

CHAPTER 3

ACTIVITY OF THE BANKING SUPERVISION DEPARTMENT

The main function of the Banking Supervision Department is to maintain the stability and resilience of the banking system, with the goal of providing optimal protection to the public. Within this context, the Banking Supervision Department seeks to strengthen the framework for the management of risks and capital by the banks, to increase the competition and efficiency in the system and to maintain fairness in the relations between banks and their customers. These activities are intended to protect the public's financial assets, as well as to ensure continuity of banking activity and fair pricing of banking services.

In 2011, the activity of the Banking Supervision Department focused on strengthening the ongoing monitoring of the banking corporations, in light of the developments and risks in the global and domestic environments. At the same time, the Banking Supervision Department strove to introduce international standards of risk management and corporate governance, and in particular sought to strengthen capital adequacy in the banking system, as part of the preparations for implementing Basel III in Israel.

This chapter is composed of three parts: The first reviews in detail the main activities of the Banking Supervision Department in 2011 to strengthen the resilience of the banking system and to increase its competitiveness and proper conduct. The second describes the organizational structure of the Banking Supervision Department and the third lists the supervisory activities that took place in 2011.

1. PRINCIPAL ACTIVITIES OF THE BANKING SUPERVISION DEPARTMENT IN 2011

During 2011, the Banking Supervision Department strengthened its ongoing monitoring and auditing of banking activity and made its position clear to each bank regarding the capital targets appropriate to its risk profile and its risk management and internal auditing methods. This was carried out in light of recent developments in the global and local environments, which included an increase of risk in global markets, particularly in Europe, the developments in the domestic capital market and the increase in asset prices. As a result, Banking Supervision broadened its disclosure requirements for the banks' financial statements and for the banks' reporting to Banking Supervision and strengthened the ongoing relations with the executives of the banks. With regard to the evaluation of risk concentrations, emphasis was placed on housing loans and on credit to the construction and real estate industry and to the large borrowers in the economy. The risks and threats were analyzed from a forward-looking perspective using new methods and various stress tests. In addition, the Banking Supervision Department promoted the preparedness of the banking system for business continuity and reinforced the management of operational risk at the banking corporations and their emergency preparedness.

In view of the developments in global regulation, Banking Supervision continued to work toward the adoption of international standards for risk management, capital and corporate governance, while preparing for the implementation of Basel III in Israel. These measures, accompanied by ongoing cooperation with regulators in Israel and abroad, positioned Israel's banking system on a par with leading banking systems in developed countries.

Along with strengthening the banking system's stability, Banking Supervision also worked to enhance the system's competitiveness and fairness, by means of, among other things, the implementation and

enforcement of legislation and directives in the area of bank-customer relations, consumer education for banking customers and the investigation of customer complaints.

a. Ongoing monitoring activities in light of the implementation of a supervisory review process

(1) Examination of risk and capital adequacy

The measures taken by Banking Supervision in 2011 were a direct continuation of those in previous years, which were aimed at strengthening capital adequacy in the banking system, improving the process of identifying and monitoring risks, developing appropriate infrastructure for risk management and strengthening corporate governance. During the course of the year, Banking Supervision worked to evaluate the activity of the banks with respect to their risk profiles and to analyze changes in the economic environment, with the goal of influencing their capital planning and risk management processes.

In accordance with the decided-upon work processes, the banks submitted ICAAP¹ (Internal Capital Adequacy Assessment Process) reports in May 2011. These included an internal evaluation of their capital adequacy relative to their risk profile and their strategy for ensuring capital adequacy. These reports were examined and analyzed by Banking Supervision, in order to formulate supervisory principles on across-the-board issues and improvements and in relation to each individual bank as well. Within this framework, Banking Supervision held numerous discussions in various forums, and maintained a dialog with each individual bank. At the end of this process, an overall risk profile was created for each bank. In addition, the banks were required to adopt corrective measures, including the strengthening of corporate governance, risk management and internal auditing.

As part of this process, Banking Supervision formulated its position regarding capital adequacy and the capital targets the banks had set for themselves, the main weaknesses in corporate governance and risk management and the main challenges that require forward-looking managerial attention. These and other findings were communicated to the banks through correspondence and at meetings held with the banking corporations' executives and boards of directors.

As part of this effort, the banks were required to formulate capital targets and plans with upward-sloping paths that resemble the actual capital ratios (core and overall) of comparable banks in developed countries and that reflect the guidelines for Israeli banks, in view of global developments.

(2) Banking Supervision Department activity in the area of corporate governance

This year, the Banking Supervision Department continued taking measures to evaluate the quality of banks' corporate governance, including the performance of the board of directors, senior management, the chief risk officer and internal auditing, relative to the requirements of best practice and of the Supervisor of Banks.

In December 2010, Proper Conduct of Banking Business Directive 301 regarding the Board of Directors was revised. As part of the revision, the function of the board of directors as a strategy maker and as the supervisor of the bank's executive was more clearly defined, while the functions of the executive are related primarily to day-to-day management. As part of the new directive, the banks' boards of directors are required, as a rule, to avoid intervening in the ongoing management of credit and their authority to approve

¹ For further details, see the Annual Survey of Israel's Banking System for 2009, Box 4.2.

deviations from established credit policy was narrowed; they are to focus on creating adequate systems for control and supervision of the executive's activities and its jurisdiction.

In 2011, Banking Supervision held a large number of discussions in a variety of forums in order to formulate supervisory principles related to the implementation of the new directive and evaluated the plans submitted by the banks based on those principles. As part of the effort to reduce the involvement of the board of directors in the credit approval process, the banks were asked to examine, among other things, the integrity of their credit policy, the appropriateness of their credit approval process and its documentation, and their monitoring and control mechanism in its very layers. Emphasis was placed on strengthening the board of directors' means of supervision and control, enhancing the procedures for reporting to the board of directors and developing additional control tools that are appropriate to the new structure of authority.

b. Reinforcing the supervision and monitoring of developments in the global environment

(1) Increasing the frequency of reporting and communication with the banks

In view of the developments in global markets, including the debt crisis in Europe, Banking Supervision closely monitored the activity of Israel's banking system. Within this framework, it maintained ongoing contact with the executives of the banks, received data and weekly reports on actual exposures and assessed the measures taken by the banks. Banking Supervision closely monitored the potential exposures of the banks to global markets, including credit exposures, direct and indirect exposure to countries and foreign financial institutions and exposures implicit in the nostro portfolios and compensation funds; verified that the banks are maintaining adequate processes to monitor exposure; and if necessary demanded that they reduce exposures, including by proactive measures.

In this context, special emphasis was placed on the managerial preparedness of the banks for global developments and their effect on the domestic market. The Banking Supervision Department carefully assessed the results of scenarios developed by the banks, as part of the risk management process, with regard to potential developments and stress scenarios in global markets and their effect on the resiliency of the banks and their capital adequacy.

(2) Expanding the disclosure requirements in financial statements and in reports to Banking Supervision

In 2011, in light of macroeconomic developments in the local and international markets, potential risks to the banks were identified, and Banking Supervision responded accordingly by requiring reports with greater detail and a higher frequency of reporting.

Later in this process, a significant increase was detected in the volume of the banks' activity in certain foreign currency derivative instruments, and as a result more detailed information was requested on this type of activity. The required information included the breakdown of transactions into shekels and foreign currency, with segmentation into standard futures contracts on the exchange rates, forward contracts on exchange rates and currency swaps and various types of options and spot transactions.

