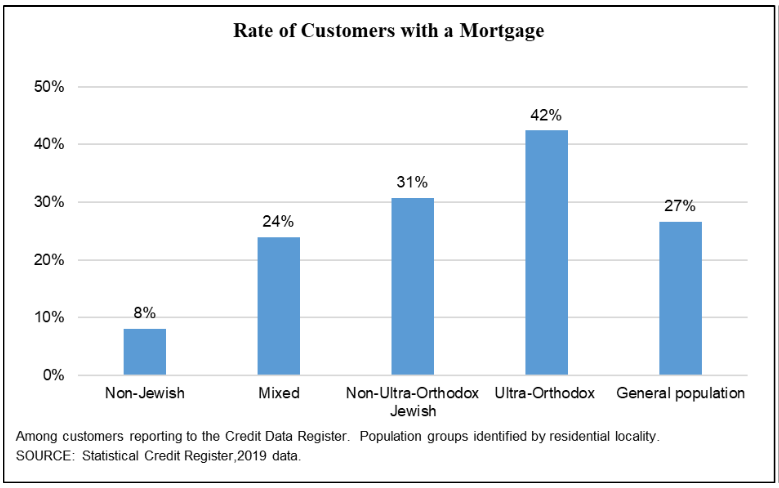
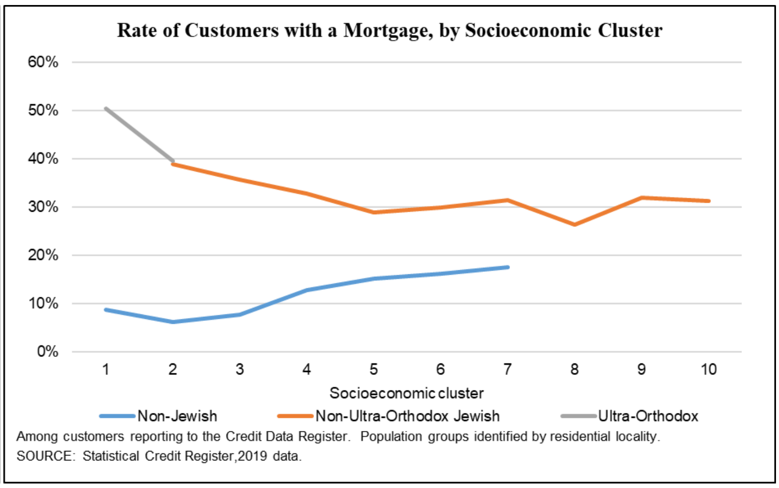
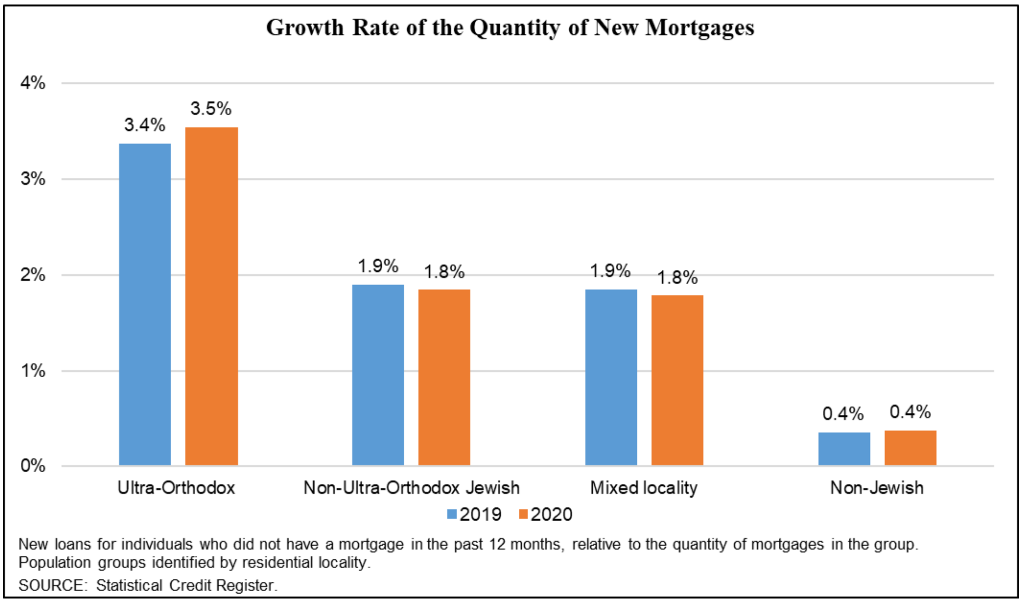


Figure D-26



An examination of the growth rate of new mortgages in 2019 and 2020 shows that the overall growth rate of mortgages is similar to the growth rate of the population, but that in Arab society, the growth rate is significantly lower than the growth of the population (Figure D-27).[28]

Figure D-27



The real estate market in most Arab localities is characterized by many structural problems that make it difficult for banks to offer mortgages. The main difficulty has to do with the lack of ability to register collateral, and if it can be registered, from the level of its tradability, such that if there is a failure, there is concern that the lender will not be able to foreclose it due to problems in regulation, registration, inability to find buyers for the property, and difficulty in enforcing contracts.

In 2017, the Banking Supervision Department analyzed the mortgage market trends in Arab society, based on a dedicated database of all mortgages between 2010 and 2014, and found that about 2 percent of mortgages provided during those years were for customers from Arab society, compared with their share of the Israeli population—21.4 percent. An updated examination of the data from this database for the years 2018–2020 shows that despite a 42 percent increase in the quantity of new housing loans in Arab society in recent years, the

[28] Between 2009 and 2020, population growth was about 1.6 percent in the non-ultra-orthodox Jewish society, about 2.4 percent in Arab society, and about 4.6 percent in *Ultra-orthodox Jewish society*.

flow of housing loans relative to the quantity of dwellings purchased or build in Arab localities remains very low compared to Jewish society (Figures D-28 and D-29).

Figure D-28

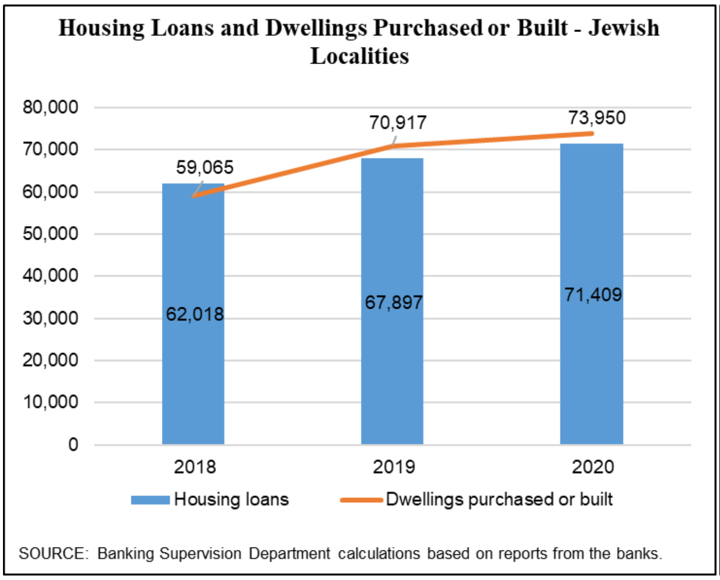
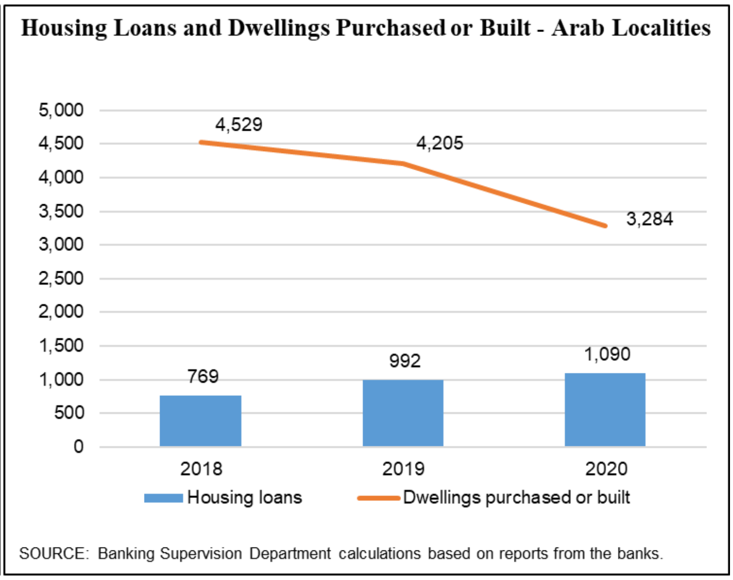


Figure D-29

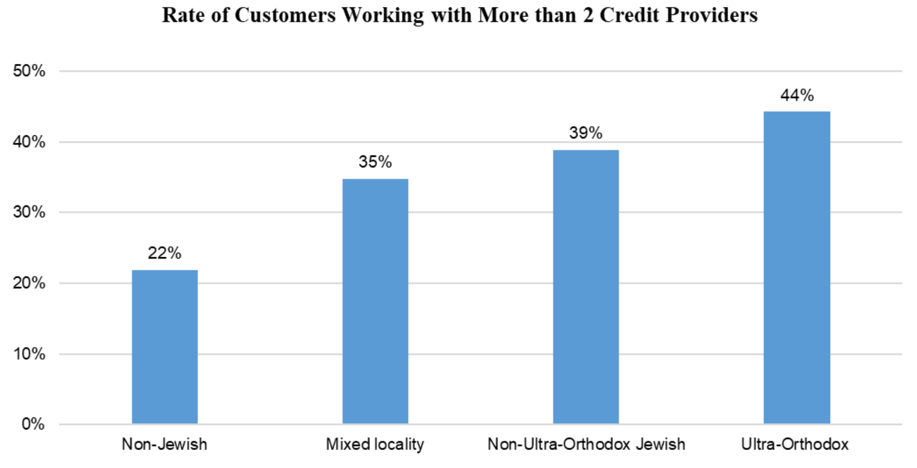


D.3.4 Diversification of the sources of credit

When a customer has loans or credit facilities originating with several credit providers, it may indicate that the customer is benefitting from a diverse supply of credit sources, and that his ability to draw competing offers from various credit sources may be greater. An analysis of the data from the statistical credit database shows that the level of credit diversification is lowest in non-Jewish localities, and highest in Ultra-Orthodox localities (Figure D-30). (The database does not include information on free-loan societies. If these had been included, the level of credit diversification would have been even higher in Ultra-Orthodox localities.)

This figure indicates constraints in demand and in the ability to utilize existing credit resources.

