Chapter 6

Structure of the Banking System and Activities of the Banking Supervision Department

The main goals of banking supervision are to maintain the stability of the banking system in a changing economic environment, protect depositors' money, and encourage fairness in bank-customer relations without compromising the competitive nature of the system. The Banking Supervision Department acts at various levels to attain these goals, including supervising the banks' business activities, the soundness of their management, monitoring their ability to manage risks and adjust to economic developments, regulating the system by means of regulations and guidelines; performing inspections; monitoring relations between banks and their customers; ensuring that the banks provide capital against unforeseen risks; and credit restrictions at the single-borrower and single-industry levels, to name but a few.

In 2002, in addition to its ongoing activities, the Department engaged in regulation in various fields: the appointment of compliance officers, procedures related to bank fees, banking corporations' repurchase of their own shares, prevention of money laundering, customer identification and record-keeping, information retrieval, financing of corporate takeovers, accounting rules for derivatives and hedging activities, etc. The Department also examined banking corporations' exposure to various credit risks after the transitional provisions of the Prohibition of Money Laundering Order went into effect, preparations for emergencies, and other matters. In view of the persistence of the economic and security problems that were evident in 2001, the Department performed special credit inspections with emphasis on evaluating the adequacy of the categorization of problematic and dubious debts and inspected on-line banking services.

The number of bank branches continue to decline in 2002, in line with the trend of the three previous years, and the banks' use of temporary branches leveled off. Greater use was made of the Internet and other technological media that give consumers direct—and almost immediate—access to banking information and allow customers to perform banking transactions without visiting the bank branch. The number of registered users of on-line services climbed to 700,000, and the number of requests for information on-line came to 16,000,000 on monthly average.

Introduction

The first part of this chapter reviews the structure of Israel's banking industry and the changes and main developments that occurred in 2002 and from a long-term perspective. The second part presents this year's issues of concern at the Banking Supervision Department in its sphere of responsibility—regulation, bank-customer relations, information and reporting by banking corporations, applied research on banking issues, and inspecting and evaluating the activities of banking corporations. The second part also describes the Department's treatment of international relations, licensing, checks without cover, and prevention of money laundering.

1. STRUCTURE OF THE ISRAELI BANKING SYSTEM

1. General remarks

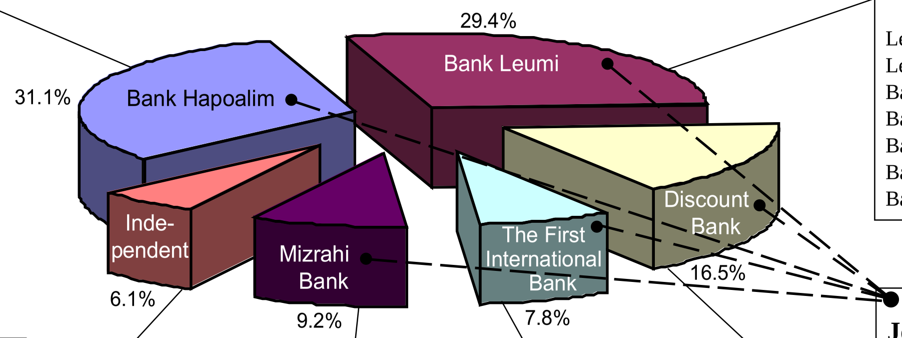
Banking activity in Israel is performed by five large banking groups, independent banks, joint service companies that engage in clearing activity for banks, and credit card companies (Figure 6.1).

As of the end of 2002, forty-one banking corporations were active in Israel (Table 6.1). During the year. Trade Bank, Ltd., was shut down after the Bank of Israel discovered an embezzlement on a scale that far exceeded the bank's capital, resulting in receivership, and Bank Leumi Finance Co., Ltd., was closed as well.[1] In February 2003, Bank Hapoalim, Ltd., acquired the ordinary shares of Maritime Bank of Israel, Ltd., and became the owner of this bank. On June 30, 2003, all activities of The Maritime Bank of Israel, Ltd., at all levels, were merged with the activities of Bank Hapoalim B.M.

The Israeli banking system is rather highly concentrated (as described in Chapter 1 of this survey), and this characteristic is also evident in the distribution of branches: 1,011 branches, more than 94 percent of all branches (Table 6.3) belong to the five large groups. The Israeli banking system is universal, i.e., banks usually provide a full range of banking services under one roof, including classical commercial banking, mortgage banking,

[1] Its banking license was revoked on July 30, 2002.

Figure 6.1
The Structure of Israel's Banking Groups, December 2002



Bank Hapoalim Group
Bank Hapoalim B.M. (1)
Israel Continental Bank Ltd (1)
Bank 'Yahav' Le'Ovdei Hamdina Ltd (1)
Bank Massad Ltd (1)
Otsar Hahayal Bank Ltd (1)
Poalim Capital Markets and Investments Ltd (2)
Mishkan–Bank Hapoalim Lemashkantaot Ltd (3)
Isracard (8)
Bank Hapoalim (Switzerland) B.M. (9)
Bank Hapoalim (Luxembourg) B.M. (9)
Bank Hapoalim (Latin America) S.A. (9)
Bank Hapoalim (Cayman Isles) B.M. (9)
Signature Bank (9)

Bank Leumi Group
Bank Leumi Le-Israel B.M. (1)
Arab Israel Bank Ltd (1)
Leumi Industrial Development Bank Ltd (4)
Leumi Mortgage Bank Ltd. (3)
Leumicard (8)
Bank Leumi (USA) (9)
Bank Leumi (UK) (9)
Bank Leumi (Switzerland) (9)
Bank Leumi (Luxembourg) (9)
Bank Leumi (Latin America) (9)

Joint Service Companies
Bank Clearing Center Ltd (6)
Automatic Bank Services Ltd

Independent corporations
Union Bank of Israel Ltd (1)
Investec (Israel) Bank Ltd (1)
Israel Bank of Agriculture Ltd (not active) (1)
The Maritime Bank of Israel Ltd (10)
Euro-Trade Bank Ltd (1)
Bank of Jerusalem Ltd (1)
Industrial Development Bank of Israel Ltd (1)
Global Investment Bank (B.H.) Ltd (1)
Bank Polska Kasa Opieki Tel Aviv Ltd (1)
Kupat Haoved Haleumi Leashrai Vehisachon BeNetanya Aguda Shitufit Ltd (1)
Otzar Hashilton Hamkomi Ltd (5)
Gahelet' Gmul Hisachon Lehinuch Ltd. (5)
'Hesech' Kupat Hisachon Lehinuch Ltd, Haifa (5)
Citibank N.A. (7)
HSBC Bank plc (7)
Standard Chartered Bank (7)

United Mizrahi Bank Group
United Mizrahi Bank Ltd (1)
Investment Corp. of the United Mizrahi Bank (5)
'Mashavim' United Mizrahi Bank Issuing Company Ltd (5)
'Tefahot' Israel Mortgage Bank Ltd (3)
Bank 'Adanim' Mortgage and Loans Ltd (3)
Eshnav–Issuing Company of 'Tefahot' Israel Mortgage Bank Ltd (5)
United Mizrahi Bank (Switzerland) (1)

First International Bank Group
The First International Bank of Israel Ltd (1)
Poalei Agudat Israel Bank Ltd (1)
The First International Mortgage Bank Ltd (3)
Atzmauth Mortgage and Development Bank Ltd (3)
FIBI Bank (UK), London (9)
FIBI Bank (Switzerland), Zurich (9)

Israel Discount Bank Group*
Israel Discount Bank Ltd (1)
Mercantile Discount Bank Ltd (1)
Discount Mortgage Bank Ltd (3)
Visa Cal; 35 percent ownership and 51 percent voting rights, consolidated in financial statements (8)
Israel Discount Bank of New York Ltd, USA (9)
Discount Bank (Latin America) (9)
Israel Discount Bank (Switzerland) (9)

(1) Commercial banks
(2) Merchant banks
(3) Mortgage banks
(4) Investment finance banks
(5) Financial institutions
(6) Joint service companies
(7) Foreign bank
(8) Credit card company
(9) Subsidiaries abroad
(10) The bank was bought by Bank Hapoalim in February 2003 and merged on 30.6.2003.

* Israel Discount Bank owns 26.5 percent of The First International Bank of Israel, but this investment is not consolidated in the financial statements.
SOURCE: Banking Supervision Department.

Table 6.1
The Structure of the Banking System, 1980–2002

	Banking corporations[a]	Commercial banks[b]	Mortgage banks	Investment finance banks	Other banking corporations[b]
1980	63	30	16	8	9
1990	58[c]	26[c]	9	8	15
1995	46	24	9	2	11
1996	45	24	9	1	11
1997	45	23	8	1	12
1998	45	24	8	1	12
1999	45	23	8	1	13
2000	45	23	8	1	13
2001	43	23	7	1	12
2002	41	22	7	1	11

[a] Includes commercial banks, foreign banks, merchant banks, credit unions, financial institutions, and joint service companies.
[b] In 1998, Bank of Jerusalem, which was a financial institution, became a commercial bank.
[c] Excluding banks in the Territories.
SOURCE: Returns to Supervisor of Banks.

activity in the capital market, stock brokerage, and safekeeping of securities. To complement the system's banking intermediation activities, various subsidiaries engage in financial leasing, issuing, capital-market activity including underwriting, portfolio management, mutual-fund management and investment banking, clearing (by means of joint service companies), and credit cards (by means of full or partial ownership of credit card companies).

Three of the forty-one corporations (Standard Chartered Bank, Ltd., HSBC Bank Plc, Ltd.; CitiBank N.A., Ltd.) are foreign banks that have Israeli branches[2] (one of them, Standard Chartered Bank, Ltd., is in the process of closing). They still account for a small share of activity in the Israeli banking system due to their short duration in the country (several years), the protracted economic crisis—especially in main industries and high-tech—and the shaky security situation.

Israeli banks also operate abroad, directly and by means of subsidiaries, branches, and agencies. In 2002, they had 117 offices of various kinds, of which 46 percent were offices of subsidiaries (Table 6.2). The banks' overseas offices are situated in economic centers in Europe (Switzerland, Germany, the UK, France, and other countries), the united States, South America (Argentina, Brazil, Chile), South Africa, and Australia; and in centers of offshore banking. They engage mainly in wholesale and private banking. Their total balance sheet in 2002 came to $ 30 billion, 18 percent of the banking groups' total assets.

[2] Additionally, two foreign banks operate in Israel—PKO and Investec—by means of subsidiaries. There is also one financial institution, Otzar Hashilton Hamkomi Ltd.

Table 6.2
Overseas Offices: Branches and Employee Posts, 1992–2002

	Total number of offices	Number of branches and representative offices[a]	Number of subsidiaries' offices[b]	Number of employee posts[c]
1992	126	70	56	3,210
1993	123	73	50	2,962
1994	114	73	41	2,717
1995	108	72	36	2,418
1996	105	72	33	2,225
1997	95	62	33	1,972
1998	93	60	33	2,055
1999	94	60	34	2,044
2000	98	62	36	2,125
2001	111	64	47	2,243
2002	117	63	54	2,469

[a] Branches and representative offices abroad of Israeli banking corporations.
[b] Branches of subsidiaries abroad.
[c] Not including overtime.
SOURCE: Returns to Supervisor of Banks.