In addition, due to the need for detailed information on the exposure of banks to foreign countries, beyond what is contained in the financial statements, and also according to segment and geographic region, two new reporting directives were added to the set of directives for reporting to Banking Supervision. The first is Directive 834 "Exposure to Foreign Countries" which requires the reporting of detailed information on exposure (both balance sheet and off-balance sheet) to each foreign country separately. The second is

Directive 856 “Types of Activity and Geographic Regions” which requires the reporting of information by segment, i.e., households, private banking, small businesses, the commerce sector and the business sector, as well as information according to geographic region, i.e., North America, South and Central America, Western Europe, Eastern Europe, Africa and the Far East.

(3) Macroprudential framework

As a result of the increased risk and developments in global markets and as part of the lessons with regard to macroprudential policy which were learned from the crisis, cooperation was expanded between the departments at the Bank of Israel, primarily between the Banking Supervision Department, and the Research Department and Market Operations Department, and a joint working framework was created for macroprudential policy.

As part of this framework, Banking Supervision receives surveys and internal analyses on a regular basis from other departments and in particular information on developments in global markets, analysis of these developments and their implications for local economic activity and analysis of local risks. Banking Supervision makes use of this information and the assessments in its analysis of possible implications for the banks in Israel and also in quantitatively estimating the risks that the banks are exposed to.

A macroprudential team, composed of representatives of the Banking Supervision Department, the Research Department and the Market Operations Department, holds joint discussions on developing threats and possible channels of contagion to the financial system as a whole and in particular to the banking system. These discussions are based on papers produced by the departments, including stress tests for the banking system and the financial system as a whole, analysis of trends in asset prices and the supply of credit, analysis of developments in the corporate bond market, etc. The papers and conclusions of the macroprudential group are submitted to the senior management of the Bank of Israel and are discussed on a regular basis in various forums, including meetings of the Monetary Committee, and are used to support the decisions of policy makers.

c. Increasing the supervision and monitoring of risk in the local environment

(1) Housing credit

In view of the rise in housing prices and the growth in the volume of mortgages during the first few months of 2011, Banking Supervision devoted supervisory resources and attention to this area. In this context, Banking Supervision required expanded disclosure of housing loans in financial statements and that a detailed discussion of the development of risk in the housing loan portfolio be included in them, as well as the measures taken in order to deal with these risks and manage them. In addition, Banking Supervision published comprehensive amendments to the directives for reporting to Banking Supervision with regard to housing loans. These included, among other things, the receipt of new information on loans according to financing rates, the value of the asset and the ratio of repayment to income, information on recycling, investment apartments and loans to foreign residents.²

During the course of the year, Banking Supervision carried out comprehensive reviews of the banks that provide mortgages, with the goal of evaluating their strategy in the provision of housing loans and

² See below: Section 3.4.

the adequacy of their underwriting policy, identifying deviations from that policy, and obtaining a detailed picture of the risk characteristics of the loan portfolios.

In addition, Banking Supervision closely monitored the development of the banks' housing credit, including comprehensive analysis on a regular basis, dialog with professionals at the bank and meetings with senior executives and the board of directors, which took place against the background of a highly competitive mortgage market.

In light of the implementation of the directive regarding the measurement of impaired debts, credit risk, and allowance for credit losses, Banking Supervision required that banking corporations create a sufficiently large collective allowance for housing loans, to take into account the allowance's lower rate of coverage in the mortgage portfolio. This followed the rapid growth recorded in housing credit in recent years, which has not yet been manifested in the allowances according to the extent of the arrears.²

In view of the high proportion of new housing loans provided at variable interest rates and the risk implicit in a possible rise in the interest rate, the Banking Supervision Department limited the variable-rate component to one-third of the total loan. This guideline led to a significant change in the composition of new mortgages and was one of a package of measures adopted by the Bank of Israel, the Prime Minister's Office, the Ministry of Finance and the Ministry of Construction and Housing, with full cooperation between them.

(2) Credit to large borrowers in the economy

One of the main concerns regarding the stability of the financial system during the second half of 2011 involved developments in the corporate bond market. Banking Supervision receives detailed information on the banks' large borrowers on a regular basis and monitors whether the banks are within the limits on the exposure to these borrowers. In addition, Banking Supervision evaluates the risk implicit in leveraged credit, such as credit for acquiring means of control. During 2011, the Banking Supervision Department tightened the limits that apply to the indebtedness of a borrower and a group of borrowers. Thus, the maximum exposure of each bank to a group of borrowers was set at 25 percent of the bank's capital base (instead of 30 percent previously), and total exposure to borrowers and borrower groups, whose individual exposure exceeds 10 percent of the bank's capital base, was limited to 120 percent of its capital base. This limit was also applied to the exposure to other banks.

As a result of the increase in yields in the corporate bond market and the increase in the number of debt restructuring arrangements, together with the concentration that is characteristic of the banks' credit portfolios, Banking Supervision decided to take a number of focused steps: it carried out a careful evaluation of the credit portfolios of the economy's large borrowers and even demanded additional disclosure in financial statements; it reviewed the structure of the companies and analyzed their activity in the capital market, including bonds' maturities; and received reports on the composition of collateral and how it had been handled by the banks. On the basis of these efforts, Banking Supervision took measures when they were called for.

(3) Credit to the construction and real estate industry

As part of the expanded supervision and monitoring of risks in the local environment, the exposure to the construction and real estate industry was given special attention. As part of this effort, an assessment was made of, among other things, the structural risks implicit in the industry's activity, strategy and policy documents and the main constraints on its activity and, in addition, an evaluation was carried out of the various control functions and the quality of corporate governance within the industry. This effort included

ongoing dialog with the banks. At the conclusion of this process, a risk evaluation was carried out and corrective measures were required of the banks, including the strengthening of corporate governance, risk management and internal auditing.

Special emphasis was placed on the results of specific scenarios developed by the banks, as part of the risk management process, with respect to their credit portfolio and in particular with respect to the level of concentration, by borrower and by industry, and its effect on the resilience of the banks and their capital adequacy. In cases where it was felt that the level of structural risk reflected an excessive risk appetite, Banking Supervision required that this exposure be reduced.

(4) Enhancement of the system's preparedness for business continuity

In 2011, Banking Supervision also focused on enhancing the banking system's preparedness for business continuity during a crisis. In this context, the Supervisor published a Proper Conduct of Banking Business Directive on December 25, 2011, concerning "Management of Business Continuity". The directive is one of the steps taken by Banking Supervision to strengthen the management of operational risk and the banks' preparedness for a crisis and is based on generally accepted standards for the management of business continuity. As part of this, a working framework for the management of business continuity was created and included the following components: (a) analysis of the business implications of a crisis situation, including identification and evaluation of the risks and their potential effect on the bank; (b) the recovery strategy, which defines targets for the level of service that a bank will seek to provide in the event of disruptions, including the lengths of time needed to renew those services; (c) a business continuity plan, which defines, among other things, the functions, areas of responsibility and decision making authority in the event of disruptions, as well as the conditions for activating that authority; and (d) monitoring of risk and a plan for simulation and assimilation.

In order to reduce the risk to the recovery ability of a bank that is reliant on vendors and service providers for critical processes, conditions were stipulated which should be considered by banks for inclusion in the contracts with these suppliers. In addition, the directive specifies guidelines for the location of infrastructure and the operation of an alternative site, which will be maintained in a state of preparedness and will enable the bank to maintain business continuity in the event that the operations of the main site are compromised.

In 2011, Banking Supervision, in its role as an essential component of the financial system in an emergency, participated in a national exercise called "Turning Point 5", which simulated a scenario of an all-out war. The banking system was included in the exercise for the first time.