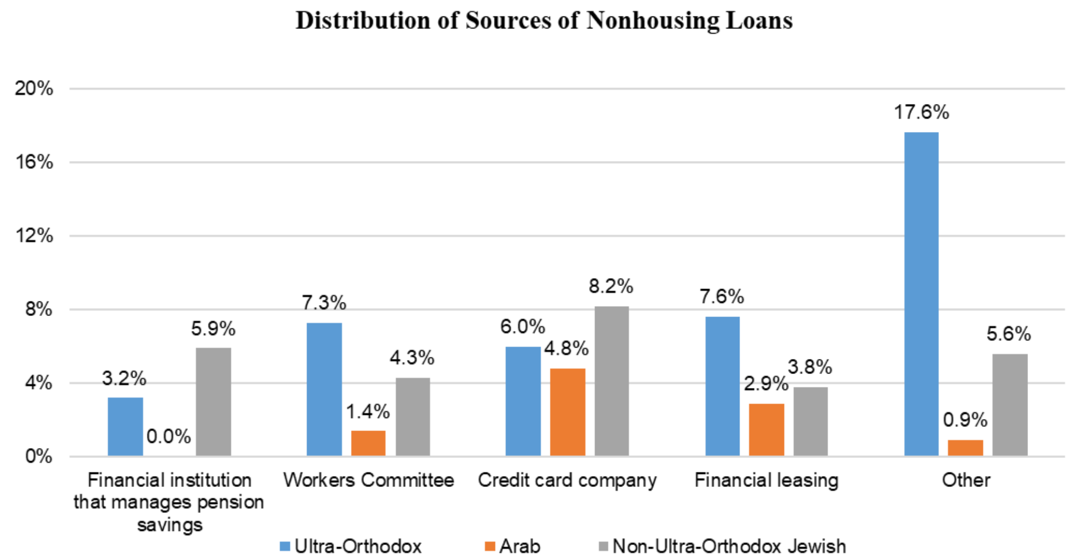
Figure D-30



Rate of customers who were reported to the Credit Data Register by more than 2 credit sources as a share of customers reported to the Credit Data Register.
SOURCE: Statistical Credit Register,2019 data.

A similar picture emerges from the Central Bureau of Statistics Long-Term Survey from 2018, which shows that Ultra-Orthodox Jewish society benefits from diversified sources of credit (even excluding the free-loan societies, which are apparently shown in the Figure as part of "other sources"), while there is less diversification in Arab society (Figure D-31).

Figure D-31



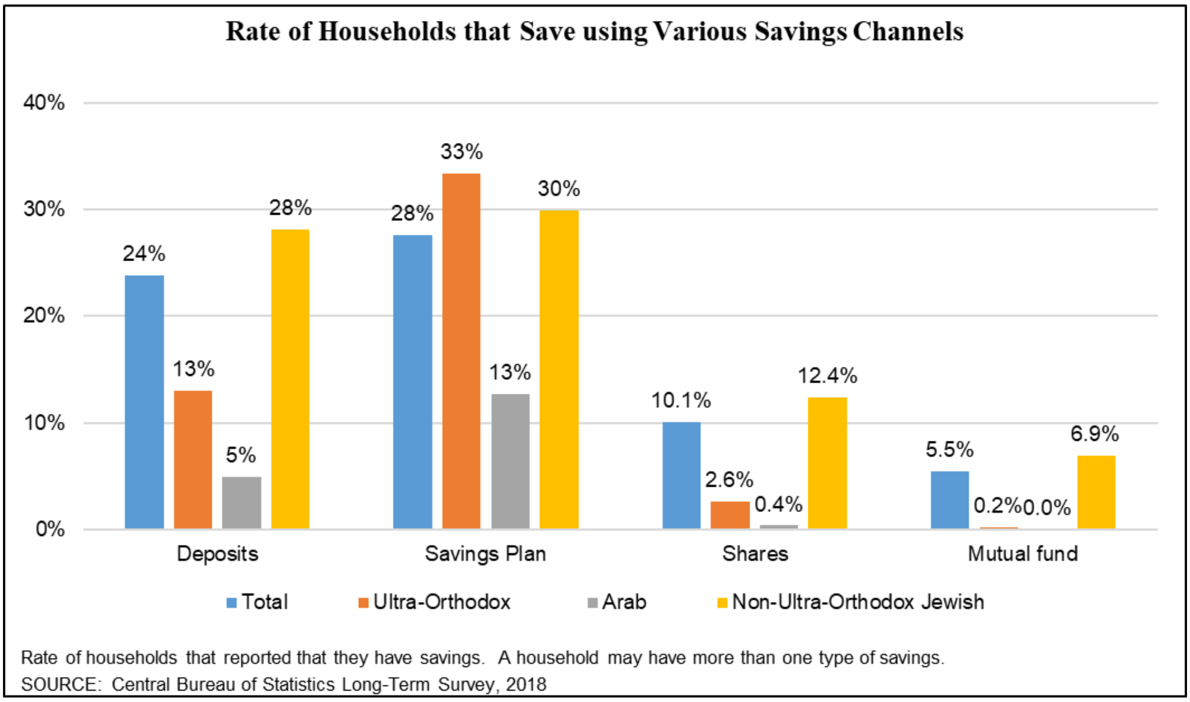
Among borrowers, the rate that tool a loan from an additional nonbank source. An individual can take loans from a number of different sources.
SOURCE: Central Bureau of Statistics Long-Term Survey, 2018

D.3.5 Savings

Financial savings is a very important tool in terms of a household's ability to smooth income and consumption, in both the short and long terms. Differences in the volume of ownership of financial assets may indicate different levels of individuals' financial literacy, as well as different levels of access to financial institutions that offer such instruments.

An examination of the variance in ownership of short-term savings shows that the savings rate in Arab society is significantly lower than in the other population groups. This discrepancy is reflected in data from the Central Bureau of Statistics Long-Term Survey, both in terms of ownership of savings plans and deposits—where the discrepancy is prominent in relation to Ultra-Orthodox Jewish society as well—and in terms of ownership of equities and mutual funds (Figure D-32).

Figure D-32



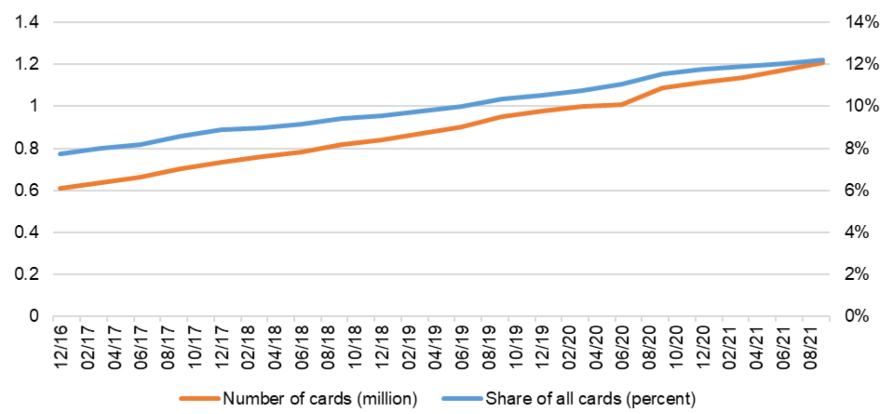
D.3.6 Means of payment

The use of means of payment is another indicator of the level of financial inclusion. The broad use of cash generally indicates a lack of financial inclusion and low financial literacy, since it requires almost no contact with a financial institution. Individuals with high levels of financial literacy will prefer using advanced means of payment that are synchronized with their bank accounts, rather than using cash.

Payments cards in Israel are generally "deferred debit" cards (credit cards), which require the provision of a credit facility, and financial institutions are not required to issue them. Due to regulatory changes in recent years, there has been a gradual increase in the distribution of debit cards, where the charge is immediate and does not require a credit facility. Banking Supervision Department directives state that every customer is entitled to receive a debit card if he requests one, and the Postal Bank also enables its customers to receive such a card (Figure D-33).

Figure D-33

Number of Active Debit Cards (million)**, and as a Share of all Payment Cards** (percent)



SOURCE: Banking Supervision Department.

A review of the data shows that there is a significant discrepancy between population groups in the volume of credit card ownership. According to a Central Bureau of Statistics survey from 2018, half of non-Jewish households did not have a payment card[29], compared with

[29] The questionnaire in the survey related to "credit card", and did not distinguish between card types. A respondent who has a debit card may have answered affirmatively when asked if he has a credit card.

about one-tenth of non-Ultra-Orthodox Jewish households (Figure D-34). Data in the statistical credit database are similar—about 40 percent of customers in non-Jewish localities, for which there are reports in the database, did not have a credit card in 2019, compared with about 14 percent in non-Ultra-Orthodox Jewish society (Figure D-35).[30] The discrepancies between Arab and Jewish societies in this context exist in all socioeconomic clusters, but are greatest in the three lowest clusters (Figure D-36).

Figure D-34

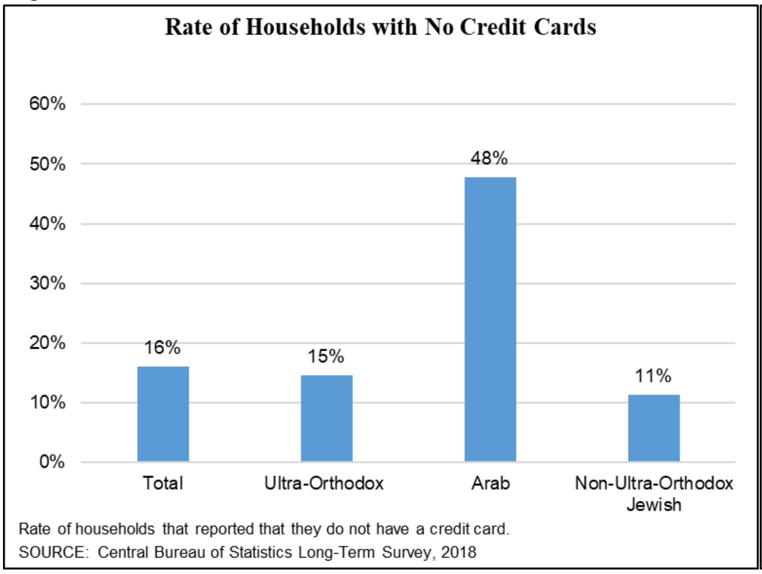


Figure D-35

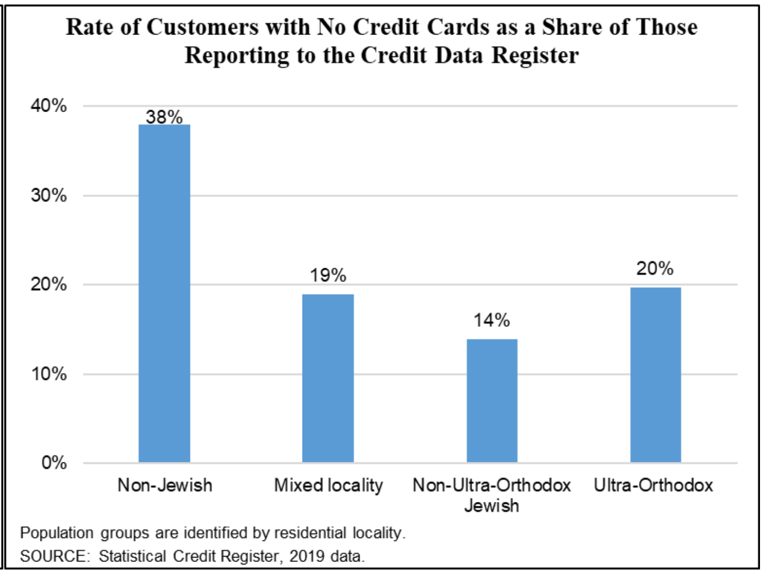
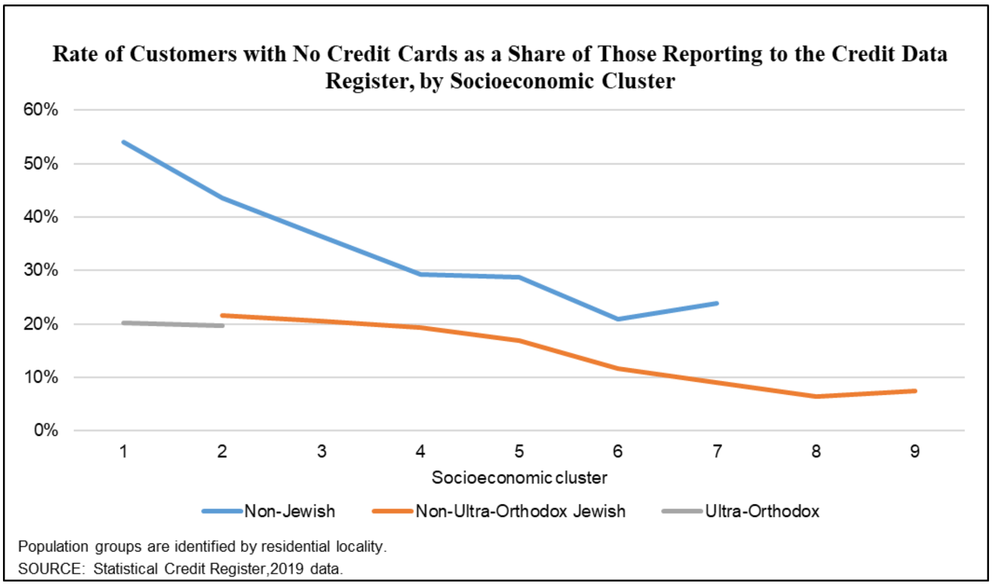