Table 6.3
Number of Offices of Commercial Banking Groups,[a] by Size of Group, 1996–2002

	Number of offices by size of bank				*Of which* Commercial	Relative share (percent)		
	Large	Medium	Small	Total[b]	banks	Large	Medium	Small
1996	610	511	72	1,193	1,075	51.1	42.8	6.0
1997	605	515	73	1,193	1,076	50.7	43.2	6.1
1998[c]	604	509	74	1,187	1,092	50.9	42.9	6.2
1999	580	485	76	1,141	1,055	50.8	42.5	6.7
2000	571	474	66	1,111	1,032	51.4	42.7	5.9
2001	575	453	64	1,092	1,013	52.7	41.5	5.9
2002	571	440	60	1,071	990	53.3	41.1	5.6

[a] Including branches of banking institutions owned by a group and operating in Israel. Branches providing commercial banking services that also have counters for other activity, such as mortgages, are counted once.
[b] Large banks: Leumi and Hapoalim (including Yahav, Massad, and Israel Continental), and Israel Discount (including Mercantile Discount and Mercantile Israel).
Medium banks: Discount, United Mizrahi, and First International.
Independent banks: The other independent banking institutions, including branches of a foreign bank.
[c] In 1998 the Jerusalem Mortgage and Development Bank was issued a commercial bank license, and its branches are included in the number of branches.
SOURCE: Returns to Supervisor of Banks.

Table 6.4
Indicators of the Structure of the Banking Industry: An International Comparison, 2000

	No. of institutions	No. of branches	Residents per office	No. of ATMs	Residents per ATM	Withdrawals per resident	Average amount of withdrawal per resident
Israel[a,b]	**41**	**1,071**	**6,196**	**1,365**	**4,861**	**18.6**	**75.3**
Belgium	119	6,610	1,551	6,860	1,495	20.4	97.8
Canada	1,916	13,701	2,252	31,909	967	48.3	66.7
France	418	25,564	2,364	35,171	1,718	17.9	56.2
Germany[c]	2,821	56,147	1,463	47,657	1,724	20.4	134.6
Italy	841	28,177	2,049	31,693	1,821	9.1	150.7
Japan	2,830	40,028	3,171	117,026	1,085	3.2	532.2
The Netherlands	113	3,790	4,201	6,925	2,299	29.5	79.8
Sweden	146	2,021	4,389	2,617	3,390	36.1	92.3
Switzerland	375	2,903	2,482	4,863	1,481	17.8	117.0
UK	500	15,059	3,963	34,311	1,739	34.0	84.5
USA	20,512	77,752	3,542	272,894	1,009	47.9	68.0
Average G10			2,857	44,410	1,505	29.1	76.5

[a] 2002 data.

[b] Number of branches, including commercial banks, merchant banks, mortgage banks, investment finance banks, financial institutions and other banks.

[c] Including the branches of Deutsche Postbank AG.

SOURCE: Statistics on payment systems in the G10 countries (2000): Bank of International Settlements. For Israel: Returns to Supervisor of Banks.

Another characteristic of the Israeli banking system is the growing use of high-tech media, including the Internet and computerized call centers, that give consumers direct and almost immediate access to banking information and allow customers to perform banking transactions without visiting the bank branch. (See Section 3 below.) Their growing use has led to a steady decline in the number of branches. More than 100 branches have been shut down over the past five years, (net[3]), bringing their number at the end of 2002 to 1,071 branches, of which 990 belong to the commercial banks (Table 6.3).

In comparison with the G10 countries, Israel has very few banking institutions, commercial bank branches (Table 6.4), and ATMs: Israel has 6,242 inhabitants per branch, as against an average of 2,857 in the G10 countries and 3,963–4,389 in the UK, the Netherlands, and Sweden. The average population per ATM in Israel, 4,861, surpasses the G10 average of 1,505. However, the number of cash withdrawals per inhabitant from ATM machines in Israel, 18.6 on annual average, is lower than the G10 average of 29.1. The average withdrawal in Israel is $ 75.5, similar to the average in the Netherlands ($ 79.8), the UK ($ 84.5), Canada ($ 66.7), and the U.S. ($ 68).

[3] The net change in the number of branches due to the opening, closing, and redesignation of branches.

2. Overseas banking offices

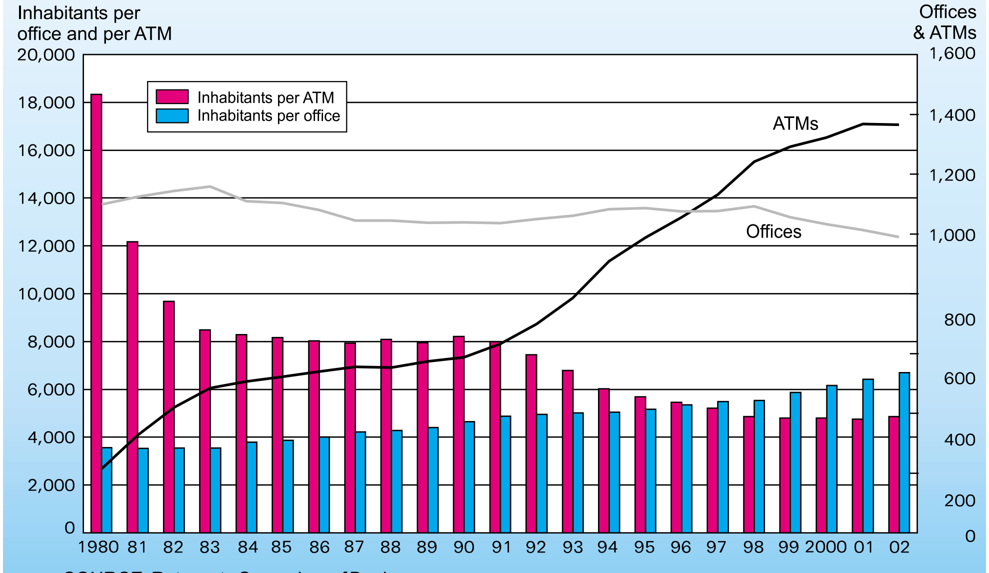
Most of the increase in the number of Israeli banks' offices overseas in 2002 was due to the opening of new offices of existing subsidiaries. The number of such offices increased for the third consecutive year, from 94 in 1999 to 117 in 2002, for a cumulative increase of nearly 25 percent (Table 6.2). Twenty new offices belonged to subsidiaries; five were representative offices, and two overseas branches and agencies of banking groups closed. The activities of overseas offices increased in 2002, both in the united States and in Europe. The balance sheet increased for reasons including the continued expansion of private banking activity as a niche and of wholesale activity, notwithstanding the economic slump in countries where the offices operate. For a broader discussion of the overseas offices, see Chapter 4 in this publication.

3. Distribution and transmission of banking services

a. Branch structure

The number of commercial bank branches declined by 2 percent relative to the previous year and stood at 990 at the end of 2002—92 percent of all branches in the Israeli banking system. Most of the decline—thirteen branches of the twenty-one—occurred among the medium-sized banks[4] (Table 6.3 and Figure 6.2).

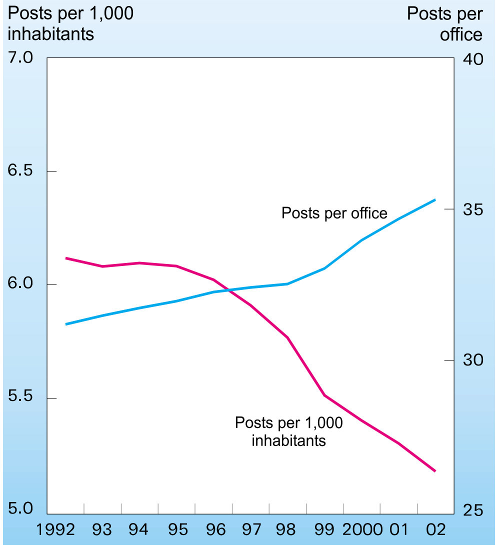
Figure 6.2
Number of Offices and ATMs, 1980–2002



SOURCE: Returns to Supervisor of Banks.

[4] Israel Discount Bank 'lost' nineteen branches and United Mizrahi Bank and First International Bank (together) 'gained' six.

Figure 6.3
Employee Posts in the Banking System, 1992–2002



SOURCE: Returns to Supervisor of Banks.

The process of obtaining a permit to open a bank branch was simplified at the beginning of 2001; today it is possible to open a branch without obtaining a specific permit. The main easing of requirements is in permits for the opening of temporary branches.[5] A temporary branch is opened for a period of up to three months and provides only the banking services that are stipulated in the Bank of Israel's permit. Banks use temporary branches as marketing tools and as vehicles of access to new areas and customers. Examples are promotions aimed at target customer groups in universities and colleges at the beginning of the academic year, exhibitions and expositions, and even business firms. The use of temporary branches expanded steadily until 2001, at which time 241 branches of these types were active. In 2002, there were only 147 active temporary branches—a 39 percent decline from 2001, occasioned by the economic slowdown (Table 6.5). Temporary branches operate for various periods of time. Twelve branches were opened for the maximum—three months—eighteen were opened for less than one week (half of them for one day only), and 117 were opened for periods ranging from one week to two months. On average, each temporary branch that was active in 2002 operated for thirty-four days. Another salient development is the use of temporary branches in academic institutions, where 126 branches of this type were opened during 2002. Their average duration of operation was usually several weeks (and only in two cases was it for sixty days or more).

The decline in the number of regular branches, on the one hand, and the use of temporary branches for marketing and initial contact with customers and the basing of routine relations with customers on complementary methods, on the other hand, are parts of a global trend in which customer visits to bank branches decline and a transition is made to receiving information, giving instructions, and making transactions by electronic and on-line means—ATMs, call centers, computer communications, the Internet, and cellular communications. In Israel, the decline in visits to branches is reflected in a decrease in the monthly average debit (cash withdrawal) and credit transactions at the counter (Table 6.5b, Table 6.7, and Figure 6.4). Over a five-year period (1997–2002), the number of debit transactions for cash withdrawal at the counters of bank branches fell by 17 percent in cumulative terms (even though they actually increased by 3 percent in 2002).

[5] For an expanded discussion, see *Israel's Banking System, 2001*, Chapter 6.

Table 6.5
Bank Branches, Employee Posts, ATMs and Activities at the Counter, 1986–2002

	No. of branches[a]	No. of temporary branches	No. of employee posts[c]	No. of ATMs for cash withdrawal	No. of ATMs for information retrieval and giving instructions	No. of employee posts per branch	No. of employee posts per thousand residents[d]	No. of residents[d] per branch	No. of residents[d] per ATM	Monthly average (thousands) Activity at the counter Debits	Credits	No. of cash withdrawals per ATM
1986–1990 (average)	1,049	-	-	555	1,320	-	-	4,311	8,043	-	-	-
1991–1995 (average)	1,063	-	-	722	1,695	-	-	5,017	6,787	-	-	-
1996–2000 (average)	1,066	148	34,604	1,208	2,094	32.7	5.7	5.693	5,041	2,073	1,422	7,145
2000	1,032	170	34,410	1,322	2,170	33.3	5.4	1,160	4,857	1,874	1,397	7,074
2001	1,013	241	34,503	1,368	2,132	34.1	5.3	6,425	4,758	1,769	1,376	6,999
2002	990	147	33,951	1,365	2,067	34.3	5.1	6,703	4,861	1,824	1,374	7,535

[a] Branches of commercial banks operating in Israel: regular branches, limited-service branches, and counters, including the branches of the Bank of Jerusalem.
[b] Branches opened for a period of up to 3 months and meant to provide banking services under terms specified in the permit.
[c] Twelve-month average; including tenured staff, trainees, pentioners, temporary staff, and part-time staff (weighted by their share of a full-time post). Includes overtime: 165 hours of overtime are counted as a full-time post.
[d] Number of residents determined by the permanent population at the end of the year.
SOURCE: Returns to Supervisor of Banks.