During 2011, following the escalation in the South, Banking Supervision closely monitored events and adjusted its guidelines to the banks to be consistent with those issued by the Home Front Command. All the bank branches operated as usual and protective shelters were placed at some of them. The banks' executives kept abreast of the situation and some of them even toured the branches in the South.

d. Reinforcing the Banking Supervision Department's methods of analysis

During 2011, Banking Supervision emphasized the development and reinforcement of methods for analyzing and estimating the risks on the level of the individual bank and that of the banking system as a whole.

(1) Improving the database

Use was made of new databases in 2011 for the purpose of analyzing the development of the risks faced by the banks. In this context, capital market data was used, which involved combining data from the capital market

with disaggregated data on the exposure of the banks to borrowers, and the use of additional databases, in order to evaluate the probability of default among borrowers active in the capital market. Information was gathered on foreign financial institutions in order to evaluate, among other things, developments on the industry level. The improvement in the rules for the measurement of impaired debts and the credit loss allowance led to an enhanced ability to evaluate credit risk in the banking system, which involved international comparisons and the use of generally accepted indexes for measuring credit risk. In addition, the detailed information received by Banking Supervision on the main risk focuses—such as housing credit, the exposure to foreign countries and financial institutions and exposure by sector—provided a broad base for in-depth analyses of developments in the risks to the banking system.

(2) Development of methods for evaluation of risk concentrations and the conducting of stress tests

In 2011, Banking Supervision conducted various new stress tests for the assessment of risk. Within this framework, macroeconomic stress tests were carried out in order to evaluate the effects of local and global stress scenarios. This test was carried out in cooperation with the Research Department and with the assistance of IMF experts. Thus, the Research Department built the scenarios and forecasts of the macro variables by means of the econometric model (DSGE) used for monetary policy and other tools, and estimated the effect of selected shocks on a group of macroeconomic variables which the Banking Supervision Department requires in the models it employs. Banking Supervision linked the changes in the macroeconomic variables to the risk concentrations in the banking system, using a number of satellite models developed by its Economics Unit. In addition, Banking Supervision estimated the effect of the risk variables on the banks' profit and loss and on their capital adequacy and that of the banking system as a whole.

In addition, Banking Supervision prepared stress scenarios for assessing the development of the sovereign debt crisis, focusing on risk factors that are specific to the banking system, such as the collapse of large borrowers, and covering borrowers that are active in the capital market, credit for acquiring means of control, exposure to foreign financial institutions, etc.

Banking Supervision also carries out sensitivity analyses of the risk from borrower concentration, interest rate risk and exchange rate risk and carries out sensitivity analyses of liquidity using an internal model for assessing liquidity risk.

The development of new methods involved meetings with representatives of the relevant supervisory authorities, participation in seminars, studying newly published material and the introduction of new databases, as mentioned above.

e. Efforts to introduce international standards for managing risk, capital, and corporate governance

(1) Project to accelerate the adoption of appropriate procedures

One of the main tasks of Banking Supervision this year was the continuing introduction of principles for optimal risk management and corporate governance within the banking system.

The Proper Conduct of Banking Business Directives issued this year, which are listed below, reflected the adoption of the Basel approach to risk management and the experience accumulated by Banking Supervision. The crisis in the financial markets, which began in mid-2007 and led to significant financial losses, revealed that many banks worldwide had not fully analyzed the risks implicit in their activity and

had not followed the basic principles of correct judgment and prudent risk management. The directives reflect, among other things, lessons learned from the crisis and reinforce the manner in which banks should manage the risks they have identified and control them.

On the basis of a survey that was aimed at identifying regulatory gaps between the Supervisor's directives and the recommendations of the Basel Committee, it was decided to focus banking regulation in 2011 on five issues:

- **Internal audit:** Banking Supervision issued Proper Conduct of a Banking Business Directive 307 on the "Internal Audit Function", which is based on Basel Committee guidelines, the Banking Legislation Directives (Internal Audit), 1992, other local legislation and regulations and on relevant international sources. The Directive deals with, among other things, the characteristics required for the internal audit function to fulfill its role efficiently and effectively. These characteristics include status, independence, resources, the role of internal audit in providing assistance to the executive and the board of directors in the fulfillment of their duties, the scope of its activity, the work methods of internal audit and its reporting functions, and the internal auditor at the head of internal auditing.
- **Credit risk (draft):** Proper Conduct of Banking Business Directives that deal with various issues related to credit risk were revised and reorganized. Some of the regulatory requirements and expectations included in the draft of the new directives are already familiar to the banks and are already being implemented by them. The revision achieves greater clarity for existing standards and adds new ones as needed. Following is a description of the main changes:

Banking Supervision published a draft Proper Conduct of Banking Business Directive with regard to "Principles of Credit Risk Management". The draft of the new directive describes the supervisory requirements with respect to risk strategy, risk policy, the structure of risk management and the allocation of responsibilities, the credit approval process and mechanisms for supervision and control, including a mechanism for independent and ongoing review of credit risk management processes and credit ratings. The new directive adopts an approach that ensures good credit decision making and neutralizes irrelevant considerations and calls for a high level of involvement by an independent entity in the business units.

Proper Conduct of Banking Business Directive 314 concerning the "Dealing with Problem Debt" was replaced by a directive on "Proper Assessment of Credit Risks and Proper Measurement of Debts". The Directive is consistent with the directives for reporting to the public with regard to the classification of debts and it provides principles for creating appropriate processes for the evaluation and measurement of credit risk and control over these processes, as well as the processes for classifying debts and determining allowances for credit losses.

Proper Conduct of Banking Business Directive 319 concerning "Credit Control" was revised such that its provisions were brought in line with advanced systems for credit risk management. The Directive's goal is to guide the activity of the Credit Control Unit towards optimal working methods, through the introduction of quantitative requirements in areas such as the functions of the Unit, to whom it reports to in the organization, the training of its workers, its work plan and the Unit's reports.

- **Risk Management (draft):** Proper Conduct of Banking Business Directive 339 concerning "Risk Management" was revised. The revised Directive is based on the guidelines formulated by the Basel Committee in October 2010 and July 2009. The Directive sets out fundamental principles for the management and control of risk from an integrated and pan-organizational viewpoint, with the goal of strengthening the ability of the banks to identify and manage risk in a way that will be appropriately

reflected in the activity of the bank, in the adequacy of its capital and in its decision making processes. For further details, see Box 3.1.

- **Operational Risk** (draft): A new Proper Conduct of Banking Business Directive was issued concerning “Operational Risk Management”, which is primarily based on the Basel guidelines. The Directive sets out the basic components for the management of operational risk, which relates to issues of corporate governance and the risk management environment. These include:
 - A strong organizational culture that sets standards and provides incentives for professional and responsible behavior.
 - A work framework for the management of operational risk which is composed of policies, processes and systems that are effectively implemented at all levels of decision making and for all products, activities, processes and major systems, and in accordance with the bank’s risk appetite and tolerance.
 - Efficient management of operational risk, including identification and evaluation, monitoring and reporting, control and risk reduction.
 - Plans for maintaining business resilience and continuity, in order to ensure the ability of the banks to maintain their normal activity and reduce losses in the case of a major disruption of business activity.
- **Liquidity Risk** (draft): Proper Conduct of Banking Business Directive 342 was revised so as to reflect current supervisory expectations with regard to meeting a minimum liquidity ratio, management of liquidity risk on a consolidated basis, evaluation of a long-term liquidity ratio (stable financing ratio) and use of tools and indices to monitor this risk. The changes also constitute an interim stage towards adopting the requirements of Basel II in the area of liquidity. Part of the regulatory activity includes revisions and interpretations of existing directives regarding various issues, which arise as a result of questions from the banking system or as a result of Basel Committee publications and by means of question and answer documents that are updated from time to time. So far, question and answer documents have been published on a variety of subjects, such as housing loans, impaired debts and credit loss allowances and Directive 301 concerning capital adequacy.