Figure D-36

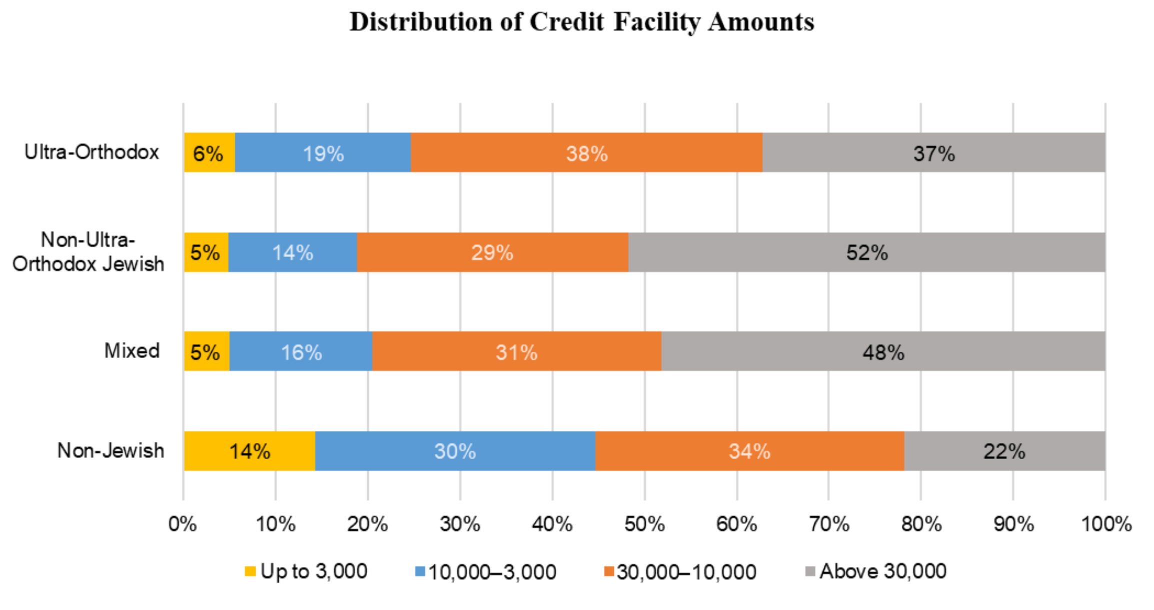


[30] Reporting to the database does not include debit cards, such that this refers only to those holding a deferred debit card (credit card).

D.3.6.1 Credit card facilities

Holding a credit card on its own does not necessarily make it possible to use it for all desired purposes, since the credit facility attached to the card is limited. According to data from the statistical credit database, the rate of customers in non-Jewish localities with a very low credit facility (up to NIS 3,000) is 3 times greater than in the rest of the population, and the rate of those with medium-low credit facilities (NIS 3,000–10,000) is particularly high. At the same time, the rate of those with high credit facilities (above NIS 30,000) is about half of that in the other population groups, and extremely low when particularly compared to the rate in Ultra-Orthodox localities, despite similar income levels (Figure D-37).

Figure D-37



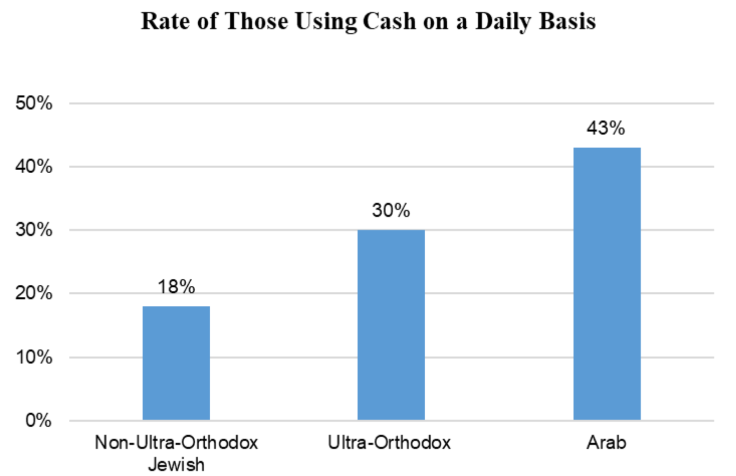
A summation of all credit card facilities was made for each customer. Population groups are identified by residential locality.
SOURCE: Statistical Credit Register,2019

D.3.6.2 Use of cash

In order to examine the variance in the use of cash between the population groups, we used various surveys conducted by the Bank of Israel concerning the use of means of payment. These surveys are conducted on an Internet platform. Since the levels of digital literacy and financial literacy may be correlated, this means that the survey's results may be downward biased in their measure of financial inclusion.

Among survey participants from Arab and Ultra-Orthodox Jewish societies, there is a greater preference for the day-to-day use of cash than in the non-Ultra-Orthodox Jewish population. When participants were asked what means of payment they would not be prepared to give up in the coming month, about 40 percent of Arab respondents and about 30 percent of Ultra-Orthodox respondents said they would not be prepared to give up the use of cash (Figure D-39).[31]

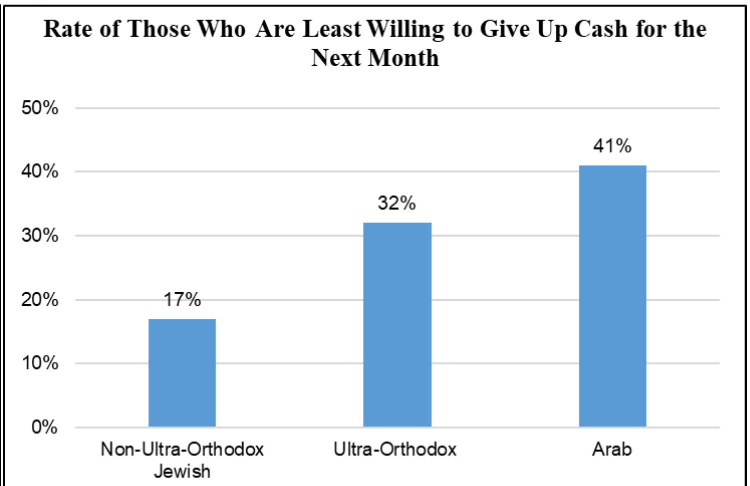
Figure D-38



Text of the question: Please rank the frequency with which you use each of the following means of payment (Closed question.

SOURCE: Bank of Israel Currency Department survey on cash use habits, March 2021.

Figure D-39



Text of the question: If you were told that for the next month you need to give up means of payment that you currently use. Which would you under no circumstances be prepared to give up for a month (Which is most essential for you)? (Closed question).

SOURCE: Bank of Israel Currency Department survey on cash use habits, March 2021.

An examination of the variance in receiving cash payments shows that among respondents in the sample, receipt of wages in cash is not common, but it is more common in Arab society than in the other population groups (Figure D-40). When respondents were asked how they would prefer to receive a monetary amount, about 60 percent of Arab respondents stated that they would prefer to receive payment in cash, compared with about 45 percent in Ultra-Orthodox Jewish society and about 34 percent among non-Jewish Ultra-Orthodox Jewish population (Figure D-41). These data indicate that the use of and preference for cash are stronger among Arab and Ultra-Orthodox Jewish societies.

[31] The text of the question: Let's say that you would be told that in the coming month you will need to give up a means of payment that you currently use. Which of them would you, under no circumstances, be prepared to give up for one month? (Which of them is most essential for your point of view?) (Closed question).

Figure D-40

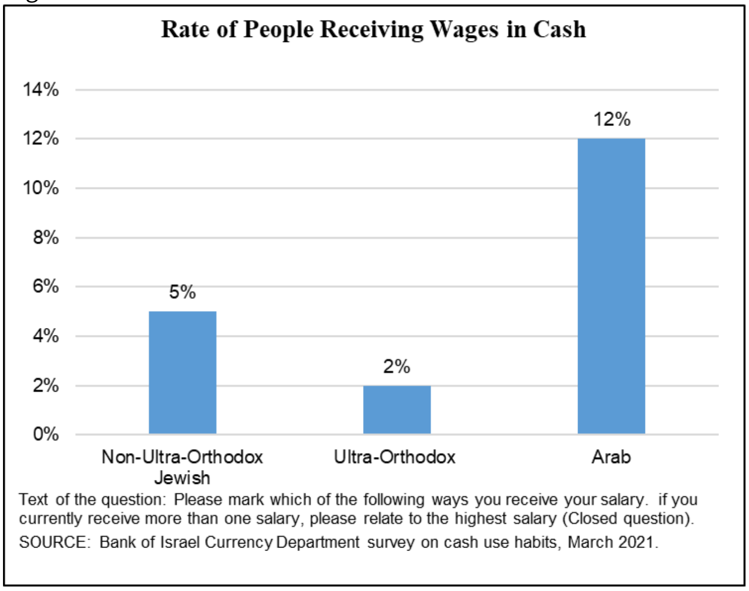
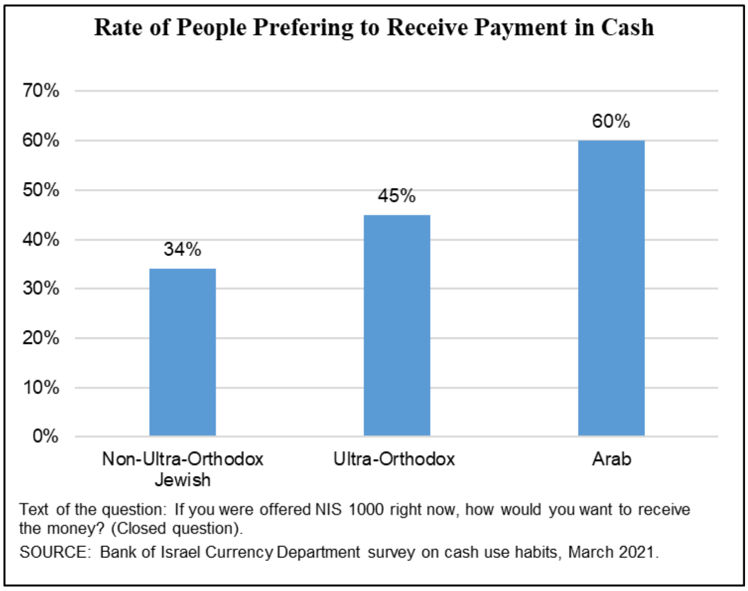


Figure D-41



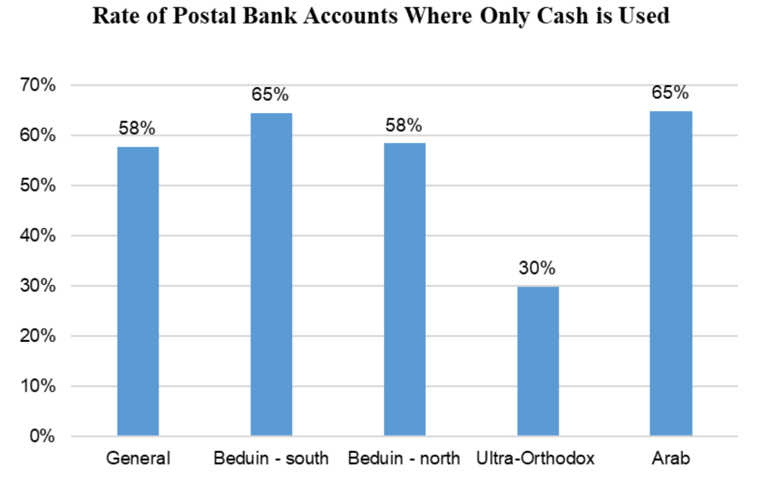
Data provided to the Team by Postal Bank and Israel Electric Company representatives support the findings of preference for the use of cash in the various population groups. Postal Bank data show that in 2019, cash alone was used in two-thirds of the accounts of customers from Arab society. (Figure D-42).