Table 6.6
On-Line Banking, 2000-02

	2000	2001		2002				Change from 2001:IV
	December	December	Qtr.IV[a]	Qtr.I[a]	Qtr.II[a]	Qtr.III[a]	Qtr.IV[a]	to 2002:IV
				(thousands)				*(percent)*
Customers (private and business)								
By means of Web browser	314	492	484	541	580	626	679	40.2
Direct on-line	38	41	39	38	37	35	34	–11.7
Requests for information								
By means of Web browser	3,870	8,335	7,571	9,192	10,468	12,306	15,771	108.3
Average number of requests per user	12	17	16	17	18	20	23	48.6
By means of computerized call center	3,270	3,716	3,651	3,828	4,147	4,040	4,331	18.6
From customer workstation	5,440	5,550	5,551	5,222	5,312	5,430	5,463	-1.6
By means of ATM	1,820	1,882	2,000	1,774	1,800	1,834	1,832	-8.4
On-line transactions								
Deposit/withdrawal of NIS	24	37	36	33	38	49	56	52.5
Transfers between accounts of same customer	3.6	11.8	11.2	12.9	14.5	17.4	20.2	80.4
Transfers to third party	0.6	5.3	4.7	5.2	6.0	7.4	9.1	94.1
Purchase/sale of securities	33.5	52.9	43.6	66.2	54.1	51.6	59.5	36.6

[a] Monthly averages of data for quarters ending in March, June, September and December respectively.
SOURCE: Returns to Supervisor of Banks.

b. High-tech banking services

The extent of use of high-tech banking services over time is largely a function of the assimilation of these services by the customer public. Use of the Internet and other high-tech media for banking information and banking transactions, making a visit to the branch unnecessary, is rising steadily. Banks encourage customers to use these services by offering discounts and incentives, since this allows them to save on operating costs (branch upkeep, payroll, etc.).

Several developments in this field are described below:

* The number of registered users (business and private) of on-line services came to 679,000 on monthly average in the last quarter of 2002, twice as many as in December 2000 and 40 percent higher than the average in the fourth quarter of 2001, reflecting an average quarterly growth rate of 10 percent (Table 6.6).

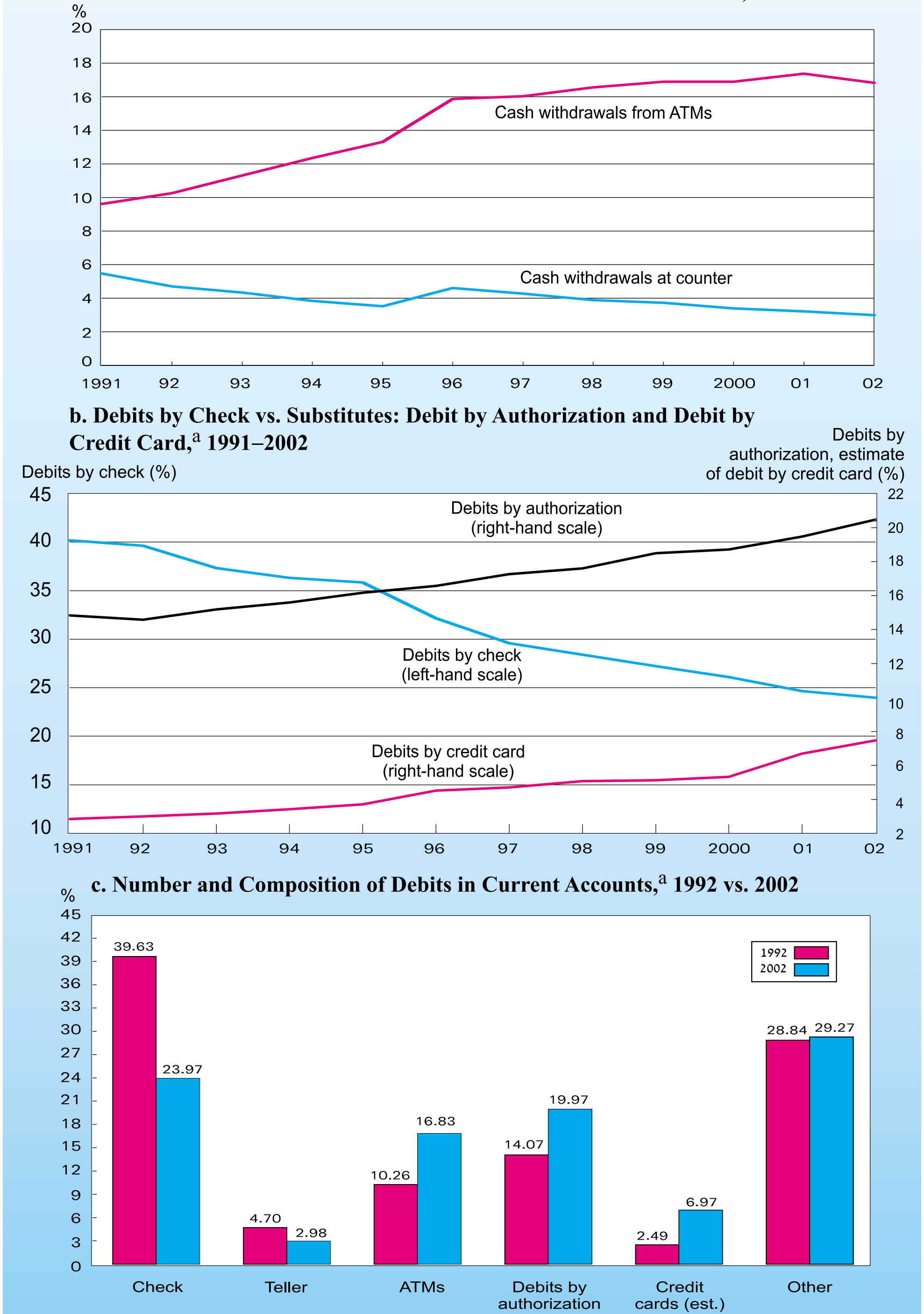
* On-line requests for information were 15.8 million on monthly average in the fourth quarter of 2002, more than twice as many as in the year-earlier period. The use of IVR (Interactive Voice-Response System) increased perceptibly, although more slowly; to 4.3 million on monthly average in the fourth quarter of 2002, a 19.8 percent increase relative to the year-earlier period.

Figure 6.4

a. Cash Withdrawals from ATMs vs. Cash Withdrawals at Counter,[a] 1991–2002

b. Debits by Check vs. Substitutes: Debit by Authorization and Debit by Credit Card,[a] 1991–2002

c. Number and Composition of Debits in Current Accounts,[a] 1992 vs. 2002



[a] Number of transactions as share of total debit transactions in current accounts.

SOURCE: Reports to Banking Supervision Department

Table 6.7
Number and Composition of Debits in Current Accounts, the Seven Major Banks, 1991–2002

(monthly average)

	Number of debits (percent of total)							
	By check	At counter	ATM	Author-ization	Credit card[a]	Other[a]	Total	Total (mill.)
1991–1995 (average)	37.9	4.4	11.4	14.8	2.7	29.1	100	48.0
1996–2000 (average)	28.7	4.0	16.5	17.2	4.4	29.3	100	52.4
2001	24.6	3.2	17.4	19.0	6.2	29.6	100	55.1
2002	24.0	3.0	16.8	20.0	7.0	29.3	100	61.1

[a] From 2001 including an estimate of debits via credit used abroad.
SOURCE: Returns to Supervisor of Banks.

* Average monthly transactions per user increased as the increase in transactions outpaced the increase in users. Per-user requests for information climbed from 17 per month at the end of 2001 to 23 in the last quarter of 2002 (Table 6.6).

* Requests for information by means of ATMs decreased—as expected—by 9 percent relative to 2001 and came to 1.8 million on monthly average, and requests for information at customer workstations declined by 1.6 percent relative to 2001 and ended 2002 at 5.4 million.

* Customers also made greater use of the Internet for capital-market transactions. Securities transactions (purchase/sale) increased by 37 percent relative to 2001 and NIS deposits/withdrawals climbed by 52 percent. However, the share of such transactions remained negligible at 60,000 securities transactions and 55,000 NIS deposits/withdrawals on monthly average in the fourth quarter of 2002. The difference in the average quarterly data in 2002 evidently reflects the changing state of the financial market; in a growing financial market, the use of on-line media for such transactions would probably be much greater.

* On-line transfers of funds, between different accounts of one customer and to accounts of third parties, increased by 80 percent and 94 percent, respectively, relative to 2001. Growth in these respects was steady and gradual throughout the year. The monthly averages in the fourth quarter were 20,000 transfers and 9,000 transfers respectively.

The long-term trend[6] of transition to high-tech methods of payment continued in 2002 (Table 6.7 and Figure 6.4). Concurrently, despite an 11 percent increase in account debiting transactions,[7] the share of the debit transactions at the counter for cash withdrawal in total monthly average debits is continuing to decline and ended 2002 at only 3.0 percent of total debits. Debits by means of checks showed a similar trend, sinking to 24 percent of total debits. In contrast, use of methods that obviate the need for a visit to the branch continued to trend up. The share of two such methods, debit authorizations and credit cards, rose in 2002 to 20 percent and 7 percent, respectively, of total debit transactions.

[6] See *Israel's Banking System, 2001,* Chapter 6.
[7] Approximately 6,000,000 debits on monthly average.

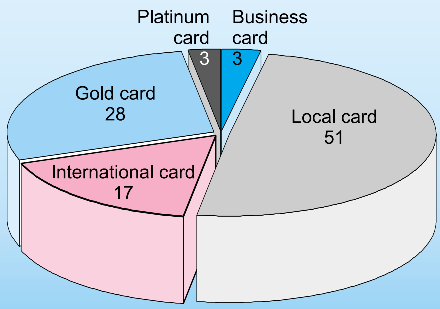
4. Sale of controlling interest and change of ownership

Due to the difficulty encountered in selling the state's share holdings in Bank Leumi le-Israel, Ltd., to a strategic investor, the Minister of Finance and the Governor of the Bank of Israel decided in late 2001 to sell the holdings by means of the capital market without controlling equity. To work out legal and other details related to the implementation of the decision, a joint committee representing the Ministry of Finance, M.I. Holdings, Ltd., and the Bank of Israel was established under the Director-General of the Ministry of Finance, Ohad Marani.

The committee recommended that any party that acquires or holds 5 percent or more of controlling equity in a banking corporation require a permit from the Governor, instead of the current minimum of 10 percent, and that the regulations concerning the composition of the board of directors and its election be adjusted. The composition of the board and the way it is elected are especially important in licensed banking corporations that have no controlling equity because relatively small shareholdings may exert much influence in them. The committee also recommended that any party holding 2.5 percent or more of controlling equity be required to report to the Supervisor of Banks and to the banking corporation. The committee also recommended rules for the approval of officers' appointments by the Supervisor of Banks and proposed that the Governor be given broader powers to act against parties that operate without a permit and that the Supervisor of Banks be empowered to dismiss directors, business managers, and authorized signatories. The committee believes that its recommendations should be enshrined in legislation and that the proportion of issued and paid-up share capital that may be sold before legislation be limited to 6–7 percent.