Box 3.1: Master directive on risk management

Within the framework of updating Proper Conduct of Banking Business Directives and adjusting them for the Basel framework, the Banking Supervision Department published a draft proposal for an update of the directive on “Risk Management”. The directive serves as a master directive for firm-wide risk management, and also refers to management of specific risks, as it delineates the primary principles of risk management. These primary principles refer to, among other things, corporate governance and the roles of various functions with regard to risk management at the banks, the internal control system which includes three lines of defense, as well as risk management processes.

Firm-wide risk management

The directive establishes the primary principles for firm-wide risk management and control, which will strengthen the ability of banks to identify risks and manage them. This is so that the risks will be

appropriately reflected in the bank's activities, in assessing capital adequacy, and in decision making processes. These principles reflect the lessons learned from the financial crisis, which began in mid-2007, in particular the need to properly identify and measure the range of risks, in light of the many challenges posed by the modern financial system.

Three lines of defense

The draft directive establishes the framework for establishing a proper risk management system by defining three lines of defense:

- Business line management—bears the responsibility for identifying and managing the inherent risks in products, activities, processes, and systems for which they are accountable.
- Risk management function—a function independent of lines of business, which serves as a second line of defense and is responsible for the planning, maintenance, and development of a risk management framework. One of the central objectives of the function is to challenge the risk management of the business lines and to examine its comprehensiveness and effectiveness.
- Internal audit—serves as a third line of defense, examines the appropriateness and effectiveness of the administrative procedures of the first two lines of defense, and reveals weaknesses in controls.

Risk management process

The draft directive sharpens the need to implement a proper culture of risk, arranges the risk management governance in the banking corporation, and defines the basic principles of the credit management procedure:

The Board of Directors must outline the **appetite for risk**—the maximum risk level that the corporation is willing to take on itself. Setting the appetite for risk is one of the central tools that the Board has in overseeing the corporation in a Top-Down approach.

The banking corporation's management must formulate, integrate, and implement the **risk management framework** derived from the appetite for risk and establish policies, specific limitations, procedures, and controls for the management of each risk and of total risk.

A quarterly **risk document** aids the Board of Directors to oversee the banking corporation's risk profile and verify that it does not deviate from the appetite for risk that was set. This document presents the developments in the risk profile and risk factors with regard to the appetite for risk and the limitations set in the framework. In addition, the document presents the effect of external and internal changes in the risk profile, deviation from policy, stress tests results, and weak points in the risk management structure.

The banking corporation is required to examine the need for updating risk management procedures in light of changes in the external environment, in the scope of business activities, the control environment, new products, etc. The draft directive regulates the required process of authorizing new products or activities as well as significant changes in existing products.

Chief Risk Officer and the risk management function

The draft directive regulates the position, independence, and responsibility of the Chief Risk Officer (CRO), who heads the risk management function, The CRO must report directly to the CEO and the

Board of Directors, and he or she must emphasize to them issues to which they should pay attention, from a risk management perspective, such as risk concentrations or deviation from the risk appetite.

The directive also clarifies the roles of the risk management function in various areas, such as formulating the risk appetite and the risk management framework, the process of assessing capital adequacy and liquidity, the process of approving new products as well as approving and validation of models.

The function is required to be involved in the risk management process in the banking corporation, to the extent that its views represent an important part of the considerations in reaching business decisions.

The directive emphasizes the independence (professional and organizational) of the risk management function in the lines of business and that its compensation must not be based directly on the revenue of the business lines. Nonetheless, the intention is not that the function be unconnected to the business lines; it is important that it understand the business activities and have access to critical data. The corporations are required to confirm that the function is staffed with quality, experienced and trained employees, and that it is allocated resources that are adequate for fulfilling its function and challenging the business lines as required.

Identification, measurement and assessment, monitoring, and reporting risks

The draft directive delineates quality demands regarding methodologies for identification, measurement, and assessment of risks, particularly through models and stress scenarios. In addition, the directive delineates requirements for a management information system and a reporting system which are critical for effective monitoring of risk.

The Banking Supervision Department is still conducting discussions with the banking corporations on the directive.

(2) Strengthening of capital adequacy as part of the implementation of Basel III in Israel

As part of the lessons learned from the crisis, the Basel III recommendations, entitled “A Global Regulatory Framework for More Resilient Banks and Banking Systems”, were published in December 2010. For the main points of the recommendations, see Box 2.4 in the Annual Survey of the Banking System for 2010: The Strengthening of the Regulatory Capital Framework (Basel III). In June 2011, the Supervisor of Banks declared that the banking system in Israel would adopt the Basel III recommendations when finalized, with making the necessary modifications where needed. In addition, revisions have been published to the Basel II framework regarding the measurement of capital and capital adequacy.

In October 2011, the Supervisor of Banks announced the establishment of working groups that will submit professional recommendations with regard to the adoption of the Basel III recommendations, in cooperation with the banking system. Within this framework, the following groups were created: a capital requirements group, a capital instruments and capital base group, a market and derivatives risk group, and a liquidity group.

In March 2012, the Supervisor of Banks published new capital requirements for the banking system, according to which the banks must meet a minimum common equity tier 1 capital ratio of 9 percent (instead of 7.5 percent previously) by January 1st, 2015. In addition, it was decided that a bank—the total assets of which (on a consolidated basis) constitute at least 20 percent of the banking system’s total assets — would

be required to increase its minimal common equity tier 1 capital ratio by one percentage point, i.e., to 10 percent, by January 1st, 2017. This requirement applies to Bank Hapoalim and Bank Leumi, each of which account for more than 20 percent of the banking system's total assets.

f. Amendment of banking legislation

Already in September 2004, an amendment was made to the banking laws, i.e., the Banking (Licensing) Law and the Banking Ordinances, (known as the "Marani Amendment"), which made it possible to operate a bank without controlling shareholders. Since then, there have been two possible structures for the holding of a bank: controlling shareholders and dispersed holding. Each of these structures has advantages and disadvantages and it is the job of the Bank of Israel to provide a solution to the weakness implicit in each structure.

In practice, during the years since the Marani Amendment, none of the banks has switched to the dispersed structure.³ Nonetheless, following a reexamination of the legal framework regarding a bank without controlling shareholders, Banking Supervision initiated another proposed amendment to the banking laws during the course of 2010, in coordination with other regulators. In March 2012, the legislative process was completed and the Banking Law (legislative amendments), 5772–2012 (hereafter: the Amendment) went into effect on March 19th, 2012.

The main goals of the Amendment are as follows:

Creation of balance in a bank without controlling shareholders between the need to prevent actual control of the bank without a permit from the Governor of the Bank of Israel and the rights of shareholders to propose candidates to serve on the board of directors and to work for them to be elected. The right to appoint a director is a significant one and if it is not restricted can lead to a situation in which the bank's activity can be controlled. Someone who wishes to control a bank can do so by obtaining a permit from the Governor of the Bank of Israel, which includes, among other things, a process to examine the applicant's integrity and financial resilience.

Strengthening of the ability to supervise a bank without controlling shareholders.

Increasing the transparency and "market discipline" in the process of choosing a bank's directors, whether it has controlling shareholders or not.

