# CHAPTER 4

**CHAPTER 4**

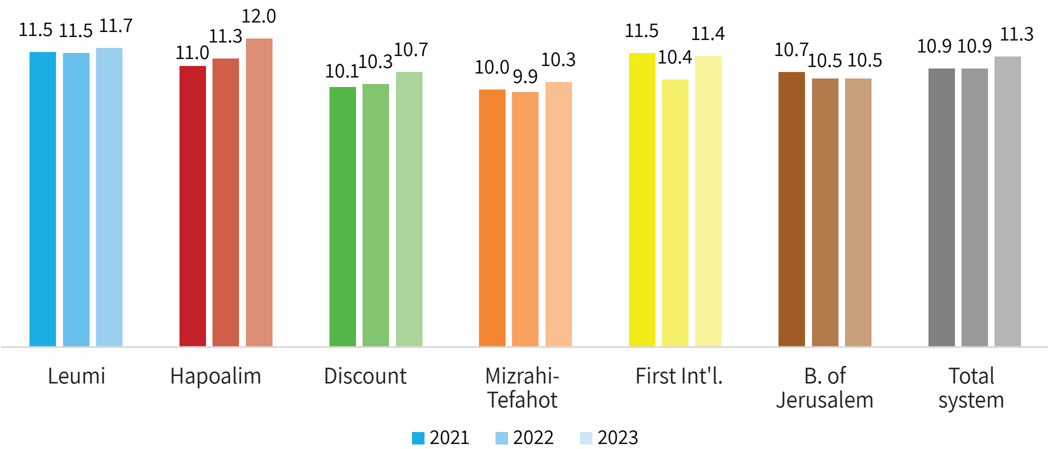
CAPITAL ADEQUACY AND LEVERAGE

## Capital adequacy and leverage

**The banking system's Tier 1 capital ratio increased during 2023, to approximately 11.3 percent (Figure 4.1), compared to 10.9 percent in 2022. The capital ratios in all the banks remained high and above the minimum requirements, indicating the robustness of the banking system and its ability to continue supporting the economy even in times of crisis. The high profitability during the year, the moderation in the growth rate of credit risk assets due to the slowdown in the growth rate of the credit portfolio (for more details, see Chapter 5.2 in this survey), and the reduction in the dividend payout rate in the second half of 2023, contributed to strengthening the capital ratios. The slowdown in the growth rate of the credit portfolio, as reflected in the moderation of the growth rate of exposures, along with the increase in capital, contributed to the improvement of the leverage ratio to 6.5 percent, compared to 6.1 percent at the end of 2022.**

There was an improvement in the capital ratios this year.

**Figure 4.1** Tier 1 Capital Ratio, Total Banking System, 2021–2023 (percent)




**SOURCE:** Based on published financial statements.

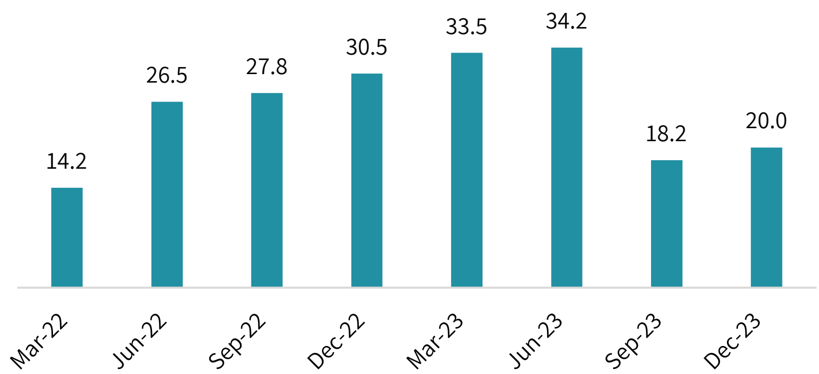
Tier 1 capital in the banking system increased by approximately 12.3 percent during 2023, reaching about NIS 177 billion (Table 12). The growth rate (in annual terms) during 2023 was similar to that in 2022 (12.1 percent) and is higher than the average during 2020–21 (7.7 percent). This increase in capital was due to the high profitability of the banking system during the year (net profit of NIS 25.8 billion in 2023 and NIS 24.3 billion in 2022; for more details, see Chapter 3.1 in this survey), as well as the increase in the value of the available-for-sale bond portfolio (an increase of about NIS 1.7 billion, compared to a decline of about NIS 7.2 billion during 2022;[1] for more details, see Chapter 2

[1] During 2022, the erosion in the value of the available-for-sale portfolio was offset by a decrease of about NIS 3.4 billion in liabilities for worker benefits.