In early 2003, pursuant to the sale of Otzar Hashilton Hamkomi Ltd. to the Dexia-Ruimi group, Dexia exercised an option for the purchase of shares from Ruimi, thereby increasing its stake in this financial institution to 65 percent.

Figure 6.5a
Distribution of Credit Cards, by Type of Card, 2002 (percent)



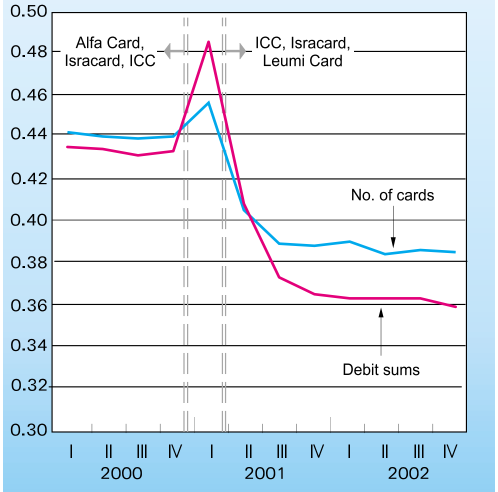
SOURCE: Returns to Supervisor of Banks.

5. The credit card market

Changes in the makeup of ownership of credit card companies and the establishment of a company owned by Bank Leumi le-Israel, Ltd., in 2000[8] led to proportional changes among the companies in terms of the number of credit cards and the extent of their use. The changes occurred as customers switched companies or acquired cards from several companies.

[8] See *Israel's Banking System, 2001*, Chapter 6.

Figure 6.5b
Activity of Credit-Card Companies (Composition and Sums), H-Index, 2000–2002



SOURCE: Published financial statements.

Some 3.5 million credit cards were in active use in 2002, on annual average, and the share of cards for which the credit card companies are responsible was 9 percent of total active cards in the last quarter of 2002 (as against 8.3 percent in the first quarter). Fifty-one percent of credit cards are for domestic use only (Figure 6.5a). According to reports to the Banking Supervision Department, credit cards were used in 385 million transactions during 2002, 110 transactions per card, 96 percent of which in Israel. The sums charged added up to NIS 87 billion, 12 percent more than in 2001. NIS 5 billion in transactions were made abroad—unchanged from 2001 in NIS terms but down in real forex terms due to the appreciation of foreign currencies against the NIS .

The companies differ in the share of cards for which each is responsible and in its long-term rate of growth. The difference in the proportions of the companies reflects competition among them, so that the net increase in the number of cards, less than 0.5 percent, includes a shift of customers among the companies. The behavior of the Herfindahl index (the H-index) for 2000–2002 (Figure 6.5b) gives an indication of competitiveness in this market. The change in ownership of Visa ICC, Ltd., at the end of 2000, the establishment of Leumicard, Ltd., and the activation of this company at the beginning of 2001 caused the H-index to fall steeply. The index decreased again in 2002, albeit gently, mainly in respect of the amounts charged.

2. ACTIVITIES OF THE BANKING SUPERVISION DEPARTMENT

a. General remarks

To keep the banking system stable in a changing economic environment, to protect depositors' money, and to assure fairness in bank-customer relations without compromising the competitive nature of the system, the Banking Supervision Department takes action at several levels. Foremost among them is regular monitoring of banks' business activity, including the soundness of their management and their ability to manage risks and adjust to economic developments, and regulation by means of regulations and guidelines, inspections, supervision of bank-customer relations, and credit restrictions at the single-borrower and single-industry levels, to name but a few.

To monitor the banks' activity, the Department gathers and analyzes banking information and draws inferences from it. The following types of information are gathered: (1) measurable quantitative data about revenues, expenses, interest rates, fees, credit, margins, etc.; (2) non-measurable qualitative information about the quality of management, data protection, adherence to procedures, completeness of information given to customers, and so on. This information is gathered by means of regular and computerized reports and in discussions between members of the Department staff and executives and employees of the banks. The inspections elicit invaluable non-quantitative banking data and information. (3) Complaints from the public to the Banking Supervision Department are another source of important information about deficiencies at an individual banking institution or, since some complaints reflect problems that many customers encounter with several banking corporations, in the system at large. (4) The Department keeps abreast of new approaches to banking supervision abroad, research on banking in various countries, and the practical conclusions that flow from them.

The Department uses this information to adjust its regulations and induce banks to correct deficiencies and reinforce their stability. Importantly, however, the Department cannot and is not entitled to manage the banks; responsibility for this belongs solely to the banks' managements and boards of directors. The Department's actions do not absolve these players and the banks' auditing officers (internal and external, e.g., an auditor-CPA) from their responsibility for the soundness of the management and actions of the banking corporation.

A review of the Department's activities in 2002 follows.

b. Regulation of banking activity

The regulation of banking activity is an important tool in banking supervision, guiding banking institutions with regard to the Supervisor's views and regulations in various banking and accounting matters. The regulations in this regard are meant to regulate the activities of banks' boards of directors and managements, improve internal and external reporting systems, strengthen internal auditing, and ensure that banking corporations are managed properly and prudently. The regulatory decisions, based on the processing and analysis of information that the Department obtains from various sources, are translated into regulations and rules of conduct for banks and are issued as *Proper Conduct of Banking Business Regulations, Guidelines for Preparing Reports to the Public,* and *Guidelines for Preparing Returns to the Supervisor of Banks.*

The main regulatory regulations issued in 2002 pertained to the appointment of compliance officers, procedures related to fees, banking corporations' repurchase of their own shares, prevention of money laundering, customer identification and record-keeping, information retrieval, 'closed-system' practices, financing of corporate takeovers, and accounting procedures in regard to derivatives and hedging.

Secondary legislation in 2002 was expressed in the Banking (Early-Payback Fees) Order, which brought the order into line with the low inflation environment that has characterized Israel in recent years as well as with the types of mortgages offered.

c. Evaluation

The Institutional Evaluation Unit was made up of seven teams in 2002, five of which were responsible for evaluating the banking groups. The other two evaluated the small independent banks; one of them combined evaluation and examination and the other dealt with evaluation and licensing.

In April 2003, the number of teams was cut back to five. The combined examination-evaluation team was unchanged but licensing activity was merged with international relations, as part of an organizational change that aims to improve the supervision of banking corporations.

The main function of the institutional evaluation teams is to centralize and formulate the Department's periodic evaluations of the stability and strength of banking corporations (including auxiliary corporations, banking subsidiaries, and overseas branches). The teams also monitor changes in banking corporations' activities and their exposure to banking risks and profits and loss factors.

In their monitoring function, the teams examine banking corporations' adherence to the Proper Conduct of Banking Business Regulations and compliance with the Banking (Licensing) Law and prepare position papers on miscellaneous banking issues.

Monitoring, analysis, and evaluation of the banking corporations' financial condition are based on information that the unit receives and gathers from various sources—mainly the banks' published statements and reports to the Bank of Israel, examiners' reports prepared by the Banking Supervision Department, information obtained from the banking corporations at the request of the Department concerning irregularities indicated by complaints from the public, and even information culled from the print and electronic media.

In addition to their monitoring and evaluation duties, the economists of the Institutional Evaluation Unit deal with various requests from banks (to open overseas offices, move into new fields of activity, issue capital notes, etc.). In 2002, the unit focused on the following:

* Assimilation of a Proper Conduct of Banking Business Regulation pertaining to the activities of a compliance officer in a banking corporation;
* Preparations for emergency at banking corporations;
* Progress and action by the banks in implementing the transitional provisions of the Prohibition of Money Laundering Order;
* Monitoring the trend in capital ratios, especially among banks that are close to the minimum, and exploring ways of increasing their capital;
* Banking corporations' positions—credit in forex, to nonresidential industries, and to large borrowers;
* Banking corporations' exposure to liquidity risks in NIS and forex;
* Banks' compliance with the Department's requirements in regard to transactions with interested parties, especially in credit;

* Continued assimilation of market-risk management by the tanks and implementation of the Supervisor's regulations in relation to it;

* Preparations by banks and bank-controlled corporations in Israel and abroad for a survey on embezzlement and fraud.

d. Inspection

The Inspection Unit comprises six teams that specialize in various aspects of banking activity and management: credit and collateral; boards of directors, control and internal audit; risk management; bank-customer relations and the capital markets; and information systems. The sixth team inspects all these areas at the independent banks and performs routine monitoring and evaluation. To do their work, the inspection teams gather information directly from the banks' documents and books of account. The examination process is meant to ensure the proper conduct of banking business, including, but not limited to, adherence to the Department's regulations in this matter and the provisions of relevant laws. The teams' reports warn of deficiencies found and set targets and deadlines for their correction. The activities of the Inspection Unit are issued in periodic working plans that, while supported by cyclical targets for coverage of specific subjects related to the corporations examined, are basically dictated by priorities derived from general economic events and changes in the activities of the banking system itself. About one-third of the unit's inputs are devoted to risk-related subjects and issues that are elucidated on an ad hoc basis during the year. With respect to independent banks, the periodic working plans are based on the foregoing as well as ongoing risk analysis at the banks and their fields of activity, by means of audits coupled with the use of data-monitoring tools.

After intensive examination of credit-related activity in 2001, the unit again emphasized the assessment of the extent to which the classification of problematic debts and loan-loss provisions was appropriate. Its examinations focused mainly on industries and transactions that give evidence of having become riskier due to the protracted economic crisis.

In respect to boards of directors, control, and internal audit, emphasis in 2002 was placed on separating day-to-day management functions, for which the executive echelon is responsible, from supervision and monitoring of the activities of the executive echelon, for which the board of directors is responsible. Additionally, identification procedures and restrictions on transactions with interested parties were enforced more stringently.

In the field risk management, the examination of the adequacy of market-risk management systems, including those at the mortgage banks, continued. Considerable resources were invested in inspection of the management of positions resulting from activities of banks and their customers in money and capital markets, and the supervision and control procedures of certain banking corporations over their offices abroad were examined.

In respect of bank-customer relations and the capital market, the unit continued to inspect the structure of activity of banks and bank-controlled corporations in order to prevent conflicts of interest. The unit also inspected the fields of investment advice, the adequacy of the banks' adjustment to changes in the Supervisor's regulations in regard to floating-interest loans, calculations of early-payback fees, interest calculations, and proper disclosure, including disclosure in regard to on-line activity. The unit made a large investment in institutionalizing its inspection array for the prevention of money laundering, as required by recent legislative changes.

In electronic data processing and information systems, the main emphasis was placed on systems that provide on-line banking services. Processes related to management and control of computer systems were also inspected, focusing on data protection. Preparations for emergency, survivability, and related matters were also strongly emphasized in 2002.

e. International relations

In the wake of globalization, the expansion of Israeli banks' international activities, and the growing interest of foreign investors in the Israeli banking system, the Department established a special unit for international relations. In accordance with recommendations of the Basle Committee, the unit was also tasked with cooperation with and information transfer among supervisory authorities around the world.

The main focus of the International Relations Unit incorporates:

* Pro-active monitoring of the regulatory policies of foreign supervisory authorities and international agencies and assistance to licensing authorities in matters in which specific expertise in aspects of banking abroad is required;

* Analysis of trends and developments in banking abroad that have implications for Israel's banking system;

* Regular contact with supervisory authorities abroad and international agencies to create an infrastructure of information channels—in order, among other things, to exchange information as required under the core principles of the Basle Committee.