The main changes made as part of the amendment were in the following areas:

- (a) Proposal of candidates to become directors in a bank without controlling shareholders;
- (b) The suitability of directors in a bank without controlling shareholders;
- (c) The obligations to report on the means of control in a bank;
- (d) The committee for choosing directors;
- (e) Additional issues in a bank without controlling shareholders;
- (f) The appointment, service and termination of service of directors in a bank that is a publicly traded company;
- (g) Confirmation that a position holder is fit and proper.

³ Starting from March 24, 2012, Bank Leumi Ltd. has been defined as a bank without controlling shareholders. In addition, it may occur that the controlling shareholders in other banks will disperse control, so that the bank will come to operate without controlling shareholders. This may occur if the controlling shareholders wish to sell their investment in a bank and are unable to find an appropriate buyer who is able to obtain a permit for control of the bank or due to the need to sell their holdings in the bank or in a real corporation as a result of the recommendations of the Committee for Increasing Competitiveness in the Economy.

Box 3.2: FSAP—the process, coverage, and results**What is the assessment?**

The Financial Sector Assessment Program (FSAP) is a comprehensive and extensive evaluation of the country's financial sector, arranged by the International Monetary Fund (IMF). The evaluation is focused on two aspects—the assessment of the stability of the financial sector, including the quality of its supervision and the regulation of its activity, and the assessment of the potential contribution of this sector to economic growth and development. The evaluation's findings serve as an input in a wider assessment of the overall economy prepared by the IMF (an assessment known as Article IV). The FSAP is conducted at the request of the country being examined. Since most countries request the evaluation, there is strong competition for the resources allocated to it by the IMF. For countries whose financial system is considered by the IMF to be important to the global system, the IMF recommends the evaluation, and the country may not deny the request. FSAP results are published for the general public on the IMF website.

The FSAP evaluation in Israel

The last evaluation of the financial system in Israel was conducted in 2001. Since then, there have been dramatic changes in both the financial system and in supervisory regulations around the world, so the Minister of Finance and the Governor of the Bank of Israel requested that the IMF conduct a new evaluation. This took place in November 2011.

The current evaluation covered all the entities involved in the supervision and regulation of financial services in Israel, including the Bank of Israel, the Banking Supervision Department, the Ministry of Finance—with an emphasis on its Capital Markets, Insurance, and Savings Division, the Israel Securities Authority, and the Tel Aviv Stock Exchange (TASE).

The evaluation encompassed the following issues: an assessment of the stability of the financial system, including the banking system and the payment and settlement system, an examination of the quality of the supervision of the financial sector—both by an examination of the quality of supervision of each financial regulator and an examination of the method of coverage of specific issues, such as macroprudential stability and handling of a failing financial institution (bank or other).

The evaluation team comprised 12 assessors, most of whom were from the IMF, and some of whom were outside experts. During the course of the assessment, the team met representatives of the entities being assessed and of the Israel Money Laundering and Terror Financing Prohibition Authority, as well as with representatives of the financial institutions, academia, and the private sector.

Assessment of the Banking Supervision Department within the FSAP evaluation

The Banking Supervision Department was evaluated on the basis of a document issued by the Basel Committee in October 2006, “Basel Core Principles for Effective Banking Supervision”. (In December 2011, the Basel Committee published a draft document for discussion, intended to update the core principles for effective banking supervision.)

In addition to examining the quality of supervision in accordance with the core principles, other specific issues were examined, the main ones being stress scenarios and dealing with a bank failure.

The core principles for effective banking supervision include 31 principles. The principles cover the following issues:

1. The supervision's powers and objectives, independence, transparency of operations, and cooperation:
2. The legal and regulatory framework for banking operations, including permitted activities and bank licensing, major shareholders, and the bank's major holdings
3. Supervision of stability-related issues, including regulation and requirements regarding capital adequacy, risk management, credit and concentration risk, market risk, liquidity risk, operational risk, interest rate risk in the bank's portfolio, internal control and audit, and preventing abuse of financial services
4. Supervisory approach and techniques
5. Reporting to supervisory authorities and to the public
6. Corrective and remedial powers of supervisors
7. Consolidated supervision
8. Home-host relationships—the relationship between the banking supervision of a parent bank and the banking supervision authorities of the country hosting an overseas subsidiary of the bank

Findings of the assessment of the Banking Supervision Department

The evaluation team found that the regulation and supervision of the Banking Supervision Department is generally compliant with international standards.

There were only two areas in which the supervision was not fully or partially compliant with the core principles—market risk, and interest rate risk in the banking book. These assessments were based primarily on the fact that the Banking Supervision Department has adopted a different approach than that of the Basel Committee. The Basel Committee sees those risks as two completely distinct risks. Although the Banking Supervision Department believes that its supervisory approach reflects the extent and features of the trading activity of banks in Israel, it intends to implement the recommendations of the evaluation team and introduce changes in the regulation and supervision in those areas, in accordance with the Basel Committee's approach.

Some of the recommendations and notes that were raised in the evaluation are already in various stages of implementation (for example, through regulatory updates and preparation of proposed amendments), and some have already or will be implemented in the Banking Supervision Department's work plan for the current year or in coming years, subject to human resources limits and to required adjustments.

g. Participation in interministerial committees on concentration and competitiveness

(1) The Concentration Committee (the Committee to Increase Competitiveness in the Economy)

In light of the development of business groups in Israel, the Prime Minister, the Minister of Finance and the Governor of the Bank of Israel appointed in October 2010 a committee to examine the level of competitiveness in the economy as a whole and in each industry (“Committee for Increasing Competitiveness in the Economy”). The goal is to achieve a more sophisticated and competitive economy. The Supervisor of Banks, David Zaken, was an active member of the Committee.

In February 2011, the Committee submitted its recommendations. The Committee’s guiding principles were as follows: ensuring that the structure of the economy is efficient and competitive, ensuring an efficient allocation of the public’s money and ensuring the resilience and financial stability of the economy, with as little intervention as possible in the activity of the free market.

(2) Team for examining increasing competitiveness in the banking industry

The Committee for Economic and Social Change (the “Trajtenberg Committee”) examined the factors that determine the cost of living in the economy’s main industries. With respect to the banking industry, the Committee pointed to the concentration in the banking system and other factors that are likely to have an impact on the level of competitiveness in the industry, such as the complexity of the banking product, the difficulty experienced by customers in gathering information for comparison and the asymmetry in information between the banks with regard to the customer’s credit history.

As a result of the Committee’s recommendations, the Governor of the Bank of Israel, Professor Stanley Fisher, and the Minister of Finance, Dr. Yuval Steinitz, appointed an interministerial working team to examine the level of competition in the banking industry. The Supervisor of Banks heads the group, and its members include representatives of the Bank of Israel, the Ministry of Finance, the Ministry of Justice, the National Economic Council and the Anti-Trust Authority. The team was asked to look at various ways of increasing competition in the banking industry and to make recommendations to achieve this goal.

The team began its work at the end of December 2011 and set milestones for itself, with the goal of examining various ways of increasing competitiveness in the banking industry, such as simplifying the banking product, increasing the customer’s bargaining power and improving and upgrading the service given by credit providers, primarily to households and small businesses.

h. Strengthening cooperation with regulators in Israel and abroad

Banking Supervision maintains ties with other bank regulators, with the goal of exchanging relevant information. This is essential in view of the developments in the financial systems and is required by the international standards formulated by the Basel Committee.