in this survey). However, at the same time, the distribution of dividends totaling NIS 7.8 billion since the beginning of the year moderated the increase in capital. Additionally, there was a reduction in the dividend payout ratio during the second half of 2023 (Figure 4.2), which contributed to the accelerated rate of capital accumulation, partly due to a letter from the Supervisor of Banks to the banking system, urging a reconsideration of dividend policy in light of the consequences of the Swords of Iron War and the uncertainty regarding potential developments.[2]

**The dividend payout rate declined during the second half of the year.**

**Figure 4.2** Dividend Distribution as a Share of Net Profit, Total Banking System, 2022–2023 (percent)




**SOURCE:** Based on published financial statements.

**Risk-weighted assets grew by 7.6 percent during 2023 (Table 12), which was lower than the average growth rate of 11.8 percent over the past two years.** The moderation in the growth rate of risk-weighted assets is mainly due to a slowdown in the growth rate of credit risk assets, (which account for about 92 percent of total risk-weighted assets), especially in the second half of the year and despite the increase in the growth rate of operational risk assets and market risk assets during the year. The growth rate of credit risk assets in 2023 was 6.7 percent, which was lower than the average annual growth rate of 12.2 percent recorded in 2021–22, due to the slowdown in the growth rate of the credit portfolio during the year (for more details, see Chapter 5.2 in this survey). In contrast, the growth rate of risk-weighted operational assets continued to rise in 2023: to 19.7 percent in 2023 and to 14.4 percent in 2022, as compared to an average annual growth rate of 4.5 percent in 2020–21. The increase in operational risk assets is due to the rise in bank profitability over the past two years, as banks apply the standardized approach for calculating operational risk assets, which is based on the banks' profitability over a three-year period.[3] Market risk assets grew by about 4.7 percent in 2023 (compared to a decrease of 0.6 percent in 2022), partly due

[2] See letter number 202339 dated November 12, 2023 and letter number 202405 dated March 5, 2024 on capital planning and dividend policy.

[3] For further details, see Proper Conduct of Banking Business Directive 206 – Operational Risk.

to market uncertainty and volatility. **It is worth mentioning that Israel's credit rating affects capital requirements for banks' exposures to the Israeli government,[4] public sector entities, institutional entities, and banks. According to the banks' assessments in their financial reports for the end of 2023, the impact of the downgrade of Israel's credit rating by S&P in April 2024 is expected to result in a reduction of about 0.2 percentage points in the Tier 1 capital ratio.[5]**

**As in the case of the Tier 1 capital ratio, the total capital ratio also improved during 2023, to approximately 14.4 percent (compared to 13.9 percent at the end of 2022; Table 12).** The improvement is partly due to an increase of about NIS 1.9 billion in the collective allowance for credit losses recognized as Tier 2 capital.[6]

**The trend of improvement in the leverage ratio continued, and as of the end of 2023, it was 6.5 percent for the entire banking system, compared to 6.1 percent at the end of 2022** (Table 13). The improvement in the banking system's leverage ratio during 2023 is due to a higher growth rate in Tier 1 capital (12.3 percent) compared to the increase in total exposures (5.4 percent). **The slowdown in the growth rate of total exposures is due to the moderation in the growth of balance-sheet exposures** over the past two years, which constitute about 87 percent of the system's total exposures (growth rates of 5.3 percent and 4.9 percent in 2023 and 2022, respectively, compared to an average growth rate of 16.8 percent in 2020–21). The slowdown in the growth rate of balance-sheet exposures is partly due to the deceleration in the growth rate of bank balance sheets (for more details, see Chapter 2 in this survey), mainly against the backdrop of the slowdown in the growth rate of the credit portfolio in the second half of 2023.

4 Exposures of banking corporations to the government of Israel and the Bank of Israel that are denominated in foreign currency or paid in foreign currency.

5 On Friday, February 9, 2024, Moody's announced the downgrade of Israel's credit rating from A1 to A2 with a negative outlook. However, the downgrade did not affect the allocation of credit risk assets, since all banks except Bank Leumi, which uses credit ratings from three agencies (S&P, Fitch, and Moody's), rely solely on S&P ratings.

The downgrade of Israel's credit rating by S&P on April 18, 2024 will lead to an increase in the credit risk assets of the banks and a deterioration of capital ratios across all banks in the system, except for Bank Leumi, which already allocates capital based on the stricter rating. The impact on the Tier 1 capital ratio, as disclosed in the financial reports, ranges from a decrease of 0.1 percentage points to 0.24 percentage points.

6 The collective provisions before the effect of tax for inclusion in Tier 2 capital should not exceed 1.25 percent of the total risk-weighted assets for credit risk calculated using the standard approach. For further details, see Proper Conduct of Banking Business Directive 202 – Regulatory Capital.