In 2001, the International Relations Unit dealt with a variety of matters related to the goals described above, mainly:

* Accompaniment of and assistance to the International Monetary Fund delegation during its visit to Israel;

* Transferring information about the Israeli banking system to various foreign agencies, including international institutions and rating services;

* Preparation of position papers on banking-supervision issues, including supervisory treatment of fraud and embezzlement risks from an international perspective;

* Israel's participation in the OECD investment accord;

* Handling issues related to the activities of Israeli branches abroad, in conjunction with supervisory authorities abroad;

* Gathering information, assistance, and study of issues such as deposit insurance, 'Basle II,' operating risks, and off-site and on-site supervision, among others.

f. Research

The Research Unit monitors developments in banking in Israel around the world and keeps abreast of new approaches toward subjects such as assets and liabilities management, risk management, hedging assessments and methods, and capital adequacy, in view of the new requirements of the Basle Committee in these regards.

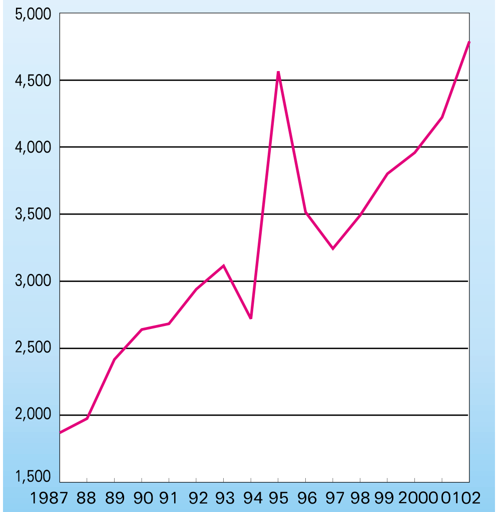
The unit culls information from the professional and research literature as a basis for position papers and research on issues in banking supervision policy, development of tools for evaluation of the performance of banking institutions, formulation of banking regulations, and adoption of other measures meant to advance Israel's banking system.

The Research Unit publishes the annual survey of the Banking Supervision Department (in Hebrew and English), which analyzes developments in Israeli banking during the review period and in the long term.

In March 2003,. the unit published Issue 16 of the journal *Banking Review* (in Hebrew). The main purpose of the journal is to promote research on banking and finance from a microeconomic point of view, with emphasis on empirical studies and applied research. The most recent issue included articles on the following topics:

* Risk premium and market strength in Israeli banking;
* Market discipline in Israeli banking;
* Measuring competitiveness in the banking system, distinguishing between the household sector and business firms;
* Mapping the Israeli banking system by means of the biplot analysis system, a model that provides advance warning of irregularities in the state of the system;
* Estimating the expected exchange rate by means of put options.

Figure 6.6
Complaints from the Public Received by the Banking Supervision Department, 1987–2002



SOURCE: Banking Supervision Department.

g. Bank-customer relations

One of the main functions of the Banking Supervision Department is the protection of the rights of bank customers. This function is enshrined in the Banking (Service to Customer) Law, 5741-1981.

To discharge this function, the Department takes action to uncover and correct deficiencies in the banks' performance with regard to customer relations. The Department invests much of its resources in this activity, which centers on the Public Enquiries Unit and teams that

Table 6.8
Investigation of Complaints[a] from the Public, 2001 and 2002

	2001		2002	
	Number of complaints	Percent of total complaints	Number of complaints	Percent of total complaints
Number on which decision was made				
Number found wholly or partly justified	770	17.6	852	16.7
Number found unjustified	1,535	35.2	1,842	36.1
Total	**2,305**	**52.8**	**2,694**	**52.7**
Number on which no stand was taken				
1. Treatment stopped due to legal proceedings	122	2.8	132	2.6
2. Treatment stopped for other reasons	218	5.0	276	5.4
3. Not within Unit's jurisdiction	182	4.2	364	7.1
4. Unable to take a stand	183	4.2	268	5.2
Total	**705**	**16.2**	**1,040**	**20.4**
Requests and clarifications				
Requests	651	14.9	430	8.4
Clarifications	702	16.1	944	18.5
Total	**1,353**	**31.0**	**1,374**	**26.9**
Total number of complaints whose treatment was concluded	**4,363**	**100.0**	**5,108**	**100.0**

[a] Out of all complaints whose treatment was concluded during the year.
SOURCE: Banking Supervision Department.

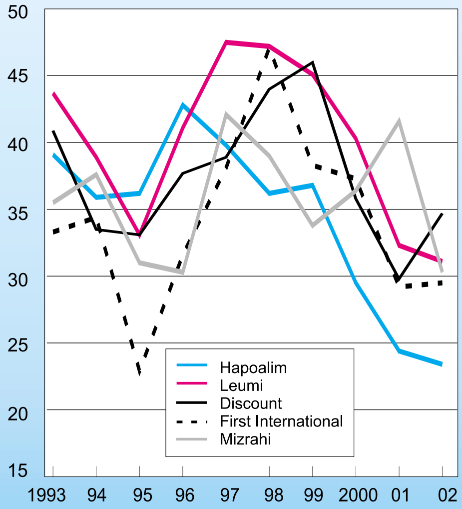
monitor bank fees and standard contracts. Additionally, the Department has an inspection team that conducts focused visits to bank branches to investigate issues in bank-customer relations.

Public enquiries

The Public Enquiries Unit derives its powers from Section 16 of the Banking (Service to Customer) Law, 5741-1981, which empowers the Supervisor of Banks to investigate public enquiries about the business practices of banking corporations. The Public Enquiries Unit investigates such enquiries in accordance with various provisions of law, rules promulgated by force of the law, and procedures that the Supervisor of Banks enacts for this purpose. After the investigation, the customer is given a detailed reply, including findings and conclusions, and is advised of the Department's attitude.

Apart from investigating enquiries and ruling on specific disputes, the unit performs a valuable service in uncovering weaknesses in the banking system at large. The unit also fields an incognito-inspection team that visits bank branches countrywide to ensure compliance with the provisions of the law and the procedures of the Supervisor of Banks in bank-customer relations.

Figure 6.7
Percentage of Justified Complaints[a] in Total Complaints Against Each of the Five Major Banks, 1993–2002



[a] On which a decision was made: justified/ partly justified/ unjustified.

SOURCE: Banking Supervision Department.

(a) Number and outcome of enquiries

In 2002, the unit received 4,787 written enquiries (13 percent more than in 2001), answered approximately 10,000 telephone enquiries, and completed its handling of 5,108 enquiries (17 percent more than in 2001), some of which it had received in previous years. Analysis of these data elicits the following findings:

(1) Of 2,694 complaints about which the unit made a decision in 2002, 32 percent—852—were found justified or partly justified. The handling of 270 complaints led, among other things, to the correction and updating of procedures and to the issuance of new guidelines by the Supervisor of Banks. In 254 of these cases, guidelines were issued for an individual bank. Thirty-six of these complaints led to refunds of money or compensation for a group of customers; the rest ended with the updating of working procedures and corrections in the bank's documents.

As a rule, the unit need not limit itself to demanding that a bank correct a deficiency that it discovered when it investigated a specific complaint. In many cases, it also demands the correction of deficiencies that, although revealed by one particular complaint, have broader implications for the bank at issue and/or for the banking system at large.

As stated above, the Enquiries Unit has a team that visits bank branches incognito to determine whether the clerks are complying with the provisions of the law and the regulations of the Banking Supervision Department in regard to bank-customer relations. The members of the team pose as potential customers, play out scenarios prepared in advance, and, if necessary, perform observations and supplementary inspections at the branch. When the inspection is over, the examiner discloses his or her identity to the branch manager, presents the manager with deficiencies discovered, if any, and asks him or her to respond to the findings. The findings are gathered in reports that are sent to the banks' managements, which are required to respond to them and take action to correct the deficiencies. The banks are informed that if the findings evoke suspicion of violations of the law, the matter will be handed over to the State Attorney's Office.

In 2002, sixty-seven bank branches were visited incognito, resulting in inspection reports noting deficiencies that the banks were ordered to correct. The findings show that the branches' performance is continuing to improve and that branch employees are increasingly aware of the importance of following regulations and procedures.

Table 6.9
Complaints and Enquiries from the Public, by Subject, 2001–2002

	Total complaints whose treatment was completed during year[a]				Total no. of justified complaints[b]		Percent of total complaints on the subject[c]	
	2001	2002	2001	2002	2001	2002	2001	2002
Subject	*(No. of complaints)*		*(percent)*					
Credit	183	258	4.2	5.1	21	26	21.9	18.3
Collateral	33	20	0.8	0.4	4	3	28.6	33.3
Implementation of court orders	150	160	3.4	3.1	25	17	26.0	19.5
Debt collection	167	191	3.8	3.7	14	19	19.2	25.7
Debit by authorization	87	113	2.0	2.2	21	33	34.4	46.5
Bank debts to customer	69	46	1.6	0.9	7	3	19.4	13.0
Long-term savings	249	309	5.7	6.0	25	35	22.7	31.0
Bank account	720	834	16.5	16.3	121	124	27.6	27.4
Debit card	476	426	10.9	8.3	166	123	47.3	38.0
Foreign currency	117	198	2.7	3.9	20	19	22.0	13.8
Bank documents	59	67	1.4	1.3	6	12	30.0	38.7
Mortgages	954	1,111	21.9	21.8	168	229	34.7	36.6
Securities	157	200	3.6	3.9	18	24	24.0	25.0
Branches	40	70	0.9	1.4	7	15	50.0	44.1
Forwards	26	23	0.6	0.5	6	5	31.6	29.4
Fees and commissions	223	269	5.1	5.3	10	27	40.0	20.1
Third party guarantees	65	74	1.5	1.4	18	14	48.6	41.2
Checks	333	361	7.6	7.1	96	97	48.5	47.5
Other banking services	150	170	3.4	3.3	17	25	26.6	33.3
Other[d]	105	208	2.4	4.1	0	2	0.0	20.0
Total	**4,363**	**5,108**	**100.0**	**100.0**	**770**	**852**	**33.4**	**31.6**

[a] Including complaints carried forward from previous year.
[b] Including those found partly justified.
[c] On which a stand was taken (justified/partly justified/unjustified).
[d] Enquiries or complaints on other subjects.
SOURCE: Banking Supervision Department.

Table 6.10
Distribution of Complaints Whose Treatment was Concluded,[a,b] 2001 and 2002 (by bank)

	Total enquiries concluded[c]		Total complaints[b]		Justified complaints[d]		Percent of justified complaints[d] in all complaints[b] against bank	
	2001	2002	2001	2002	2001	2002	2001	2002
Hapoalim	661	782	389	471	95	110	24.4	23.4
Leumi	681	773	396	486	128	151	32.3	31.1
Discount	369	379	208	213	62	74	29.8	34.7
First Intl.	269	317	171	193	50	57	29.2	29.5
Mizrahi	244	281	137	178	57	54	41.6	30.3
Other commercial banks[e]	783	969	513	466	209	175	40.7	37.6
Total	**3,007**	**3,501**	**1,814**	**2,007**	**601**	**621**	**33.1**	**30.9**
Tefahot	231	208	116	126	49	41	42.2	32.5
Leumi Mortgage	300	434	154	307	74	124	48.1	40.4
Mishkan	213	212	128	121	39	51	30.5	42.1
Other mortgage banks	138	132	62	109	7	14	11.3	12.8
Total	**882**	**986**	**460**	**663**	**169**	**230**	**36.7**	**34.7**
Grand total	**3,889**	**4,487**	**2,274**	**2,670**	**770**	**851**	**33.9**	**31.9**

[a] Including enquiries and/or complaints from previous years whose treatment was completed in the year shown.
[b] Regarding which a decision (justified/partly justified/unjustified) was made.
[c] Excluding complaints in which the name of the bank is not noted.
[d] Including complaints found to be partly justified.
[e] Including credit-card companies and financial institutions.
SOURCE: Banking Supervision Department.