In July 2011, a delegation of US bank supervisors from Washington and New York visited Israel and participated in working meetings. During the month of August, a memorandum of understanding was signed between Banking Supervision and the regulatory bodies in the US (the FDIC and FRB), regarding coordination and exchange of regulatory information. In addition, it was agreed that there would be cooperation with other regulators, on such topics as the “fit and proper” criterion.

The Banking Supervision Department also participated in a number of working groups. In June, Israel joined a European regional advisory group within the FSB. In addition, Banking Supervision participated in

the work of the OECD Committee for Financial Markets which examined supervisory policy and regulatory changes and in discussions at the offices of the OECD in Paris.

From July until December 2011, an FSAP⁴ evaluation was carried out in Israel by the IMF and the World Bank. The evaluation focused on Banking Supervision compliance with the core principles of the Basel Committee and international standards regarding the stability of the banking system and whether international standards are being met in the construction and implementation of stress tests. For further details, see Box 3.2.

In this context, Banking Supervision is holding regular meetings with various foreign entities in order to increase transparency and reduce Israel's risk premium, both for the purpose of Israel's sovereign credit rating and the rating of Israeli banks. Ongoing meetings are also being held for the purpose of, among others, sharing information between Banking Supervision and correspondent banks that work with the banking system in Israel.

i. Increasing competitiveness and fairness in the banking system

The Banking Supervision Department acts to increase fairness in relations between the banks and their customers, to enhance competition between banks and to strengthen the position of the customer. These activities include the formulation, implementation and enforcement of legislation and directives in the area of bank-customer relations, providing consumer information to the banks' customers, handling complaints and enquiries from the public, identifying and correcting systemic irregularities and dealing with bank fees and restricted accounts and restricted customers.

1. Legislation and regulation in 2011 for the protection of bank customers

Banking Supervision amends the Proper Conduct of Banking Business Directives and promotes legislation in the area of bank-customer relations. In this context, Banking Supervision presents the position of the Bank of Israel in Knesset committees and ministerial committees on issues of banking consumer protection. There was a high level of activity in the parliamentary area in 2011 with regard to banking consumer protection. This was reflected in the large amount of proposed legislation by Knesset members, which required the professional input of Banking Supervision. Some of the proposed legislation was passed into law already during the course of 2011.

Following is a summary of bank consumer regulation:

a. Proper Bank Management Directives

(1) Directive 431 regarding checkbooks

The potential for loss to customers who use checks with unrestricted negotiability motivated a change in the Banking (Service to Customer) Law, 5741–1981. In accordance with the amendment to the law, amendments were made to Proper Conduct of Banking Business Directive 431 which changed the default for the issuing of checks. Thus, checks issued to individuals who are not corporations must be crossed and must be printed with texts indicating that they are not negotiable. Nonetheless, those customers may request that the bank issue uncrossed checks that do not include the text stating that they are not negotiable.

⁴ For further details, see Box 3.2 above.

This arrangement is meant to prevent situations in which customers, who are not aware of the option to restrict the negotiability of checks by marking them “to payee only”, suffer financial loss—for example, when a transaction to supply a good or service is cancelled but the check that the customer issued has been transferred by the seller to a third party and that third party demands that it be redeemed.

(2) Directive 470 regarding debit cards

In order to improve the ability of a customer to monitor the transactions he carried out with his card and to make it easier to identify the business with which the transaction was made, two disclosure requirements were added to the Directive:

- **Stating the name of the supplier:** In accordance with Proper Conduct of Banking Business Directive 470 (hereinafter: “the Directive”), the issuer must provide information on the monthly statements about the transactions carried out by the customer and for which he has been charged. As part of the amendment of the Directive, a requirement was added that the issuer list on the statement the name of the business as it is presented to the public. This requirement is meant to prevent cases in which a business is known by one name for commercial purposes while in its records and on the statements it is presented under a different name. The lack of consistency between the two makes it difficult for the customer to verify the accuracy of the information on his monthly statement and sometimes leads to unnecessary enquiries to the business and the card issuer.
- **Presentation of the card when a transaction is made:** Another amendment to the Directive specifies that the issuer of the card is to indicate on the statement sent to the customer whether or not the customer’s credit card was presented at the time of the transaction. This requirement is meant to increase the awareness of the customer and to improve his ability to monitor transactions in which his card was not presented to the business (for example, transactions made over the phone or on the Internet). In these transactions, there is greater concern that a card has been misused or fraudulently used by a third party and therefore there is a need to draw the attention of the customer to them. Since the name of the business which the issuer states on the monthly statement is reported to the issuer by the clearinghouse, the issuer must work with the clearinghouse in order to verify that the name presented to him is the commercial name that the business presents to its customers. In special cases, in which it is particularly difficult to present the name of the business as it is known to the public, the Supervisor has the authority to exempt the issuer from fulfilling this requirement, after receiving a detailed request to do so.

(3) Directive 420 concerning the electronic transfer of information

In view of the need to introduce future changes in existing regulations regarding the sending of notices to customers by the banks, Circular 2291-06 of the Supervisor of Banks which lists the notices that are permitted to be sent electronically was integrated into a new Proper Conduct of Banking Business Directive.

The purpose of the Directive is to specify which types of notices can be sent by email or via the bank’s website, instead of by mail.

b. Letters from the Banking Supervision Department

Appeals of account restrictions based on the Checks Without Cover Law, 5741–1981; agreement of the bank to a compromise settlement

A letter was distributed by Banking Supervision on this issue to the banking system with the purpose of clarifying the banks' obligations in managing the legal processes involved in the appeal of a restriction placed on the accounts of their customers according to law.

The banks have a unique status with regard to the Checks Without Cover Law, according to which they represent the public interest by protecting the public against those who write checks with no coverage. Therefore, if a restriction has been placed on a customer, the bank, according to law, is not permitted to negotiate a compromise with the customer and must bring the matter before the courts, as required by law.

c. Enforcement of the banking directives concerning consumer protection

Banking Supervision carries out evaluations of compliance and audits on a regular basis, in order to enforce the existing consumer protection regulations.

Banking Supervision has the authority to place financial sanctions on a bank if it violates one of the Proper Conduct of Banking Business Directives, the Banking (Service to the Customer) Law (Disclosure and Provision of Documents), or the Banking (Service to Customer) Law.

During the course of 2011, the Banking Regulations (Service to the Customer) (Maximum Rates of Reduction of Financial Sanction) 5771–2011 were formulated. The rules provide the Supervisor with the authority to reduce the amount of the maximum financial sanction, given the appropriate circumstances. The imposing of administrative sanctions became more flexible, thus making it possible to fit the sanctions to each individual case.

Banking Supervision attributes great importance to the enforcement of the consumer-related directives. Violations are discovered through the Public Enquiries Unit which is part of the Banking Supervision Department, and also through the involvement of Banking Supervision in class action suits.

2. Consumer information

In 2011, Banking Supervision launched a financial education publicity campaign. The "Taking Responsibility for our Money: Understanding Money Makes You a Winner" program was launched on August 3rd, 2011.

The goal of the program is to expand young peoples' financial knowledge and to provide them with the tools for intelligent economic conduct. The information campaign includes four financial issues: planning a budget and savings; opening a bank account; choosing a bank; and managing a bank account. The topics were chosen with care, and attention was paid to the needs of youth, who are taking their first steps as bank customers.

The campaign presented banking and financial information in a manner that was straightforward and that was young and dynamic. The goal is to present economic concepts, such as the interest rate, linkage, and credit and debit balances, in a clear and interesting manner. In addition to information, advice, and guidance, some short video clips were produced, as well as calculators and other tools developed to assist youth in understanding how to read a bank statement, calculators for savings, budget tables, questions and answers, a glossary of financial terms, and more. Facebook was chosen as the main platform for presenting the information with the goal of reaching youth through a medium that most of them use extensively. The content was also presented on the Bank of Israel website (in Hebrew, English, Russian and Arabic) and at a mobile site that is appropriate for cellular phones.