Israel Electric Company data regarding how payment is made for its services[32] show that in 2018, about half of electricity customers in non-Jewish localities paid in cash, compared with about 15 percent in Ultra-Orthodox and non-Ultra-Orthodox Jewish communities (Figure D-43). In 2020, there was a decline in the number of accounts that were paid in cash[33], but the variance between the population groups remained. (The decline may be explained by the trends of transitioning to digital payments during the COVID-19 period.)

[32] The manner of paying an account for various infrastructure services (utility bills) is a common measure of financial inclusion in the literature.

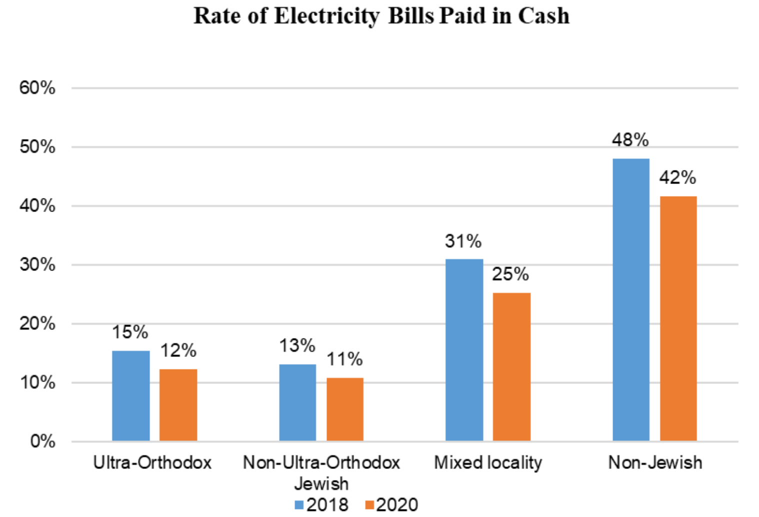
[33] Apparently in view of the COVID-19 crisis.

Figure D-42



Among all Postal Bank customers. Foreign citizens are included in the General population group.
Among active accounts (activity in the past 12 months).
SOURCE: Postal Bank data, 2019

Figure D-43



Population groups are identified by residential locality.
SOURCE: Information provided to the Team by the Israel Electric Company.

FINANCIAL INCLUSION FROM AN INTERNATIONAL PERSPECTIVE

E. Financial inclusion from an international perspective

For the purpose of the Team's work, students from Columbia University (as part of the SIPA CAPSTONE program) conducted an international comparison of national programs to increase financial inclusion in countries that are comparable to Israel, with an emphasis on programs that focus of national or ethnic minority populations.[34] The comparison examined programs in Australia, Canada, Estonia, France, Japan, New Zealand, Singapore, Sweden, and the United States. In addition, the survey focused on four areas of financial inclusion: Financial education and literacy, trust-building and consumer protection, credit and financial services for minority groups, and digitization of financial services. The main insight gained from the survey is that even in advanced economies with high levels of financial inclusion, the authorities are placing emphasis on increasing financial inclusion among special population groups, minorities, and so forth.

E.1 National strategy for financial literacy

The term financial literacy relates to a broader scope than providing financial **knowledge** to citizens. Financial literacy also relates to increasing people's ability and improving their capability to make independent and informed financial decisions. For instance, a national strategy was adopted in New Zealand to increase financial capability. The strategy set out financial literacy targets in conjunction with the government and the private sector, providing adapted financial education. Similar to New Zealand, the "Count Me In, Canada" project was instituted in Canada, with the aim of strengthening households' financial well-being. It should be noted that these programs emphasize the integration of minority populations. In Australia as well, there is a financial education program for minority groups, which addresses the cultural differences between the groups.

[34] The full survey is available at https://www.sipa.columbia.edu/academics/capstone-projects/developing-financial-inclusion-program-israels-arab-and-ultra-orthodox

Main points of financial literacy strategies:

Public sector – private sector partnership: The content of the national financial education program in New Zealand was provided in schools by community organizations. In addition, the content in the "Dollars and Sense" program in Canada was provided to minority populations by nonprofit organizations.

i. Intermediation to minority populations through community organizations: In New Zealand's "Good With Money" program, content is provided to the Maori population by central bank employees from Maori background. The Australian Indigenous Outreach Program used industry to provide financial content to indigenous people. In addition, a hotline was established for these population groups to receive financial guidance and help. In Australia, knowledge is also provided to indigenous adults by volunteers from the community through the "Money Matters" program.

ii. Building a dedicated financial education program for various population segments: For instance, the "Indigenous Outreach Program" in Australia, the Money Matters for Indigenous Peoples" in Canada, and the Maori Tribal Council in New Zealand.

iii. Evaluation of national financial education programs using surveys: A survey conducted in 2005 in New Zealand first identified low financial literacy among minority groups. This survey formed the foundation for a financial literacy program in 2008. There is also a survey in Singapore that evaluates financial planning and allows the country to improve its financial literacy programs.

Deciding on the body to coordinate financial inclusion: Between 2014 and 2019, there was a national financial education supervisor in Canada, which was replaced by a dedicated agency dealing with the matter – the Financial Consumer Agency of Canada. Similarly, the Financial Literacy and Education Committee was established in 2003 in the US. This agency includes various government bodies, and leads the area of financial education. The Banque de France and the public financial education institute created a government partnership in 2016 to develop financial curricula.

E.2 Consumer protection and financial inclusion programs

In some countries, minority groups are dealing with difficulties that are unique to them, which are due to difficulties in understanding the financial system, and to discrimination. Without creating contacts and consumer protection for these communities, they may be financially excluded, individuals from these communities may receive conditions that are not favorable, and they may experience additional financial difficulties. Consumer protection must therefore be strengthened for minority population groups, and their level of financial inclusion must be increased.

Main points of creating an infrastructure for consumer protection and increasing financial inclusion:

iv. Providing basic financial rights: As part of the banking reform law in France in 1984, every citizen was ensured the ability to open a bank account and to receive initial access to credit. In addition, a Household Debt Commission was created as a mechanism through which households with debts would be able to negotiate with credit providers so that all sides could reach a settlement.

v. Legislation creating a consumer protection infrastructure: In 2019, the New Zealand government passed consumer protection laws intended to protect customers against exploitative credit providers. Similarly, the Consumer Financial Protection Bureau was established in the US in 2011 in order to lead financial education programs and regulations to increase consumer protection. In Japan, the law for selling financial products requires financial institutions to bear the responsibility for customer losses if not all relevant information is shared or if regulatory requirements are not met.

vi. Creating a national program to increase financial inclusion: A Financial Inclusion Action Plan was implemented in Australia to increase financial inclusion through cooperation between the public and private sectors. In addition, a dedicated program was created by the Indigenous Business Australia organization to provide loans to indigenous groups for businesses and the purchase of a first home. The aim of this program is to increase inclusion among indigenous population groups.

E.3 Microfinancing and credit ratings

Many countries offer microfinancing programs as a way to improve the financial well-being of those who are financially excluded. Creating an alternative credit rating may also provide credit options to excluded customers who would otherwise not be able to consume financial products.

Main points of providing microfinancing and building credit ratings for excluded population groups:

vii. Offering low-interest loans for low-income families: In New Zealand, there is a microfinancing program called Nga Tangata, in which customers with no guarantors, credit history, or employment can take out loans. In addition, the DEBTsolve program was instituted, with the aim of providing financial counseling and restructuring high debts for households in order to rehabilitate them.

viii. Using alternative data to create a credit rating in order to increase financial inclusion: The US Department of the Treasury, in conjunction with FICO, created a credit rating that does not rely on traditional credit data, thereby offering those who are excluded from the credit system the opportunity to take out credit. In addition, alternative data such as payment of bills, payments for cellphones, and rent payments can be used to build a credit rating

ix. Creating partnerships with public and private entities in order to provide microfinancing: In addition to New Zealand, Australia also offers a No-Interest Loan Scheme for consumer loans up to A$1,500. In the US, the Community Development Financial Institutions Fund, which is a joint public-private fund, directs government funding to community loans for people who do not receive loans from the banking system. This fund also operates among minority population groups.

E.4 Community access and digitalization

In order to make financial services accessible to various population groups, proactive measures must be taken to bridge the gaps with these groups.

Main points of community financial access and digitalization:

x. Coaching services to help people navigate the financial system, and creating the proper infrastructure for it: The innovation fund in the US provided money to the City of San Francisco in order to provide financial coaching services to those living in public housing projects. In Sweden, the Swedish Post and Telecom Post authorities are helping municipalities implement payment systems. The Estonian government cooperated with banks to provide kiosks throughout the country where people can learn how to connect to the Internet.

xi. Changing payment methods: The use of cash in Sweden has declined drastically over the past decade, due to the use of the Swish payment application. The advantage of the application is that it was created by the six largest banks in Sweden, which makes it easy to use for banking customers.

xii. Digitalization of government services: Government digitalization increased greatly in Estonia. Since the law there requires all Estonian government agencies to accept digitally signed documents, the private sector now prefers to use such services as well. Estonia's X-Road technology enables information sharing between sectors, and the country also has electronic identification (e-ID).

RECOMMENDATIONS

F. Recommendations

F.1 Increasing access to credit

F.1.1 Mortgages in Arab society

Recommendations:

- Examining partial guarantees by the State for mortgages in Arab localities;
- Creating a registration interface for Israel Lands Authority tenders for high-density construction in Arab localities;
- Clarifications to the Banking Supervision Department directives regarding how housing loans can be provided without an encumbrance.