(b) Monitoring of fees and standard contracts

The Department's array in matters related to bank-customer relations includes, as stated, a team that monitors bank fees and systematically examines standard contracts between banks and customers in order to cleanse them of clauses that are disadvantageous to customers.

(1) Fees

At the initiative of the Banking Supervision Department, the Banking (Service to Customer) (Proper Disclosure and Provision of Documents) Regulations, 5752-1992, was amended to expand and improve the proper-disclosure requirements that banks must meet vis-à-vis customers. The amendment, which went into effect on April 1, 2003, contains the following main provisions:

* A banking corporation must inform the customer about any fee charged, with mention made of the nature, rate, and sum of the fee and how it was calculated.

* A bank that changes its fee rates must advertise the change in the branch and also in two daily newspapers.

* A bank must inform its customers about benefits or discounts that it offers to certain customer groups (students, retirees, etc.) in accordance with the criteria that it determined.

* The requirement about advising customers of effective cost was expanded: banks must provide this information for non-housing loans up to NIS 500,000 and for housing loans up to NIS 1,000,000 (instead of loans up to NIS 60,000, as stipulated before the amendment).

(2) Uniform contracts

Legal proceedings continued in the Standard Contracts Court concerning a request to strike down conditions adverse to customers that were found in a housing-loan agreement routinely used by First International Mortgage Bank, Ltd.

In view of the increasing use of on-line banking services, the unit examined contracts that pertain to the obtaining of information and the performance of transactions by means of these services. In view of the findings, the unit asked the Standard Contacts Court to nullify or correct conditions that are disadvantageous to customers in the standard contract of Bank Hapoalim, Ltd., for the provision of banking services by Internet and cellular telephone.

Since home-buying entails a large financial outlay, purchasers' investments are usually assured by means of a bank guarantee. However, the guarantee includes many conditions that make it difficult to exercise when necessary. Consequently, the unit looked into the bank-guarantee letters that homebuyers are given and, in view of the findings, asked the Standard Contracts Court to nullify or modify disadvantageous conditions in the standard contrast of "Tefahot" Israel Mortgage Bank, Ltd., concerning homebuyers' guarantees under the Sale (Apartments) (Assurance of Investments of Persons Acquiring Apartments) Law, 5735-1974.

h. Information and financial reporting

Information and Reporting Unit

The Information and Reporting Unit is responsible for receiving reports from banks and converting them into readily-available, reliable data which can be used by the various units of the Banking Supervision Department to monitor the banks' activities. The banks report and present data about their areas of activity in different cross-sections and using different reporting systems. The data are obtained at different frequencies, depending on the Department's needs, and are funneled into forty-three reporting systems. For each reporting system, the unit uses sophisticated statistical tools to perform numerous checks and identify problems with the data simultaneous with the process by which the banks prepare the data, i.e., before the Department receives it. The unit receives the banks' reports and manages the Department's databases. This process, too, involves sophisticated checks in which data from diverse reporting systems and different banks, for different reporting periods, are compared. The unit summarizes the results of these checks in an 'examination report' that includes recommendations for corrections at the banks and in the unit's own systems. The unit uses the information to monitor the banks' compliance with the quantitative restrictions that are issued in the Banking (Licensing) Law and in Proper Conduct of Banking Business Regulations.

The unit prepares new reporting regulations and updates existing regulations to improve the information available to the Department. This is done partly due to the realization that changes in the Proper Conduct of Banking Business Regulations and Guidelines for Preparing Reports to the Public make adjustments necessary, but it is also partly done at the unit's own initiative. Any change in or preparation of a Guideline for Preparing Returns to the Supervisor of Banks leads to adjustments and further development of the computer system that receives new returns from the banks. The development work includes the preparation of a reporting format and the performance of logical and other checks. Due to the complexity of the information systems, the unit also helps the banks to assimilate them. In view of the priority that the prevention of money laundering has been given, the Banking Supervision Department also assimilated a reporting system for this purpose and the unit provides the banks with aggregate information for feedback purposes. The banks use this information as a management tool and as a way to compare their data with those of the system at large.

Each year, the unit handles more than 1,500 requests for information from various economic entities and advertises fortnightly (in print and over the Internet) the maximum and average interest rates in the 'gray market' that mortgage banks use to calculate their early-payback fee.

The unit issues several publications: *Annual Information on the Banking Corporations,* containing information on the banking system in Israel over a five-year period,[9] *Current Information on the Banking Corporations,* a loose-leaf binder with up-to-date information

[9] Available at the Bank of Israel Web site, www.bankisrael.gov.il, under 'Publications and Information.'

on the banking system in Israel; and *Main Data on the Activity of Each Bank*, a quarterly publication (in Hebrew) that compares the banks on the basis of information culled from their financial statements.

The unit, in conjunction with the Financial Statements Unit, undertakes examinations in banks to verify the reliability of their returns to the Department. By identifying deficiencies, these examinations, coupled with internal inspections that are performed, make it possible to improve the reporting system and the data that the banks provide.

This year, the unit was also asked to coordinate emergency activity. To accomplish this, it reviewed and reconstituted the list of 'core branches,' those at which the banking system will continue to provide banking services during an emergency if the banks cannot keep their entire branch system going. The unit also developed a computerized system to receive condensed reports from banks during emergencies and tested it several times to make sure that the banks were prepared for this type of reporting under emergency conditions. A secondary group of companies that provide services to the banks was determined and the companies on this list were recognized as essential emergency enterprises.

Financial Statements Unit

The unit has two main functions: (1) preparing regulations for the banks on the preparation of annual and quarterly published reports (which include a statement by the board of directors, a management survey, and the banking corporation's financial statement) and regulation of the work of the CPA-auditor of a banking corporation, and (2) inspecting, at both the system and the individual-bank levels, the banks' financial statements and their returns to the Banking Supervision Department.[10]

As a related activity, the unit deals with day-to-day matters pertaining to the banks' financial statements (answering banks' enquiries, solving occasional problems, issuing guidelines to specific banks and to the system at large, dispensations in disclosure, etc.).

In 2002, the unit completed the preparation of regulations and regulations in the following aspects of reporting to the public:

(1) Accounting of derivatives and hedging transactions—aligning the format for disclosure of derivatives and hedging with the American rules in this regard (FASB 133);

(2) Disclosure in the statement of the board of directors and the management about their responsibility for the annual statement of the adoption by the Banking Supervision Department of auditing standards published by the Financial Accounting Standards Board (FASB) in the United States;

(3) Adjustment and broadening of regulations in the following matters: the fee of a CPA-auditor of the statement of the board of directors; industry-itemized credit risk, and

[10] This activity takes place in conjunction with the Information and Reporting Unit.

compulsory disclosure in a note to the abstract of the financial statements, in accordance with the structure of the banking group;
(4) Aligning the regulations on reporting to the public with changes in Generally Accepted Accounting Practices:

* *Aligning securities regulations with the banking system:* attaching the financial statements of included companies and providing quantitative disclosure of exposure to market risks and their management.

* *Guidelines for the implementation of new accounting standards issued by the Israeli accounting standards institute:* Accounting Standard 7, 'Event after Balance-Sheet Date,' and Accounting Standard 8, 'Discontinued Activities.'

In 2002, the unit completed the regulation of two aspects of the work of a CPA-auditor of a banking corporation:
(1) Replacement of partner-in-charge at a CPA firm that audits a banking corporation—amendments to Proper Conduct of Banking Business Regulation 302.
(2) Requiring the CPA-auditor of a banking corporation to apply specific FASB auditing standards.

The inspections performed in 2002 focused on system-level disclosure (at all banking corporations) in reporting on activity segments in statements for 2001 and on interest income on account of problematic debts. The findings of these inspections served as a basis for system-level inspection letters that included guidelines for the implementation of the Department's regulations in the relevant matters.

i. Licensing

The licensing function includes the processing of requests that entail licensing from the Governor of the Bank of Israel or the Supervisor of Banks. The main areas of concern are:

* Fitness of candidates for acquisition of control or instruments of control in a banking corporation in Israel;

* Applications by banking corporations to establish banking subsidiaries in Israel or abroad;

* Preparation of branch policy and processing of applications to open branches;

* Applications from foreign banks to open offices in Israel or to include the word 'Bank' in the name of a representative office that they are establishing in Israel.

The main issues dealt with in 2002 were:

* Preparation of a draft amendment to allow for the privatization of Bank Leumi le-Israel, Ltd., by means of the capital market (the Marani Committee report);

* Acquisition of The Maritime Bank of Israel, Ltd., by Bank Hapoalim, Ltd.;

* The implications of the restructuring of the global Investec Group for the bank's holdings in Israel;

* The increase to 65 percent, at the beginning of 2003, in the share in equity of the European banking concern Dexia in Otzar Hashilton Hamkomi Ltd.

j. Checks without cover

The Checks Without Cover Section, on the basis of information received from commercial banks and sources such as the Execution Office (bailiffs' service) and the rabbinical courts, operates a complex computer system that deals with people who write 'bad checks.' The system, developed by the Banking Supervision Department, is based on the provisions of the Checks Without Cover Law, 5741-1981, and is meant mainly to implement the provisions of this statute, as amended in 1992, and to serve goals of forewarning and deterrence.

This section has diverse and broad functions, of which the main ones—declaring customers as restricted customers under aggravated circumstances and sending notices

Table 6.11
Restricted Customers and Accounts, 2000–02 (end of year)

	2000	2001	2002	Rate of change in 2002 (%)
Restricted accounts	135,500	133,683	149,616	11.9
of which For checks returned	93,797	89,375	95,196	6.5
Restricted customers	76,860	75,795	85,465	12.8
of which Under ordinary circumstances	33,600	32,096	36,007	12.2
Under aggravated circumstances	33,632	30,862	29,956	–2.9
Under special circumstances	9,628	12,837	19,502	51.9

SOURCE: Returns to Supervisor of Banks.

to these customers—are enshrined in the law. Such customers are those who had been restricted under ordinary circumstances and were restricted again during the term of the restriction or within three years after its end.

Due to legislative changes in 1994 and 1995 that expanded the restriction obligations of the Supervisor of Banks, the unit has extended the designation of 'restriction under aggravated circumstances' to men who have refused to grant their wives a divorce under religious law and to persons whose accounts, in accordance with the order of the director of the Execution Office, should be restricted under aggravated circumstances.

The main function of the system is forewarning and deterrence in order to stanch the plague of bad checks. The Department receives lists of accounts restricted under ordinary circumstances and guides the banking system in regard to banks' computerized systems that deal with restrictions and the control of these systems. The Department deals with violations of the law and with oral and written enquiries from the public in cases where court appeals have been filed. It cooperates with the police in handling cases of fraud and acts to improve the systems that deal with writers of bad checks.