The information campaign was met with great interest among youth, many of whom visited the program's Facebook page. The site provides youth with an address where they can obtain answers to their questions in the area of banking consumer protection and is also a platform for Banking Supervision to present professional consumer issues.

3. Handling public enquiries and complaints⁵

One of the division's core activities is handling customers' enquiries and customers' complaints against the banking corporations, and detecting systemic problems from the processing of complaints. This activity is centered in the Public Enquiries and Bank Fees Unit, and includes deciding on complaints while providing suitable relief if necessary, supplying information to the banks' customers in order to reduce the information gaps between them and the banking corporations, and the detection and correction of systemic irregularities.

The Public Enquiries Unit operates under Section 16 of the Banking Law (Service to the Customer), 5741–1981, which confers the Supervisor of Banks with the authority to clarify the public's complaints regarding their activities with the banking corporations. The unit comprises economists, lawyers and accountants, and serves as an objective external body for deciding on disputes between the banks and their customers in accordance with legal principles and in view of the value of fairness in bank-customer relations.

In 2011 the Banking Supervision Department processed 5,889 written enquiries and complaints from customers of the banks and credit card companies (not including complaints to the call center, which are estimated at 17,000 a year), of which 1,902 were complaints and the rest were enquiries and requests. A position was determined with respect to 1,323 complaints—justified or unjustified—while no position was determined regarding the remaining complaints, due to the inability to make a decision with respect to conflicting verbal claims or concurrent legal proceedings, or because the bank had in any case agreed to accede to the customer's request.

Ninety-two percent of the complaints that were submitted to the Banking Supervision Department in 2011 were processed within six months, compared with 85 percent in 2010. Replies are given to enquiries from the public concerning questions and requests for information shortly after they are received. Handling complaints takes longer, as the activity is conducted vis-à-vis the banks and credit card companies as well. A number of clarifications are sometimes necessary in order to make a decision on a complaint, depending on its scale and complexity.

Below is the distribution of the ratio of enquiries and complaints whose processing was completed, by the length of time spent in processing them at the Public Enquiries Unit:

As can be seen in Figure 3.1 below, of the complaints about banks and credit card companies in which a position was taken in 2011, 26.1 percent were found to be justified, compared with 25 percent in the previous year. After a decline in the proportion of justified complaints in the first half of the past decade, stability in the number of complaints was recorded in the second half.

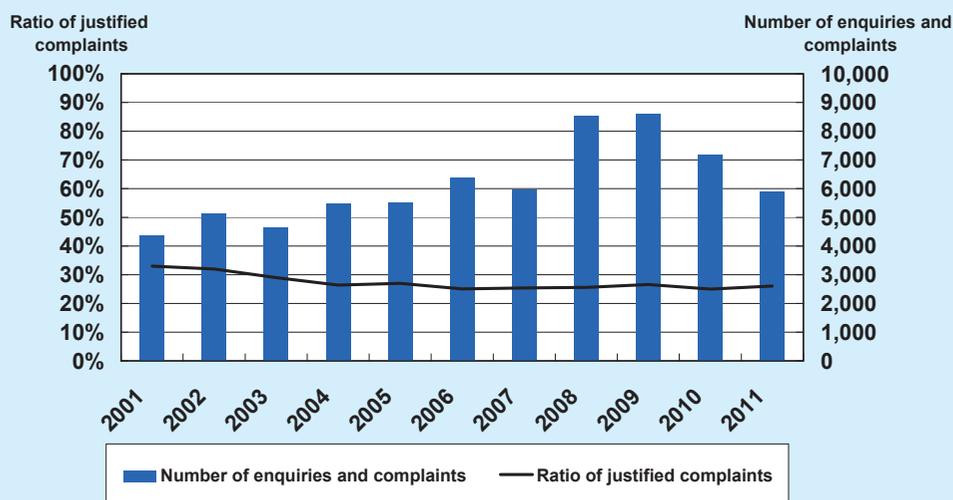
As a result of the Banking Supervision Department's intervention, the banking corporations paid their customers a total amount of NIS 7.21 million in 2011 (about NIS 1.74 million for individual complaints, and about NIS 5.47 million within the framework of handling systemic issues, including conducting audits).

Complaints and enquiries are also used to identify and correct system-wide problems in the banking system. In 2011, about 60 such problems were dealt with. As a result, the banks were required to take

⁵ For a detailed discussion of the data on banking corporations based on data drawn from the handling of public enquiries and complaints, see a separate report published on the Bank of Israel website on April 30, 2012.

Up to 3 months	3–6 months	6–9 months	9–12 months	More than 12 months
84%	8.1%	3.7%	1.8%	2.3%

Figure 3.1
Number of complaints and enquiries, and ratio of justified complaints, 2001–11



SOURCE: Banking Supervision Department.

various steps, including: the addition or amendment of work procedures, the service improvements, and refunds to groups of customers.

An analysis of the figures indicates that the biggest source of complaints (40 percent) is the human factor. In a significant number of complaints, failures were identified which derived from noncompliance with the law or with Supervisor of Banks directives (25 percent). In the other complaints, the failures derive from incorrect work procedures (11 percent), defects in technological systems (9 percent), or by the banking corporation's policies, primarily in the area of marketing products and services (9 percent). Several justified complaints were connected with the manner of the service provided by the banking corporation's representatives—generally, these are oral conversations, and thus it is usually difficult to decide between the conflicting versions.

4. Handling systemic issues

Complaints and enquiries are also used to detect and correct system-level deficiencies in the banking system. In addition, the information that they yield serves the following goals: identifying matters that require regulation by means of Proper Conduct of Banking Business Directives from the Supervisor of

Banks; pinpointing topics for audits at the banking corporation; and focusing on issues that entail the provision of information to the public.

In 2011, sixty system-wide deficiencies were dealt with, in which banking corporations were instructed to take various measures such as introducing or revising working procedures, improving processes or a service, improving technological systems, and refunding customers' money. The Department is monitoring the implementation of these measures.

Below are examples of system-level matters that were dealt with.

a. Early payback of housing loans

Most complaints that the Public Enquiries Unit received about mortgage loans concerned procedures for early payback of housing loans at two banks—Discount Mortgage Bank and Mizrahi-Tefahot Bank. When borrowers made early payback of their housing loans, they encountered delays in receiving documents relating to the clearance of the loan, e.g., certification of clearance, consent to providing property of equal status as collateral (*pari-passu*), letters of intent, or certification of cancellation of lien. Also, many complaints were received about inaccurate information from banks concerning the balance of the loan to be cleared.

The banks were instructed to compensate customers who were affected by these unsound processes and to act to prevent similar cases in various ways—revision of working procedures, improvement of controls, and improvement of technological systems.