The subcommittee on financial inclusion in Arab society[35], which operated as part of the work of the interministerial team, focused on finding solutions for the low supply of mortgages in Arab localities, which was first documented by the Banking Supervision Department in 2017.[36] The subcommittee proposed a number of solutions, and acted in order to include them as part of the appropriate government decisions. In the end, Government Decision 550 set out that "the target for this issue is to double the rate of mortgage borrowers from Arab society who live in the program's localities within five years, such that home buyers who are not entitled to obtain a mortgage due to structural barriers, including due to the difficulty in registering the property in the land registries or a lack of tradability, will be entitled to obtain credit under mortgage conditions from financial institutions". The Director General of the Ministry of Finance was tasked with establishing an additional committee led by the Accountant General of the Ministry of Finance, to

[35] Led by the Director General of the Ministry for Social Equality.

[36] Banking Supervision Department (2017). "Analysis of the Mortgage Market for Borrowers from the Arab Sector in View of Structural Failures in the Housing Area in this Sector" (in Hebrew).

examine increasing Arab society's access to housing credit. Some of the Financial Inclusion team's members are also members of the team concerning mortgages in Arab society, the recommendations of which have not yet been published.

It is important to note that alongside the mortgage issue, a report is expected to be published in the near future regarding the problem of registering properties in non-Jewish localities. The report is the result of the work of an interministerial team led by the Deputy Attorney General and the Counsel and Legislation Division (Civil Law) of the Ministry of Justice. The Team's recommendations focuses on implementing solutions to increase registration proceedings in Arab, Druze, and Circassian localities. Among other things, the Team will recommend on initiating processes that will connect the planning stages to registration that would take place following approval of the plans, and additional steps to increase awareness of the importance of proper registration. In addition, the report will recommend starting a pilot project relating to the number of plans in non-Jewish localities that are currently being advanced, and where, following their completion, it will be possible to ascertain whether the proposed processes actually help complete the registration process efficiently. The Team believes that it is important to implement the recommendations of this report, and to thereby contribute to a long-term solution for the issue of registration in Arab localities in general, and the issue of housing credit in these localities, and to derive conclusions relating to a broader application of the recommendations following the pilot stage.

The following are three detailed recommendations formulated as part of the work of the Team to Increase Financial Inclusion, and the subcommittee, which were presented to the committee led by the Accountant General:

Partial State guarantee for mortgages in Arab localities:

The problem of financing in Arab society is mainly based on the problem of registration of land rights, and on the low tradability of properties in those localities, which is derived from an undeveloped real estate market. These factors make it difficult for banks to use properties as collateral, and therefore make it difficult to provide mortgages to customers in Arab localities.

The Team recommends examining the establishment of a mechanism for banks (or other regulated credit providers) to provide housing loans to borrowers who can be underwritten, with partial guarantees from the government. The guarantee will reduce the risk to which the banks are exposed in providing housing credit in view of the registration difficulties and tradability of the real estate in Arab localities. It will provide an interim solution to the barriers found in the Team's work, until a more comprehensive solution can be provided for the root problems in the real estate market in these localities. To the extent that this recommendation is adopted and such a mechanism is established by the Accountant General in the Ministry of Finance, the Team believes that the mechanism should define the localities and types of property that will receive partial government guarantees, with the aim of not impairing the motivation to properly register properties.

Correcting the registration method in Israel Lands Authority tenders for high-density construction in Arab localities:

In recent years, there has been wide-ranging government work on increasing land marketing in Arab localities, partly through high-density construction. However, the process frequently does not end in an orderly division of housing units in the property, which may make it difficult to provide mortgages against these properties in the future. Action must be taken so that the process ends with the registration of a joint property agreement with the Land Rights Registration and Regulation Authority and the proper division of housing units in the property. Without immediate treatment of this issue, the problem of properties with multiple owners will increase.

The Team was told that, in accordance with the terms of the tenders and contracts that the ILA prepares with contractors that are advancing development of high-density construction, in the Arab sector as well, the developers are required to register the joint property and the rights in the Land Registry. Regarding independent construction marketed by the ILA, the

ILA is currently conducting a pilot project to advance the concentrated registration of purchasers' rights to the land. The ILA is also integrated in the general work to examine the possibilities of registering land rights in a joint residence when the request for the most updated permit that according to it the building was built, is submitted, around the time the building's occupancy form is obtained.

The Team recommends that the various authorities, as well as the Israel Lands Authority, continue to work to incentivize the registration of property rights, as soon as possible after construction and registration of the join residence with the Land Rights Registration and Regulation Authority.

Clarification of the Banking Supervision Department directives on providing housing loans without property encumbrance

The work of the Team and the subcommittee showed that many in Arab society take out consumer credit as an alternative to a housing loan, despite the fact that according to Banking Supervision Department directives, a housing loan can be provided even without a property encumbrance. The Banking Supervision Department directives devote special attention to the issue of housing loans, since they are one of the most important credit decisions any household makes. As such, the directives contain special disclosure and consumer protection requirements that should remain in place.

However, in the absence of an ability to register an encumbrance on a property or to make appropriate property valuations, LTV indices can essentially not be calculated as required, for instance in Directive 329, and some credit providers claim that it becomes too complex to provide housing credit without a property encumbrance while fulfilling Banking Supervision directives. Many customers thus find it necessary to take out a consumer loan.

The Team recommends that the Banking Supervision Department examine the need to revise or clarify Proper Conduct of Banking Business directives 451 and 329 concerning how housing loans are provided without a property, in a way that will simplify the process of providing housing loans of up to NIS 300,000, while maintaining the consumer protections that the directives provide to customers.

F.1.2 Providing credit solutions for excluded customers

Recommendations:

- Secured credit card – a credit card for customers who cannot be underwritten;
- Solutions for credit-excluded individuals through funds.

Those who might suffer financial exclusion include disadvantaged populations groups that receive state benefits, customers with low income, and customers who have previously been labeled "problematic", or customer who do not have a credit history. The lack of access to basic credit for current consumption in the formal system might disincentive people from integrating into the official financial system, and prevent them from gaining access to basic credit, even if they have legitimate credit needs such as large one-off expenses for medical treatments, purchasing durable goods, and so forth, which many people prefer to finance through payments or consumer loans. In particular, the Team's work showed that many people avoid obtaining a credit facility through credit cards, which basically does not allow them to use such cards as means of payment. The Team therefore examines various measures that can be taken to rehabilitate excluded customers and include them in the world of credit. It should be clarified that in any case, the Team's position is that credit must be taken and provided responsibly, in accordance with the customer's needs and repayment abilities.

Secured credit card – a credit card for customers who cannot be underwritten, against a deposit

This recommendation has three main purposes. The first is to enable people who were not customers of the formal financial system and for whom there is insufficient information, to obtain initial credit that will enable them to build a credit history. The second is to return those who were excluded from the formal financial system back into the world of credit in such a way that they will be able to create a positive credit history. The third is to enable nonbank credit providers to provide credit facilities to customers with whom they are not acquainted, and to create for them an appropriate collateral that is limited in time, while increasing the variety of competitive possibilities available to the customer.

The Team recommends that the financial regulators examine the need to publish regulations that would remove barriers and work to create consumer protections in cases where an issuer chooses to issue a credit card against a deposit. In order for nonbank payment service providers, whom the government is currently working to regulate, to be able to offer this service, it is worth considering taking this issue into account in PSD regulations as well.

Solutions for credit-excluded individuals through funds

The State of Israel has funds, the purpose of which is to provide credit to disadvantaged population groups that do not receive funding from the traditional banking system. A small portion of the funds receive support from the State, while most of them are mainly based on volunteer organizations. The aim of the recommendation is to create a situation where the provision of credit solutions to excluded customers will enable them to create a credit history, which will help them go back to using the official system. For instance, if the funds support the provision of a credit card facility, this will enable customers to "smooth" their expenses (for instance, spreading large one-off expenses into payments), and may also help bring them back into the official cycle of credit more rapidly. In addition, it is important that the operators of government funds measure and report the representation of population groups in the funds, which will contribute to the fund's support being divided more proportionally among all parts of Israeli society. Finally, even though this recommendation is complex to implement, it is important to create measurable tools that will enable the provision of assistance to the population groups most in need of it.

The Team recommends that the provision of money or guarantees by the government funds, whether private or mixed, be only in conjunction with credit providers that report to the credit data register, so that a positive credit history can be created for those receiving the assistance. In relation to private funds, the Team recommends that the Supervisor of Credit Data Sharing and the Supervisor of the Capital Market jointly contact all the private funds operating in the field in order to explain this issue. The Team proposes that the variety of credit products provided by the funds to individuals include a credit card facility.

It is important to make sure that the general government funds are made accessible to the entire Israeli population. The Team recommends creating a model – for instance in the form of accumulating credit points in accordance with socioeconomic status, which will make it possible to prioritize those receiving assistance. Finally, it is important to bring together all the information and methods of contacting all funds in one central place that will be accessible to the general public.

F.1.3 Increasing awareness of the Central Credit Register and its implications for borrowers among unique population groups.

Recommendations:

- A targeted public information campaign regarding the Central Credit Register's implications for borrowers and how borrowers can use it to their benefit. The campaign will take into account the characteristics of the various population groups.

The Central Credit Register was established by the Bank of Israel based on the Credit Data Law, 5776–2016, as part of the measures to advanced competition in the Israeli credit market, and began operating in 2019. The Register gathers data regarding credit liabilities of Israeli citizens and residents, as well as regarding how those liabilities are paid off. By making information accessible to credit providers, it helps increase competition in the retail credit market, expand access to credit, and reduce discrimination in the provision of credit, as well as economic gaps. From time to time, the Bank of Israel conducts public information campaigns to explain the Register's advantages to the general public. The Team has found that there are those among the population who are not aware of its existence or of the ability to use it to their benefit. In particular, people are unaware of the implications that their financial conduct may have on their credit rating as set out by the institutions that use the Register's information.

The Team recommends that, in addition to the general public information efforts currently being made, the Central Credit Register should conduct targeted public information campaigns aimed at the Arab society (in Arabic) and at the Ultra-Orthodox Jewish society, while taking into account the unique characteristics of each population group and the information channels that are relevant to them.

F.1.4 Assistance for customers having difficulties due to taking out credit

Recommendations:

- Human contact with customers from disadvantaged population groups regarding debts with late payments before transferring the debt to collection via legal proceedings;
- Prioritization of regulatory control, supervision, and enforcement of implementation of directives concerning consumer credit and debt collection;
- Assistance in managing customers' debts.

An economic decline due to debts leads to economic exclusion. This exclusion takes place due to contact with unacceptable channels for credit provision and the negative effects this can have, and because those debtors have difficulty in obtaining various financial services from the traditional system later on. With this in mind, the team examined what measures should be promoted in terms of managing the debts of customers who encounter difficulties after taking out credit.

Human contact with customers from disadvantaged population groups regarding debts with late payments before transferring the debt to collection via legal proceedings

Discussions that the Team held showed that there are customers who do not understand the collections notices that are sent to them and what possibilities are open to them to deal with the debt. In this context, the team believes that when collection is still in the hands of the financial service provider (before being sent to legal proceedings), there is room to consider creating a human connection in order to bridge the gap and prevent the deepening of the insolvency.

The Team recommends examining the need to expand regulatory directives so that the credit provider will have to set out mechanisms within its policy that will include human contact with customers who are from disadvantaged population groups as part of the debt recovery process—before transferring the debt for collection through legal proceedings. There should be an examination of whether it is correct to impose this obligation only in relation to those who provided the loan in a traditional (not online) way.

Implementation of directives concerning consumer credit and debt collection

Some of the claims made by the public in relation to consumer credit and improper conduct on the part of the various financial institutions are already being dealt with at the regulatory level through directives issued by the Capital Market, Insurance, and Savings Authority and the Banking Supervision Department.