There were 149,616 restricted accounts at the end of 2002, 12 percent more than in the previous year. There were 85,465 restricted customers at year's end—36,007 under ordinary circumstances,[11] 29,956 under aggravated circumstances,[12] and 19,512 under special circumstances.[13]

Table 6.12
Public Enquiries and Complaints Regarding Checks without Cover, 2001 and 2002

(cumulative data per year)

	2001	2002	Percent change in 2002
In writing	870	1,124	29.2
Appeals to courts	730	876	20.0
Via answerphone	15,000	20,000	33.3
By phone to the unit	6,500	6,000	–7.7
To Bank of Israel web site	4,308	43,000	898

SOURCE: Returns to Supervisor of Banks.

The number of 'special restriction' customers—men who refuse to grant their wives a divorce and persons with Execution Office files—climbed to 19,507 this year, 51.9 percent more than in 2001. Most of the increase was due to an upturn in the population of persons with files at the Execution Office, a matter related to the protracted deterioration in the economic situation.

About 5,000 customers on monthly average were restricted under aggravated circumstances in 2002, due to the restriction of 6,000 accounts that had been under prior restriction.

Use of the IVR center and the Web site to submit requests for investigation of bad checks rose steadily during the year. Average enquiries were 20,000 in 2002 as against 15,000 in 2001. The IVR service began to operate in November 2001 and by the end of 2002 it was receiving calls at an annual pace of 43,000 as against 24,000 in its first few months of activity. During the year reviewed, private individuals and other entities submitted some 2,000 written enquiries (including 800 appeals to the courts) and an estimated 6,000 telephone requests for investigation and information.

The website (www.bankisrael.gov.il/black.html) and the IVR service (tel. 1212332755) that provide the public with information about restricted accounts and customers were expanded. Thus, today one may use them to obtain information about restricted checking

[11] A customer restricted under ordinary circumstances is restricted in one account and is allowed to use other accounts but may not open new accounts.

[12] A customer restricted under aggravated circumstances is restricted in two accounts and may not draw checks on any of his/her accounts.

[13] A customer restricted under special circumstances is restricted by the director of the Execution Office or by a rabbinical court.

accounts as well as the ID numbers of private customers and corporations that have been restricted under aggravated circumstances.[14] These services are provided at no charge, on the basis of Paragraph 14 of the Checks Without Cover Act, 5741-1981.

In a recent innovation, the Bank of Israel has begun to advertise information about restricted accounts on its Web site. Previously, the Bank sold this information to approximately sixty corporations, some of which processed and distributed it for a fee. The purpose of the new method is to reach more people and more companies so that they can make sure, in real time, that checks that they have received were not drawn on accounts that are restricted under ordinary or aggravated circumstances. This will make it possible to step up of the war on bad checks—a plague that has been spreading with particular vigor since the current recession began.

k. Prohibition of money laundering—legislation and regulation

Legislation and regulation

The Prohibition of Money Laundering Order (Compulsory Identification, Reporting, and Record-Keeping by Banking Corporation), 5761-2001—gazetted on January 25, 2001, and effective as of February 17, 2002—includes three main types of provisions: identification of customers and verification of their identifying particulars; reporting to relevant authorities—objective reporting (by size and type of transaction) and subjective reporting (about irregular transactions)—and management and documentation of records.

In May 2002, Proper Conduct of Banking Business Regulation 411, 'Prevention of Money Laundering—Customer Identification and Record-Keeping,' was amended extensively and the international 'Know Your Customer' (KYC) standards, published by the Basle Committee in October 2001, were adopted. The standards cover policy on the identification and reporting of irregular transactions, classification of high-risk accounts in respect to money laundering, trust accounts, accounts of public figures, numbered accounts, and additional matters. The comprehensive change went into effect on September 1, 2002, and regulations requiring computer preparedness for its implementation will go into effect on September 1, 2003. The banks were required to advise the Banking Supervision Department of their progress in implementing the transitional provisions in the Order.

During 2002, a Bank of Israel team—in conjunction with the Ministry of Justice, the Israel Money Laundering Prohibition Authority (IMPA), the Ministry of Public Security, the Israel Police, and the Association of Banks—drafted an amendment to the Order on the basis of experience gained in its implementation and in accordance with IMF recommendations that the Bank adopted. The draft amendment will be presented to the Knesset's Constitution, Law and Justice Committee for approval.

[14] Information about customers restricted under aggravated circumstances does not include data on customers with 'special restrictions' (due to liquidation, a file with the Execution Office, or refusal to grant a divorce), customers who have appealed their restriction in Magistrate's Court, and customers who were apprised of their restriction less than sixty days earlier.

Inspections by foreign agencies in Israel

In May 2002, a team from the Financial Action Task Force (FATF) visited Israel to learn what the country has done in the war on money laundering. In June, after the visit, the FATF deleted Israel from the NCCT, the blacklist of countries and territories that were deemed non-cooperative in the war on money laundering.[15] Israel was removed from the blacklist due to its efforts to fight money laundering in legislation and in the implementation thereof.

Another inspection in regard to the prohibition of money laundering, by a delegation of the International Monetary Fund, was performed in December. After meeting with representatives of the Bank of Israel and Israeli banking corporations, among others, the delegation came away with a strongly positive impression of Israel's efforts to tackle the money-laundering problem while noting several matters in which corrective action was needed. Some of its comments found expression in the draft amendment to the Order.

Enforcement

In 2002, a joint team of the Bank of Israel (Banking Supervision Department and Legal Department) performed general evaluation examinations in regard to the prohibition of money laundering at fifteen banking corporations. The banks' procedures, operational and computer preparedness, and assimilation of the topic among staff were examined. The inspection unit of the Banking Supervision Department also examined several banks in this matter. Since September 2002, the inspections have also pertained to compliance with Proper Conduct of Banking Business Regulation 411, which went into effect at that time. These examinations are quite important both for enforcement and for training of banks' compliance officers.

In April 2002, a sanctions committee was established, as required by the law. The committee held its first meeting in April 2003 to discuss the violation of requirements by one of the banking corporations as revealed in an inspection at the bank at issue.

[15] Israel was placed on the blacklist in June 2000, when the FATF went into action.

APPENDIX 6.1
Activities of the Banking Supervision Department in 2002

1 January
As part of the regulation of bank-customer relations, the regulation concerning procedures related to fees was amended. The main provisions of the amendments follow:
1. The regulation was applied to auxiliary corporations that issue credit cards .
2. Charging of fees for the recording of a transaction that is split into several components, at the bank's instigation, was prohibited.
3. A banking corporation must reimburse a customer for the pro-rated share of any fee charged up-front in the event that the service for which it is charged is discontinued before the end of the original period.
4. A banking corporation may not charge a fee to a housing-loan recipient who acquires insurance by means other than the bank for sending a notice about the expiration of home-owner's or life insurance toward the end of the insurance year.
5. To improve disclosure to customers of fees charged to them and to allow customers to verify the accuracy of the charges, a banking corporation must itemize fixed and variable management fees separately on the account statement.

6 January
In view of technological developments in on-line communications and to encourage competition in the banking system, a new regulation in regard to 'closed-system' activities of banking corporations was issued. The regulation states that customers may deposit funds with a banking corporation even if they do not conduct regular activity with it, without entering the branch, and without opening a current account. At the end of the deposit term, the proceeds shall be transferred back to the current account from which the deposit sum had been withdrawn with no further instruction from the depositor.

16 January
1. In view of the tightening of reporting deadlines for public companies and the development of systems that manage information in borrowers' files, the regulation regarding financial information in borrowers' files was amended. The amended regulation shortens the period for the updated financial statement that the borrower must present the bank, stipulates the periods during which the report is considered up-to-date, and adjusts the sums of money that entail the presentation of an updated financial statement in regard to the issue of credit to an interested party.
2. A regulation regarding the repurchase of its shares by a banking corporation was issued. According to this regulation, banking corporations and bank-controlled corporations may neither acquire their own shares nor finance such an acquisition. Notwithstanding this prohibition, they may finance an acquisition that is part of an employee securities purchase plan if said financing has been examined and approved by the Supervisor of Banks, and may do so as part of the acquisition of shares in the Ma'of index, up to a limited sum.

17 January

1. To help a banking corporation's board of directors and management exercise their responsibility for their corporation's compliance with legal and regulatory requirements in customer relations and prohibition of money laundering, a regulation stipulating the appointment of a compliance officer was issued. Every banking corporation must appoint a compliance officer and adhere to guidelines for the discharge of said officer's duties, including basic actions that the board and the management must take. The need for a compliance officer belongs to the general field of risk management and the appointment is made to lessen the probability of a violation of laws or regulations, to lead to early discovery of such violations, to minimize the exposure of the corporation and its executives to claims—including claims concerning breach of the prudence and fidelity requirements that bank officers must meet—to spare the banking corporation from financial losses for these reasons, and to maintain the bank's reputation.

2. According to the Guidelines for Preparing Reports to the Public, banking corporations must show in detail the total outstanding credit risk due to problem loans and must do so in the board of directors' report, using a stipulated format.

6 February

The permit to provide some banking services was broadened. A banking corporation may sign customers of all types to a contract for purchase of automobile at the sales agencies of licensed automobile importers under the terms issued in the permit. The purpose of the permit is to assure adherence to crucial principles of sound banking activity.

2 May

In response to the international war on money laundering and its reflection in Israeli legislature, the regulation concerning prevention of money laundering, identification of customers, and record-keeping was amended. A banking corporation must establish a 'Know Your Customer' policy and procedure that covers opening of accounts and defining types of customers; must establish procedures for the protection of information about the customer's identity and business—including source of information, how long it should be kept, type of customer, and expectation of extent of activity in the account—and must update this information from time to time. A banking corporation must also issued rules and maintain a control system for customer accounts that are at high risk (in respect to the prevention of money laundering) by using a set of indicators including customer type, customer background, country from which the customer receives transfers of funds, and types of transactions. The banking corporation must also record the identifying particulars of any person who cashes a check in the sum of NIS 10,000 or more.

22 July

On the basis of a written contract between the Stock Exchange and a foreign bank, pertaining among other things to the division of responsibility between an Israeli bank, the Stock Exchange, and the foreign bank, the regulation concerning a banking corporation's dealings in securities for its customers was amended. The rule requiring a banking corporation that deposits securities with others for protection must sign a written agreement with the protector, spelling out the terms of the relationship, shall not apply to protection by means of the clearinghouse of the Tel Aviv Stock Exchange, Ltd.

30 July
The financial-institution license of Bank Leumi Finance Co., Ltd., was cancelled.

25 August
The reporting format for boards of directors and managements with regard to their responsibility for the annual statement was updated. Boards and managements must advise users of banking corporations' financial statements that the annual statements were audited in accordance with standards issued in the CPA regulations and certain auditing standards of the Financial Accounting Standards Board of the United States and that their use is mandated by guidelines from the Supervisor of Banks.

29 September
The Supervisor issued a detailed set of clarifications about his views on reporting the distribution of credit risk among nonresidential industries. After Accounting Standard 7, 'Event after Balance-Sheet Date,' and Accounting Standard 8, 'Discontinued Activities,' were published, the Guidelines for Preparing Reports to the Public were aligned with the rules issued in the standards.

28 October
The regulation concerning accounting of derivatives and hedging activities in banking corporations' financial statements was updated (and went into effect in the quarter ending on March 31, 2003). The updated regulation incorporates the rules issued in the regulation on derivatives in the Guidelines for Preparing Reports to the Public and aligns the format for disclosure of derivatives and hedging activities in a banking corporation's financial statement with the reporting regulations of the American regulatory authorities.