The Team recommends that the financial regulators make sure that the financial institutions are properly implementing these directives, and that there are no discrepancies between the normative directives and the way in which they are actually being implemented in practice.

Assistance in managing customers' debts

The Team recommends creating a simple and accessible information page that will be attached to collections notices, regarding the need to manage debts holistically, with referrals to various entities that can help debtors manage their debt (such as various nonprofit organizations, legal assistance, counselling services (Ministry of Welfare), and more.

The Team also recommends examining the promotion of a voluntary treaty with the financial system, as part of which the system will commit to suspending debt collections for a defined period, on condition that the debtor obtain financial counseling and present a rehabilitation plan to the financial service provider, which will include a description of how the debt will be paid off, and which will propose ways to deal with the root of the problem and not just its symptoms.

F.2 Increasing access to and use of advanced means of payment

F.2.1 Removing barriers to the use of immediate payment cards, and making them accessible to customers

Recommendations:

- Increasing awareness of the use of debit cards and improving their image;
- Supervision of monthly fees on debit cards for a limited period;
- Examining the feasibility of removing barriers to the various uses of debit cards;
- A reporting directive on attaching means of payment to current accounts;
- Prohibiting the payment of wages in cash

The payment action using advanced means of payment (transfer from an account, payment card, payment applications, and so forth) is the most basic action that can be taken in the financial system, and forms the basis of a deeper relationship between a financial institution and its customers—a relationship that includes credit, savings, and more. The advanced means of payment in Israel are generally based on payment cards, and the Team's findings showed that many citizens do not have such cards, or do not often use them, for various reasons. On the demand side, certain population groups prefer using cash, while on the supply side, customers that cannot be underwritten cannot obtain a credit card, receipt of which depends on a credit facility. A debit card could be a solution for many customers that do not use advanced means of payment, since Banking Supervision Department directives make it obligatory to issue such a card to anyone who has a current account. Even the Postal Bank enables its customers to obtain such a card, and having one does not require a credit facility. Using a debit card, customers can make a wide variety of transactions—at merchants, over the Internet, and abroad. But awareness of the advantages of a debit card is low. It also suffers from some inferiority compared with credit cards, since there are transactions that cannot be made with a debit card (standing orders, transactions using deferred payments, and so forth), and there is are limits on the maximum amount of a single transaction and on daily use of such a card.

Increasing awareness of the use of debit cards and improving their image

The Team recommends that the Bank of Israel and the banking system take action to increase awareness of the advantages of using debit cards and to improve the image of using them. Concurrently, the Bank of Israel should instruct debit card issuers to proactively market these cards to every customer that does not have a payment card of some kind attached to his or her account.

Supervision of monthly fees on debit cards for a limited period

The monthly fee charged by issuers for holding a debit card is very low—just a few shekels per month. However, exempting first-time customers from the fee for using a debit card, in parallel with other measures to increase awareness, will support the card's penetration to as many customers as possible. Following the exemption period, we must assume that at least some customers will get used to the advantages of using the card and will agree to pay the monthly user fees in order to keep it.

The Team recommends instituting supervision over the monthly fee on debit cards for a period of one year (so that there will be an exemption from fees for the first year). The supervision will apply to all debit card issuers—banks and Isracard as the issuer of debit cards to Postal Bank customers.

Examining the feasibility of removing barriers to the various uses of debit cards

There are payment transactions that can be made using a payment card, but not using a debit card. Customers that have unsuccessfully tried making such transactions may lose interest in debit cards and return to using cash. In particular, debit cards have a single transaction limit or a daily limit in order to limit the risk to which the issuer is exposed in the event of a serious failure, use of a stolen card, and so forth.

The Team recommends that the Bank of Israel will examine the feasibility of creating a track through which customers will be able to ask the issuer for a one-off increase in the usage limit in order to make an unusual purchase for an amount that is higher than the limit set by the issuer. In addition, the Bank of Israel should examine the feasibility of payments by authorized debit of the card, with clear explanations of the risk to the merchant in honoring such a transaction, which is greater than the risk for credit card transactions. In addition, the Bank of Israel should examine the reasons why certain merchants do not agree to accept debit cards for certain transactions, and if the reasons involve regulatory or structural barriers, the Bank of Israel should work to remove them.

A reporting directive on attaching means of payment to current accounts

In order to examine the efficacy of the various policy measure instituted to increase the use of debit cards, the usage rate of such cards among the general population should be monitored. This will make it possible to formulate new policy measures and make adjustments to those already institute in order to increase the use of advanced means of payment.

The Team recommends setting out a reporting directive on the rate of account by means of payment attached to them—credit card, debit card, or an account with no means of payment. In particular, the directive will require each bank to measure the rate of accounts without means of payment, before and after the proactive marketing activity.

F.2.2 Incentives to increase market penetration of advanced means of payment

Recommendations:

- Financial support of entities that work to increase the volume of payments using advanced means in localities where financial inclusion is particularly low;
- Creating a public incentive for financial institutions to increase payment activities using advanced means in these localities.

Financial support of entities that work to increase the volume of payments using advanced means in localities where financial inclusion is particularly low

Payment actions are the most basic actions in the financial system, and form the basis of a deeper relationship between a financial institution and its customers—a relationship that includes credit, savings, and more. The Team's findings show that in many localities, almost all of which are in Arab society, there is a particularly low level of financial inclusion, which is reflected **in the widespread use of cash and the low use of advanced means of payment.**

The economic literature and international experience[37] show that the provision of monetary incentives may be effective in reducing the use of cash and increasing the use of advanced means of payment. In recent years, a number of advanced payment solutions have been developed in Israel, which do not require the merchant or payment recipient to join a clearing service—payment applications, and dedicated websites to receive payment at restaurants, or even give gifts at events. As far as we know, these solutions are not accessible to Arab society, and the entities offering them are not investing in adapting their products to the Arab public. The Team believes that monetary support of entities that initiate processes to harness customers—households and micro and small businesses—to the use

[37] Sung et al. (2017). "Can Tax Incentives for Electronic Payments Reduce the Shadow Economy? Korea's Attempt to Reduce Underreporting in Retail Businesses". Policy Research Working Paper No. 7936, World Bank.

of such means of payment will be able to contribute to change in the entire ecosystem—merchants as well as customers.

The Team recommends that the Ministry of Economy, in conjunction with the Ministry of Social Equality, operate a program to provide financial support[38] to entities that work to increase advanced payments in the relevant localities. The following are recommended features of such a program:

1. The program will operate in a list of localities where there is a particularly low level of financial inclusion according to an index that the Bank of Israel built for this purpose. Initial estimations show that the 30 localities with the lowest level of financial inclusion, including about 630,000 residents, are all Arab localities.

2. A financial or business institution (acquirer, credit card issuer, bank, payment service provider pursuant to the "Payment Services Law", payment application, or other appropriate business) will be eligible for support against increasing digital payment activities in the relevant localities according to criteria to be determined. It should be emphasized that the grant will be given against an increase in online payment activity that is beyond that entity's natural increase over the past three years, should there be any. The grant may be given for diverting existing activity in the same entity from cash or checks to advanced means of payment.

    - It should be emphasized that among the banks and acquirers, new institutions that had no activity among the public in 2022 will be eligible for support.[39]

3. The following payment activities recognized in the program in order to receive monetary support:

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[38] For instance, according to Finance and Economy Directive number 6.2.1, "Support from the State Budget for Other Entities".

[39] For instance, the new digital bank One-Zero, or the new acquirers that obtained a license in recent years and that will soon begin operations.

- Settling debit card transactions at small and micro businesses (located in localities defined according to Section 1), which are connected or shall be connected with the financial institution in the settlement transaction;
- Payment card transactions by customers living in such localities;
- Transfers using payment applications by customers living in such localities, including the use of banking applications and websites in order to transfer the money between accounts.

4. The program will include support tests, as part of which:

- Preference will be given to institutions that show an increase in the number of new customers that made transactions (merchants that were not connected with any acquirer in a settlement transaction, customers that did not have a payment card, and so forth);
- Preference will be given to institutions that show growth in localities with the lowest level of financial inclusion;
- Preference will be given to institutions that establish online operations for the relevant population (for instance, applications in Arabic, customer clubs that will include merchants from the list of relevant localities, and so forth).

Creating a public incentive for financial institutions to increase payment activities using advanced means in these localities

Publication of an annual index by the regulator or government will incentivize institutions to increase their activity among customers in these localities, thereby bringing about an increase in financial inclusion.

At the end of the first year of the program, the Bank of Israel, Ministry of Social Equality, and Ministry of Economy will publish an index that will present the institutions' ratings by the volume of increase of digital payment transactions of their customers in the relevant localities. The index will be published with a high profile, in a way that will positively mention the institutions that worked to create financial inclusion in this way. The index will include all financial institutions, including existing banks and acquirers. Based on the experience accumulated from this index and the extent of its effectiveness, additional indices will be examined to grade various financial institutions by their activity to increase financial inclusion.

F.2.3 Requiring merchants to have the means to accept advanced means of payment

Recommendations:

- Requiring merchants to have dedicated means to read payment cards or accept payment through another electronic means of payment

There are businesses that do not have any way of accepting payment using advanced means of payment, and basically require their customers to pay only in cash. If a customer makes purchases at a large number of such merchants, there is less incentive to hold an advanced means of payment. The Team believes that this recommendation will lead to the expanded use of advanced means of payment in order to make and receive payments, and will thereby contribute to increased financial inclusion in the Israeli economy.

The Team recommends that the Minister of Finance use his authority as set out in Article 28 of the Reducing the Use of Cash Law, 5778–2018, and that with the approval of the Knesset Finance Committee, he set out rules that will require merchants to have a dedicated means of reading payment cards or settling other electronic means of payment. The Team recommends that the expense for purchasing this dedicated terminal be recognized as a current expense in the year in which the purchase is made, and that this obligation not apply to an exempt merchant or anyone making a random transaction as defined in the Value Added Tax Law, 5736–1975.

F.2.4 Increasing the use of advanced payments in municipalities in Arab society

Recommendations:

- Allocating dedicated budgets to promoting digitalization in the Arab municipalities;
- Initiating advertising and public awareness campaigns, and making digital tools and services more accessible;
- Advancing organizational infrastructure at the municipal level to support digitalization;
- Providing monetary incentives to increase the use of digital tools in the localities;
- Managing a digitalization array at the government ministry level

Evidence from around the world presented to the Team showed that one of the catalysts for increasing the use of digital means of payment in general, and payment cards in particular, is improved digitalization in the municipality and in how municipal services are provided. The transition to digital payments in the municipality increases the municipality's income, improves citizens' well-being, and reduces the shadow economy by reducing the use of cash. The Team's findings show that there is little digitalization in the Arab municipalities, and that even in those that make digital services and payment accessible, the use of these tools is lower than in Jewish municipalities. Improved digitalization in the municipalities will lead to increased use of advanced means of payment by the public and will increase financial inclusion.

Allocating dedicated budgets to promoting digitalization in the Arab municipalities

Digital payments have not yet been instituted in all municipalities. In some municipalities where they have been instituted, they are hardly used. Their use can be increased by public information and advertising, increasing awareness, and providing financial incentives for a limited period to those who use digital means.

The Team recommends that dedicated government budgets be allocated for the purchase and installation of tools for digital payments, based on a mapping of the existing situation by the Ministry of the Interior and Digital Services. The mapping will create an up-to-date picture of digitalization in the municipalities—the existing tools, their quality, and the extent of their use. After that, budgets should be provided to the municipalities for the purchase and implementation of the tools. The Team recommends integrating digitalization as a project within the Ministry of the Interior's development budget (Government Decision 550).

Initiating advertising and public awareness campaigns, and making digital tools and services more accessible

Assistance should be given to the municipalities in advancing the accessibility of digital tools and services, in order to ensure that after the tools are implemented, residents will actually use them. The Team's findings show that the existing tools are sometimes not linguistically or culturally appropriate, and are not user-friendly.

The Team recommends the allocation of dedicated budgets for the development of digital services and payments for residents by the **Ministry of the Interior**. The Team recommends setting a variety of formats for building online payment systems by the municipalities, and making them user-friendly and convenient, with the aim of increasing awareness and use among the residents. It is important to also discuss increasing the residents' awareness of the existence of these means and of the advantages of using them, through public awareness and advertising campaigns.

The Team recommends making the tools intended for digital payments, as well as information and instructions, linguistically accessible and culturally appropriate, and that the work on linguistic accessibility be done on two levels. At the first level, work should be done with the main companies that provide digital payment tools, in order to linguistically and culturally adapt those tools. At the second level, the municipality should make the published instructions linguistically accessible to residents.

Advancing organizational infrastructure at the municipal level to support digitalization

The Team's findings show that due to a lack of appropriate manpower, digitalization in some of the municipalities is low. There is a need for training municipal employees to increase their digital and technological literacy. The municipalities currently do not have a function that is directly responsible for digitalization.

- The Team recommends examining the need for setting a technological specialist at the municipal level or at the level of groups or clusters of municipalities. That specialist will manage and advance the issue within the municipality and vis-à-vis residents, set goals, and execute control over the extent of success in the matter.
- The Team recommends advancing training programs for municipal employees in order to improve their digital literacy.

Providing monetary incentives to increase the use of digital tools in the localities

Municipalities' transition to digital payments presents a challenge and a significant change in how they receive payments. From the residents' standpoint as well, there is sometimes a disincentive for online payments. This is because some residents are used to going physically to the municipal offices so that they can submit special requests, bargain over payment terms, and get discounts or easier payment terms. Financial incentives will encourage the municipalities to increase digitalization, and the short-term expense may pay off in the form of higher revenue once the tools are installed and there is more use of them. The incentives would operate for a limited time.

- The Team recommends examining incentives for the municipalities for meeting digital payment targets. A Ministry of the Interior incentive should be set for municipalities who implement digital payment tools, advertise, and increase the rate of payments made digitally.

- The Team recommends examining the provision of benefits to residents for a limited period if they make payments digitally (discounts in municipal tax, suspension of fines, and so forth).

Managing a digitalization array at the government ministry level

Setting out a program for managing a digitalization array at the government level, with the aim of mapping the existing situation, helping municipalities advance the issue, and monitoring its actual implementation.

The Team recommends formulating a program for managing a digitalization array in the Arab municipalities in order to map the situation and monitor implementation. The Team also recommends clarifying and publishing uniform ministry guidelines regarding municipal collections, and implementing them among municipal management and employees.

F.2.5 Prohibiting the payment of wages in cash

Recommendations:

- Amending the Wage Protection Law so that it prohibits the payment of wages in cash.

The payment of wages in cash is widespread in many industries, in relation to both local and foreign workers. These industries include: construction and renovations, agriculture, restaurants and waiters, housekeeping, and long-term care. Beyond that, there are employers or workers who have encountered financial difficulties, which limits their ability to open a normal bank account. The payment of wages in cash leads to the continued widespread use of cash instead of advanced means of payment, with all that that entails, while there are a variety of solutions that enable both the payment and the receipt of wages through noncash means.

The Team recommends that the Ministry of Economy and the Ministry of Finance examine amendments to the Wage Protection Law that will reduce the payment of wages in cash and enable the payment of wages through advanced means, particularly by employers who are required to maintain a payroll and issue a salary slip to employees. The examination should take into account international treaties and arrangements regarding labor relationships.

F.3. Multiyear financial education program in Israel

Recommendations:

- The Capital Market, Insurance and Savings Authority shall be the overall coordinator of financial education in Israel, and shall lead this field in conjunction with the Bank of Israel and the Israel Securities Authority;
- Establishing a subcommittee to formulate a plan of action to increase financial literacy in Arab society;
- Establishing a national portal that will include information on financial education at different points in a person's life;
- Establishing financial education as a compulsory program in the education system;

As outlined in Section A.2 of this report, one of the policy tools through which the public's financial literacy can be improved is increased financial education. As part of a quantitative study (the findings of which are detailed in Chapter C) and as part of the qualitative research discussion and discussions held with various interested parties, the Team conducted an in-depth examination of financial education in Israel. In view of its findings, the Team recommends a number of steps to regulate the field of financial education in Israel and to implement targeted steps to increase financial education in the context of increasing financial inclusion.

The Capital Market, Insurance and Savings Authority shall be the overall coordinator of financial education in Israel, and shall lead this field in conjunction with the Bank of Israel and the Israel Securities Authority

The mapping done by the Team shows that there are many entities dealing with financial education in Israel. These include regulators, government ministries, various nonprofit organizations, and the business sector. Each entity operates within its area of responsibility or interest, with an outline that it chooses to adopt, and reaches out to various target audiences that it chooses. The overall coverage of these programs is not all that wide. Large segments of the population are not exposed to the content of the programs. In particular, there is no mechanism to ensure that any citizen is exposed to the relevant content at relevant times (for instance, when opening a first bank account, when entering the labor market, when taking out a mortgage, etc.).

In December 2011, the government decided to increase financial education in Israel. Based on this decision, the Financial Education Division was established in the Capital Market, Insurance, and Savings Division of the Ministry of Finance (today the Capital Market, Insurance and Savings Authority - CMISA), to coordinate financial education in Israel. In practice, the Division does not act as coordinator, and has engaged in relatively little financial education activity.

The Team believes that there must be a defined leader and coordinator on a national level, which will synchronize all entities working in the field of financial education (both in Israel and toward the rest of the world), and promote financial education activities in full coordination between the relevant entities. Some of this body's responsibility will be to create a mechanism through which people will be exposed to relevant content at all stages of their financial life. The CMISA has expressed readiness to serve as the coordinating body for financial education in Israel, and the Team recommends that the CMISA lead this in conjunction with the Bank of Israel and the Israel Securities Authority. This should use the model of a steering committee, led by the CMISA, which will have the task of formulating a plan of action to promote financial education in Israel and putting that plan into action. The plan will relate to various population groups in Israel—youth, students, households, senior citizens, and so forth—and will present a variety of possibilities for how to transmit content to the general public, through digital means with the establishment of a website and online training programs, and through frontal means with training programs, workshops, and so forth. Alongside the digital interfaces, it is important to create human and active interfaces, particularly among disadvantaged population groups that often do not have access to digital means and who do not proactively seek such content. In addition, it is important to transmit some of the content through "agents of change" from within the various population groups, and to create relevant cooperative arrangements. The Team recommends that the government allocate a dedicated budget to the CMISA in order to advance financial education in Israel.

Establishing a subcommittee to formulate a plan of action to increase financial literacy in Arab society

As part of the Team's work, it conducted accompanying research, the findings of which show that the level of financial inclusion is low, particularly in Arab society, partly due to a low rate of use of banking services, a low rate of users of advanced means of payment, and a low payment ethic

The Team recommends focusing on the preparation of a financial education program for Arab society, with an emphasis on banking services and the use of advanced means of payment. The program should be formulated by a committee that the Bank of Israel will coordinate in conjunction with the Capital Market, Insurance and Savings Authority, the Israeli Securities Authority, and a representative of the Minorities Authority of the Ministry of Social Equality (hereinafter: the Committee). The Committee will also include the participation of relevant government ministries. The aim of the program will be to increase financial awareness in Arab society.

The budget for putting the financial education program for Arab society into action will be based on the government decision regarding a five-year plan for Arab society, which sets out a maximum budget of 15 NIS million for the strategic program to reduce financial inclusion gaps in Arab society, including means to increase financial literacy, reduce the use of cash, and increase the use of advanced means of payment. The budgetary amounts will be diverted from the sources for the government decision.

Establishing a national portal that will include information on financial education at different points in a person's life

There is currently a lot of financial information on websites of the various regulators in Israel. The location of financial information in various places makes it difficult for people to obtain this information, and thereby prevents citizens from gaining useful knowledge that could be beneficial when making financial decisions.

The Team recommends establishing a single portal to bring together financial information in various fields, and provide a response at various points in a person's life, in order to make it easier for people to efficiently consume financial information.

The portal, which will be established in Hebrew and Arabic, will provide financial education at a number of points in a person's life cycle—the education system, national/military service, students, households, senior citizens, and more. It will contain content that is adapted to each subgroup and written in a clear and friendly language with integrate infographics and short video clips to deliver the content. The portal will also include a glossary of financial terms that will translate professional terminology into simple language; calculators to help the public in its contacts with the banks, insurance companies, pension funds, and so forth[40]; study materials; and games.

The Team recommends that regulators instruct the various financial entities to direct the public to the portal before making financial transactions, in order to obtain further relevant information that will help in the decision-making process and increase awareness of various points that they should examine before making financial decisions.

Implementing financial education programs in the education system

[40] With the aim of making it easier for the general public, the site will also enable references to dedicated sites of private groups who wish to cooperate with the initiative and present information and study materials on the topic, subject to advance examination and approval by the designated government agency that will manage the portal. It is suggested that access to the portal also be provided through the personal area on the government website.

The Team believes that financial education must be encouraged as an integral part of the curriculum in the education system, including necessary adjustments for the Arab and Ultra-Orthodox Jewish societies.

For this purpose, the Ministry of Education should formulate financial education content and create a database of programs that will be made accessible in the GEFEN system (an administrative and pedagogical flexibility system that provides schools with discretionary budgets for scholastic content and administrative management of curricula) and that meet this need. The materials will focus on topics where research has found discrepancies between the various population groups. To the extent that this recommendation is advanced, with the Ministry of Education's consent, budgetary sources will need to be found for its implementation.

Formulating indicators of success to test the implementation of financial education programs, and conducting a survey of financial literacy

There are currently no indicators of success that are measured over time for financial education programs. The Team recommends the formulation of tangible success indicators in accordance with accepted practice abroad. It should be noted that the OECD has a broad methodology for how to build surveys that measure financial literacy, and the Team recommends using this methodology with necessary changes.

The last financial literacy survey that was carried out in Israel by the Central Bureau of Statistics took place in 2012. In view of the long period of time since then and the need to map the existing situation based on a reliable survey that includes a representative sample of all parts of society, the team believes that another survey must be conducted. The Team recommends that the Central Bureau of Statistics conduct the survey every four-five years so that it can form the basis for measuring all activities over the long term, similar to what is being done in most OECD countries.

F.4. Removing linguistic, social, and religious barriers to financial inclusion

Recommendations:

- Making financial content accessible in Arabic;
- Encouraging employment diversity in financial companies;
- Examining the need to remove barriers to the launch of Sharia-compliant financial instruments
- Formulating indicators of success to test the implementation of financial education programs, and conducting a survey of financial literacy.