6 November
An amendment to the Banking Rules (Service to Customers) (Proper Disclosure and Presentation of Documents) (Amendment), 5763–2002, was approved by the Knesset's Finance Committee. The amendment went into effect on April 1, 2003.

12 November
In view of a new American statute—the Sarbanes-Oxley Act of 2002—and in accordance with American and British accounting norms, the regulation concerning a CPA who audits a banking corporation was amended. Henceforth, a CPA-auditor shall appoint, in every banking corporation, a partner in charge of the audit and a partner in charge of the annual audit review. These partners may hold these positions for no more than five successive year, after which they must be replaced.

18 November
After securities regulations on reporting of market risks and risk management were approved, the ad hoc regulation concerning reporting to the public was updated to require quantitative disclosure of market-risk exposure in addition to qualitative reporting.

20 November
To give customers more effective control of the transactions and balances in their accounts, a regulation concerning information retrieval by customers was issued. Banking corporations must provide customers with an automatic method (a workstation on the bank premises) of retrieving information about all their accounts, at their initiative and without being dependent on a clerk, at the initiative of the banking corporation, or by generation of information at the instigation of the bank's computer system. The system required shall be able to generate, upon demand, a detailed balance statement and provide up-to-date current information about every asset and liability.

12 December
The regulation concerning minors' accounts was amended to allow banking corporations to provide minors who have reached the age of fourteen with:
1. A cash-withdrawal card, provided that the minor's account has a positive balance;
2. A limited debit card, issued with the consent of the minor's legal guardian, provided that the Supervisor of Banks has authorized the bank to issue such a card. The card shall be usable for transactions in Israel only, shall debit the account immediately, shall function only if the minor's account has a positive balance, and shall be limited to NIS 400 in daily transactions.

22 December
1. The restrictions pertaining to financing the acquisition of instruments of corporate control were toughened. Outstanding credit for such acquisitions, in cases where the share of financing in the total transaction exceeds 50 percent (as against 70 percent heretofore), shall not exceed 70 percent of the banking corporation's capital (as against 100 percent). The restrictions on acquiring instruments of control in banking corporations were toughened to limit the proportion of financing to 30 percent (instead of 50 percent heretofore).

Since the value of the corporation being acquired and the collateral for the credit are difficult to determine, the banking corporation must verify these values on its own, must take the potential decline in said values into account, and must not base itself solely on a valuation performed by parties related to the acquired company or to the borrower.
2. The regulation concerning third-party guarantees to banking corporations was amended and aligned with the Guarantees Law, 5727–1967. The amended regulation adds obligations vis-à-vis a 'sole guarantor' and other guarantors, mainly in respect to proper disclosure and serving of notices.

APPENDIX 6.2
Enquiries From The Public That Have General Implications, 2002

The enquiries described below are examples of issues that affect the public at large. The information they provide may serve the public in its dealings with banking corporations. The examples should not be considered representative of all enquiries processed by the Public Enquiries Unit.

The issues described below, with which the Unit dealt in 2002, concern general matters and questions of principle that originated in specific enquiries and have comprehensive implications for other customers of the relevant banks.

Customary interest rate on mortgage loans

Investigation of complaints from borrowers who took floating-interest housing loans showed that where the contract stipulated the bank's 'customary interest rate' as the basis for adjusting the interest rate, banks construed the term 'customary interest' as the 'schedule' interest rate, i.e., the rate advertised in the bank's interest schedules. We believed that the rate at issue should be the customary rate that the bank charges for housing loans at the time the adjustment is made. Therefore, in regard to interest-adjustment dates in 1998 and thereafter, we instructed the banks to correct the interest rates on loans for which the bank's customary interest rate at the time of the adjustment had been lower than the rate that the banks actually set and ordered the banks to reimburse borrowers accordingly. Banks that performed the correction have reimbursed customers in the sum of NIS 7.4 million thus far.

Fee for deposit of funds with mortgage bank by means other than standing order

Investigation of complaints showed that one of the mortgage banks, in cases of early payback of a mortgage loan, regularly charged customers an NIS 15 fee for making a deposit 'not by means of standing order,' i.e., at the counter. The bank also charged the transaction fee that is enshrined in the Banking (Early-Payback Fees) Order. Thus, it charged two fees for one banking transaction. Upon our demand, the bank desisted from charging the fee that was not anchored in the Order and reimbursed all borrowers who had been charged this fee in the past seven years in the total sum of NIS 1.9 million.

Circumvention of the Checks Without Cover Law

After receiving several complaints against one bank, we became suspicious that the bank at issue was allowing customers who had been restricted under the Checks Without Cover Act to continue doing extensive checking activity—and, at times, business activity—by means of accounts that had ostensibly been opened by others. The accounts were actually managed by restricted customers who are enjoined by law, for various periods of time, from drawing checks on their restricted account and opening checking accounts even if they do not sign the checks personally. The bank knew about the practice and seemed to be aiding this circumvention of the provisions of the Act. Due to the suspicion that the case brought to light and the Supervisor's grave view of the phenomenon, the files were forwarded to the State Attorney's office for further handling.

The 'Frequent Flyer Club'

A customer of one of the banks alleged that the bank had enrolled him in El Al's 'Frequent Flyer Club,' without his knowledge or consent. When the complaint was investigated, the bank explained that it had mistakenly transferred to this club a file of customers who had enrolled in another El Al club, 'Fly and Buy.' As a result of the switch, the customers were charged a $ 10 membership fee even though the switch was supposedly free of charge. The Banking Supervision Department ordered the bank to reimburse all affected customers for the unlawful fee plus interest at the bank's highest customary lending rate, so that no customer be harmed by the earlier charge to his/her current account. Consequently, 3,519 customers were reimbursed in the sum of $ 10 plus interest as stated. Furthermore, due to the severity with which the Department viewed the incident, the matter was handed on to the State Attorney's office for handling.

Mailing of charge statements to holders of cancelled credit cards

Pursuant to complaints that we investigated, we found that one of the credit card companies did not regularly send monthly charge statements to customers who cancelled their credit cards and still had debts on account of transactions preceding the cancellation. Customers who requested charge statements were charged an NIS 9 mailing fee. Since this fee does not appear on the company's schedule of fees, it is improper. We ordered the company to desist from charging the fee at once and to track down and reimburse all customers who had been so charged. The company located 2,130 customers and reimbursed them in the total sum of NIS 55,000.

Semiannual charging of credit card membership fee

An investigation of a customer's complaint revealed that in certain cases one of the credit card companies had been charging its customers a semiannual membership fee even though the contract exempted them from the charge if they made a certain number of transactions with the card during one year. At the end of the year, the credit card company credited customers who met the exemption terms on the basis of the US$ exchange rate. Since customers' compliance with the exemption terms could be examined only at the end of the year (since, according to the contract, it is based on an annual average) and the practice of semiannual charging constituted a breach of contract with the customer, the company was ordered to credit all affected customers with indexation differentials and interest as required by law and to send each customer a letter advising him or her of the reimbursement. In the letter, the company was ordered to note that if the customer proves that he/she suffered further damage due to the charge, he/she would be entitled to full compensation for it. In all, 3,308 customers were reimbursed in the total sum of NIS 16,000.

Arrangements for repayment of overdue debts

It was the practice at one of the mortgage banks to send warning letters to borrowers and guarantors for payback arrears even after the bank had concluded payback terms with the borrowers and after the borrowers had complied with the terms. We ordered the bank to desist from charging a fee for mailing the warning letters in cases where borrowers had concluded and honored such arrangements and to reimburse borrowers for the improper charge. In all, the accounts of customers who had been charged in this manner were credited in the total sum of NIS 53,000.

Incremental loans at floating interest

A clause in the Supervisor's procedures for the issue of housing loans stipulates that incremental loans should be treated in the manner of floating-interest loans—i.e., that the interest rate on each part of the loan be determined on an external objective basis. Investigation of complaints made it clear that one of the mortgage banks was violating this rule. After we intervened, the bank was ordered to refund the interest charged to all borrowers who had taken incremental loans at floating interest after the relevant clause in the procedure went into effect. The total refund was NIS 309,000.

Charging of early-payback fee despite rollover of loan

We discovered in the investigation of a complaint that, at the time loans were rolled over, one of the mortgage banks regularly charged a 1 percent fee for failure to serve prior notice, in contravention of Paragraph 4(b)(1) of the Banking (Early-Payback Fees) Order, 5742-1981. The bank was ordered to refund the fee and did so in the total sum of NIS 27,000.

Charging of fee for return of check due to lack of endorsement

When payments to Leumi Mortgage Bank, Ltd., on account of mortgage loans are not made by standing order, they are usually made by means of personal checks that borrowers deposit with branches of Bank Leumi le-Israel, Ltd. When a payment is made in this manner, the clerk who makes the deposit is supposed to stamp the back of the check with the expression, 'We have debited the bearer's account with us' in lieu of an endorsement signature of Leumi Mortgage Bank, Ltd. Customers called our attention to cases in which the clerk had failed to stamp the check. Where this occurred, the check was returned due to lack of endorsement and the borrower was charged an NIS 70 fee. After the deficiency was corrected, the check was presented again but the borrower was caused further damage for having missed the original payment deadline. Our view, which we explained to the bank as we investigated the enquiries in this matter, was that the fee is unsound and should be discontinued at once. We also ordered the bank to reimburse all customers for fees charged to them in the past seven years and to compensate them for any damage inflicted on them due to the return of the checks. Since it was impossible to locate all borrowers in whose accounts checks had been returned during those seven years, the bank was ordered to advertise, in three large-circulation daily newspapers, a notice inviting such customers to contact the nearest office of the bank and to itemize the total damage caused them by the return of their checks. The bank complied with our instructions and has made NIS 250,000 in refunds thus far.

Collection by standing order after early payback of mortgage loan

Investigation of complaints against one of the mortgage banks showed that in many cases borrowers who paid back their loans in full before the due date (early payback) were charged an additional monthly payment the following month by means of their standing order. This caused these borrowers' current accounts with the commercial banks severe damage, including overdraft charges, recording-of-transaction fees, and 'bouncing' of checks and standing-order transfers drawn on the commercial bank accounts in cases of insufficient funds.

The bank was ordered to desist at once from charging any account by standing order after full early payback and, in the event of a partial early payback, to desist from charging any sum that exceeds the unpaid balance. The bank was also ordered to reimburse customers for all sums unlawfully charged to them and to compensate them for any proven damage inflicted on them as a result of said charging. Thus far, the bank has made NIS 185,000 in reimbursements.

Charging of early-payback fee in contravention of Section 4(c) of the Banking (Early-Repayment Fees) Order, 5742-1981

According to the Banking (Early-Repayment Fees) Order, 5742-1981, if early payback is made within two years of the final payback date of the loan, the average interest rate shall be lowered by 1 percentage point. This results in an increase in the share of the fee. Investigation of a complaint showed that two mortgage banks construed the day of change in interest rate on floating-interest loans as the final date of the loan. As a result of this interpretation, they charged excessive fees to borrowers who paid back floating-interest loans during the two years preceding the date of change in their contractual interest rate. We informed these banks that this interpretation of the Order was legally unsound and ordered them to reimburse for the overcharge all borrowers who, in the past seven years, had made early payback of floating-interest loans and were charged in contravention of our view. Thus far, the two banks have made reimbursement in the sum of NIS 453,500 on account of the years 2000 and 2001.

The Banking Supervision Department:Organizational Structure