Financial services are based on the customer's trust in the financial institution. That trust is based on a sense of belonging and on the customer's ability to understand the terms of consuming the financial product. The sense of belonging may be impaired in a situation where there is a lack of employment diversity in the financial system, where the composition of manpower in financial institutions does not reflect the composition of the population. The customer's ability to understand the terms depends first and foremost on the extent of his fluency in the language in which the service is provided. The Team found that these factors greatly influence the ability and desire of some in the Arab community to consume services from the financial system, while most financial entities make only a small part of their financial content—operational, marketing, and advertising—accessible in Arabic, if at all. The Team also found that there might be religious barriers that prevent Muslim customers from consuming some of these services.

F.4.1 Making financial content accessible in Arabic

The Team recommends that the financial regulators instruct their supervised entities to make material documents that have consumer significance, as well as material explanatory documents on the financial institutions' websites accessible in Arabic, without needing an active consumer request. In addition, the Team recommends that the regulators instruct their supervised entities to provide the basic and common services on their websites and/or applications in Arabic.

The Team recommends that the public enquiries units of the financial regulators provide responses to people interested in making enquiries in Arabic, even if the final answer is provided in Hebrew. It also recommends that the financial regulators make significant applications that are commonly used on their own websites accessible in Arabic.

F.4.2 Encouraging employment diversity in financial companies

The Team recommends that the financial regulators examine ways to encourage their supervised entities to publish information on employment diversity in the financial institutions. The publication of this information will create a public atmosphere that will encourage employment diversity and support customers' sense of belonging and trust in the financial institution from which they receive service.

F.4.3 Examining the need to remove barriers to the launch of Sharia-compliant financial instruments

The Islamic religion completely prohibits transactions that carry interest. Charging interest is considered to be profiteering while exploiting the weakness of another. The prohibition of interest does not allow for the taking of an interest-bearing loan, and is expanded to other credit-based services such as deposits, credit facilities in an account, and credit cards, as well as investments and insurance. There is a common phenomenon called "Islamic banking", which operates according to Sharia rules. Islamic banking finds solutions for the provision of financial services without charging or paying interest, but it may contravene basic elements of the financial regulation that is customary in non-Muslim countries. The Team found that parts of the Muslim community in Israel avoid consuming some financial services since they are not in line with the Islamic rules, or they have no choice but to consume such services despite their preference to consume Sharia-compliant services.

The Team recommends that the Banking Supervision Department and the Capital Market, Insurance and Savings Authority—each in their own areas—publish a call inviting the public to bring Sharia-compliant financial initiatives to the regulators, while noting the regulatory barriers that prevent or delay the launch of such financial instruments, should any exist. The regulators will establish a dedicated team to examine the proposals and how to remove the barriers, with the aim of creating a legal and/or regulator environment that will enable existing and new entities to offer Sharia-compliant services.

F.5. Additional recommendations

F.5.1 Financial consulting

Recommendations:

- Examining the need to regulate the field of financial consulting.

Consumer protection in the financial field is at the focus of efforts by the government and financial regulators. There are various legislative items that regulate consumer aspects of the use of various financial products (such as credit and means of payment), and there is much supervisory work in the field (via regulatory directives and the use of supervisory and enforcement powers). Strengthening consumer protection is important, and has tremendous value in terms of financial inclusion, due to the built-in power gaps between consumers and financial service providers. The more significant the consumer protections are, the more trust consumers will have when using financial products, which will encourage them to use them.

In general, a customer who approaches a financial service provider accompanied by a professional will obtain better results than a customer who comes alone—in terms of access to financial services, the terms of the financial service, and more. In contrast, there are financial advisors and agents whose activity is not currently supervised, and this poses a risk for customers—both due to advise that is impartial and due to exposure to fraud and confidence schemes on the part of those advisors or agents.

Examining the need to regulate the field of financial consulting

The Team recommends that the Ministry of Finance, in conjunction with the Ministry of Justice and in consultation with the relevant regulators, examine the need to regulate the field of financial consulting. As part of this, the following alternatives should be examined:

- Imposing a licensing requirement and relatively "light" supervision;
- Legislating a framework law with basic standards for the content of financial consulting and agency (enforcement by the Consumer Protection and Fair Trade Authority);
- A social treaty or standard for financial consultants

The Team also recommends examining the expansion of the Consumer Protection and Fair Trade Authority's power against those who are not supervised by a financial regulator, such that the Authority will be able to order the return of money to customers in the event of fraud. Currently, the Authority's main power in such cases is to impose a financial sanction on the contravening company. The Team believes that strengthening the customer's consumer rights to receive his money back will help customers that have fallen victim to confidence schemes, and will help deter such bodies from engaging in them.

F.5.2 Maintaining access to bank branches, particularly in Arab localities

Recommendations:

- Providing services at branches where the manpower is consistent with the cultural and social characteristics of the customers;
- Banks will pay attention to how services are provided and make them consistent with the quantity and residential location of customers;
- During the next two years, no branches in Arab localities will be closed without providing a suitable alternative within the locality in which the closing branch is located.

Banking is undergoing changes, with a trend of closing branches and transitioning a growing number of customers to digital consumption of banking services. In the past decade, there has been an increase in the number of branches in Arab localities, at the same time as a decline in the number of branches in Jewish localities. However, some of the public has difficulty consuming banking services digitally. The digital gap, and with it the need to consume services at physical bank branches, is greater in Arab society than in Jewish society.

Providing services at branches where the manpower is consistent with the cultural and social characteristics of the customers

The Team recommends that the provision of service at bank branches, and that manpower at the branches, be consistent with the cultural and social characteristics of the customers. For instance, at branches with a high rate of Arabic-speaking customers, the staff should be able to provide service in Arabic. In this matter, the Banking Supervision Department should instruct the banks to formulate optimal service indices, and if the index shows a result that is below the set target, the banking corporation will have to act within a defined period of time to reach the minimum required benchmark. This measure will ensure that customers will be able to obtain service that is in line with their needs, even if their branch is not in the locality in which they live.

Banks will pay attention to how services are provided and make them consistent with the quantity and residential location of customers

The Team recommends that the Banking Supervision Department issue instructions that, as part of the banks' branch policy, each bank will be required to detail how services are provided and how they are made consistent with the quantity and residential location of its customers. The banks will be instructed to set a measure of the characteristics of the services provided, which will take into account demographic and consumption characteristics, among other things. Based on this measure, the needs to expand physical and digital services will be determined. As part of this, the Banking Supervision Department will instruct the banks to examine the need to open branches in localities where no bank has a branch and where the population is greater than 5,000 people aged 15 and over.

During the next two years, no branches in Arab localities will be closed without providing a suitable alternative within the locality in which the closing branch is located

The Team recommends that based on the Banking Supervision Department's authority to approve the closure of bank branches, no branch in the Arab community will be closed in the next two years without a suitable alternative within the locality in which the closing branch is located or in close proximity, at the Banking Supervision Department's discretion. This period will support closing the gap between branch services in Arab localities and those in Jewish localities. The Banking Supervision Department will formulate criteria for shortening the period if the Department finds that in each individual case there are suitable alternatives.

F.5.3 Continued monitoring of the level of financial inclusion and implementation of the recommendations

With the aim of examining how the Financial Inclusion Team's vision and targets are being met and the effectiveness of the policies implemented due to the Team's recommendations, the Team recommends continuing the quantitative measurement of financial inclusion in a number of select measurable areas.

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APPENDIX A – MINORITY POSITION

The Budget Department's Position on the Financial Inclusion Report

Chapter C of the Report outlines the mechanisms that affect financial inclusion. This chapter notes a number of barriers that affect financial inclusion, but the most significant factor—the low level of banking competition—is conspicuous by its absence. In our opinion, many of the barriers that were mentioned, such as language barriers, cultural barriers, the preference for using cash, and concern over consumer protection issues, are barriers that are derived from a low level of competition, and are characteristic of markets that are not competitive and are highly concentrated. In such markets, the business focus of existing participants tends toward maintaining market share or toward market segments with particularly high potential profitability.

In other words, in order to make financial products more accessible to population groups with unique characteristics, the financial institutions must invest in adapting their financial products to those population groups, and invest in innovation that will enable this. **In markets that are not competitive, the participants can achieve high levels of profitability by maintaining the existing situation and appealing to simpler market segments, and therefore tend to avoid dealing with more complex population groups.**

Moreover, the lack of competition and high level of concentration in the credit market and may have a negative impact on the supply of credit in the economy, and lead to credit rationing—a situation in which at market equilibrium, lenders choose to provide credit only at low interest rates, thereby excluding population groups with risk levels that are not in line with the set interest rate. In contrast, in a competitive and decentralized credit market, the lender's ability to influence credit supply in the economy or to choose to issue credit at low interest rates at the expense of avoiding whole population categories is low. In a market state such as this, only population groups with medium-high risk levels generally obtain a response, whether through the traditional or innovative financial institutions.

As such, in the Budget Department's view, it would have been worth examining the level of competitiveness in the financial markets, and even more so of the markets in which financial inclusion discrepancies were identified—the credit market and the payments market (markets that are currently controlled by the banking system), and the barriers to competition in those markets.

Furthermore, in the Budget Department's view, it would have been proper to consider ways to increase competition in the financial system, and in the banking system in particular, and to integrate recommendations in this regard. For instance, removing barriers to the operation of nonbank financial entities, particularly innovative nonbank entities, would enable those entities to provide services for population groups that are not financially included, similar to the way they operate in other countries.

Without taking anything away from how important competition and its advancement are to financial inclusion, we believe that a public and regulatory incentive should be created for financial institutions to expand their activity in places where financial inclusion discrepancies have been identified—banking system services in Arab society. This should be similar to the Community Reinvestment Act in the United States, based on which regulators examine the scope and nature of banks' operations in areas where they operate and whether they provide the credit needs of low- and medium-income population groups. Such examinations attract publicity and can be viewed on the regulators' websites. At the end of the examination, each bank receives a score. Moreover, as part of this legislation, regulatory leniencies are given for banks that provide credit to the widest variety of communities.

With that, the periodic publication of the volume of the banking system's activities in areas where the Team has found that financial inclusion is low, and the regulator's assessment of the level of financial inclusion at each institution, should be examined. Furthermore, consideration should also be given to the use of such assessments in places where the Banking Supervision Department uses discretion, such as when approving or rejecting the closure of bank branches.

In addition, the Budget Department has reservations regarding the recommendation to provide grants for using advanced means of payment, which is proposed in the Report. These reservations are because the recommendation was made without an economic analysis of its effectiveness, and mainly because there was no mention of the material barriers that prevent companies providing innovative means of payment from operating in Israel in general or in Arab society in particular. For instance, the lack of appropriate regulation of payment service providers, and the providers' difficulties in opening bank accounts. The Budget Department's position is that if the Team is interested in creating an incentive for expanded use of advanced manes of payment, assistance can be given to businesses in areas where the use of advanced means of payment is low, so that they can purchase settlement terminals and allow contactless payments through cellphones and advanced payment applications.

In addition, the Budget Department's position is that a main factor in the issue of financial literacy is financial institutions' lack of transparency toward customers, which results in customers' difficulty comparing financial product. Therefore, the

Budget Department recommends that the regulators obligate the financial institutions to make the substantial terms of each transaction more accessible, similar to the periodic pension reports and a measure being advanced by the Bank of Israel to require the banks to provide customers with an approval in principle in a uniform format for mortgages. As stated in a Bank of Israel notice, making information more accessible to customers in a clear and transparent manner enables customers to better understand the terms of the mortgage being offered and its implications for future payments, make an informed and easier comparison of the various offers being made by a number of banks, and submit a request for mortgage proposals more rapidly and conveniently. All of these will increase customers' power, and thereby improve the competitive environment in the market.