Lessons learned from customers' complaints in this matter also served as a basis for the formulation of proposals for amendments to Proper Conduct of Banking Business Directive 451, "Housing Loan Issue Procedures," which regulates this matter.

b. Charging a fee for the issue of a replacement nonbank credit card

Isracard Ltd. charged a replacement card issuance fee to a customer who asked to change the number of the account to be credited for the use of a non-bank card. The Banking Supervision Department explained its position that such a fee should not be charged because the customer had not asked the company to issue a replacement card; rather, he had instructed the company to charge transactions carried out by means of his card to a different account. It was found that replacement cards had been issued due to a constraint relating to the company's technological systems. The company was instructed to correct the constraint that had led to the erroneous charge and to credit customers who had been mistakenly charged as stated. The company corrected the deficiency and credited the customers; 139 customers who canceled their cards have not yet been located. Customers who were charged and have not yet been credited are advised to contact the company's offices to receive the credit.

c. Charging a letter of intent fee in contravention of Proper Conduct of Banking Business Directive 451

A letter of intent is a letter in which a bank declares its intention to cancel a lien recorded in its favor against a property if the borrower deposits enough money to clear the balance of the mortgage loan. Proper Conduct of Banking Business Directive 451 states that such a letter shall be issued to a customer at no charge twice per calendar year. In certain cases, Mizrahi-Tefahot Bank charged customers in contravention of the directive. The Banking Supervision Department ordered the bank to credit the customers who had been harmed by this practice.

d. Charging delinquency interest for first payback of non-indexed housing loan

In the investigation of a complaint against Mizrahi-Tefahot Bank, it was found that due to a constraint in the bank's systems, no charge was made for the first payback of a loan at the beginning of the month following the execution of the loan. The bank then charged delinquency interest on account of the ostensible "delinquency" in payment. The bank was instructed to correct the constraint in its systems and to locate and credit the group of customers whom the constraint had affected.

e. Overcharging of tax in *teshurat hemshekh diyur* savings plans

In the investigation of a complaint in the past, it was found that Mizrahi-Tefahot Bank charged customers too much tax due to a technological glitch. The bank corrected the glitch and in 2011 reimbursed all affected customers for the overcharge.

f. Presenting cost of "issue charge" to customer before performance of transaction

When customers transfer money abroad, they are charged a fee called the "issue charge"—an actual expense that the bank incurs vis-à-vis the correspondent bank through which the transfer to the foreign bank is made. An investigation of complaints found that three banks—Otsar Hahayal, Jerusalem, and Massad—had not been showing this charge on requests for transfers of funds or on their fee schedules. The banks were instructed to correct this.

g. Delinquency in sending letter concerning changes in insurance policy

In the investigation of complaints against Bank Hapoalim, it was found that in several cases the bank had been delinquent in sending out letters advising customers that insurance policies they had taken out in favor of the bank were unsound. This is a breach of the directive that requires the bank to send such notice within fourteen days. The bank was instructed to revise its working processes and comply with the Banking Supervision Department's directives.

h. Deposit by clerk without instruction from customer

In the investigation of complaints against Bank Hapoalim, it was found that clerks at various branches of the bank had been depositing current account credit balances into term deposits for customers who regularly transferred such surpluses to deposits, doing so with good intentions but without their knowledge. This conduct contravenes Proper Conduct of Banking Business Directive 407, which enjoins a banking corporation against making investment decisions about a customer's money without the customer's explicit consent. The bank was instructed to learn the lessons of what had happened and prevent recurrence.

i. Charging fees when customers close accounts and transfer activity

In an audit that the Banking Supervision Department performed at Bank Hapoalim, inter alia after receiving complaints from the public on the topic, it was found that some customers of the bank who closed their accounts had been charged fees that did not appear on the bank's fee schedule. The Department instructed the bank to track down the accounts for which these fees had been charged and to refund the overcharge to its customers. The total refund was NIS 5 million. In the aftermath of this deficiency, the Supervisor of Banks also imposed a financial sanction on the bank in the sum of NIS 600,000.

Following is a summary of funds returned to groups of customers by the banking corporations following the handling of cases of systemic deficiencies:

Systemic issue	Banking corporation	Amount of refund (NIS '000)
Charging a fee for closing an account ¹	Bank Hapoalim	5,000
Non-bank credit card issuance fee	Isracard	339
Various issues at Mizrahi-Tefahot ²	Mizrahi-Tefahot	127
Total		5,466

¹ The refund noted was provided following an audit carried out by the Banking Supervision Department.

² The issues include interest on delays, charging fees for letters of intent, charging minimal interest due to technological issues, and overcharging tax.

5. Bank fees⁶

In 2011, Banking Supervision continued to exercise the powers granted to it by law in order to promote transparency in the pricing of banking services. This was accomplished primarily through the following activities:

a. Reporting to the Knesset and the public

Banking Supervision reported to the Knesset and the public on the main trends in bank fees, which included the following findings:

- During 2011, the downward trend continued in the actual monthly expenditure on the most common current account services (all customer-executed or teller-executed activities in current accounts⁷, and overdraft facilities) for the five major banking groups (a drop of 6 percent in real terms relative to the data for 2010). In addition, the cost of holding a credit card was reduced (by 5 percent in real terms relative to the data for 2010).
- During the fourth quarter of 2011, two banks announced that they were reducing their most common fees for households: First International Bank reduced its fees for a teller-executed activity (from NIS 6.50 to NIS 6.30) and its customer-executed activity fee (from NIS 2.50 to NIS 1.95) while the Arab Israel Bank reduced its customer-executed activity fee (from NIS 2.20 to NIS 1.95).

b. Comparison of the cost of current account management at the small banks

In 2011, Banking Supervision published information, for the first time, on all the banks in the banking system (excluding the Bank of Jerusalem and U Bank).⁸ This information includes the average actual cost of managing a current account according to the specific activity profile of its customers. Up until that point, data was published only on the five major banks. The inclusion of all the banks in the comparison showed that about 70 percent of households that hold current accounts actually pay less than NIS 15 per month.

In addition, a comparison was published this year, for the first time, of the actual average cost of managing an account according to a uniform activity profile (which is based on 10 customer-executed activities and

⁶ For a detailed discussion of major developments in the area of fees, see a separate report published on the Bank of Israel website on January 2, 2012.

⁷ Deposit and withdrawal of cash; deposit, withdrawal and cashing of checks; deposit or transfer to another account; payment by means of a payment stub; debits according to a standing order; and providing change for up to NIS 10,000.

⁸ These banks do not have a significant number of current accounts held by households.

0.7 teller-executed activities, without the addition to reach the minimal fee). The comparison between the banks showed that the monthly average expense per account at Bank Yahav was the cheapest in the system (NIS 6.30) while the Arab Israel Bank was the most expensive (NIS 22.60).

c. Comparison of fees for activities in securities

In 2012, the reports to the Knesset and to the public included, for the first time, a comparison of fees charged for activities in securities traded in Israel (fees for buying, selling and redemption of securities⁹ and fees for the management of a securities deposit¹⁰). The comparison showed a high level of variation and large differences between the banks in these two fees. It was found that the cheapest fees were to be found at Bank Yahav and the most expensive at Bank Massad.

d. Exploitation of discounts on bank fees by elderly citizens

According to the Banking Regulations (Customer Service) (Fees), 5768–2008, an elderly citizen is eligible for a discount on fees for a teller-executed activity, which is conditional on the customer requesting the discount from the bank and presenting proof of his age. In 2011, Banking Supervision initiated a measure according to which the banks would provide the discount to elderly citizens automatically when they reach the age specified by law. Joining the arrangement is voluntary and most of the banks have already done so and are making the preparations to provide the discount. Bank Leumi and Arab Israel Bank began providing this discount soon after the rules for banking fees went into effect. Bank Mizrahi-Tefahot refused to join the voluntary arrangement.

e. A bank guarantee backed up by a cash deposit

As a result of information in the media and following a discussion in the Economics Committee of the Knesset, Banking Supervision has worked to reduce the fees on bank guarantees backed up by a cash deposit. The reduction went into effect in March 2012 and as a result the banks reduced the fee for this service by rates ranging from 40 to 60 percent.

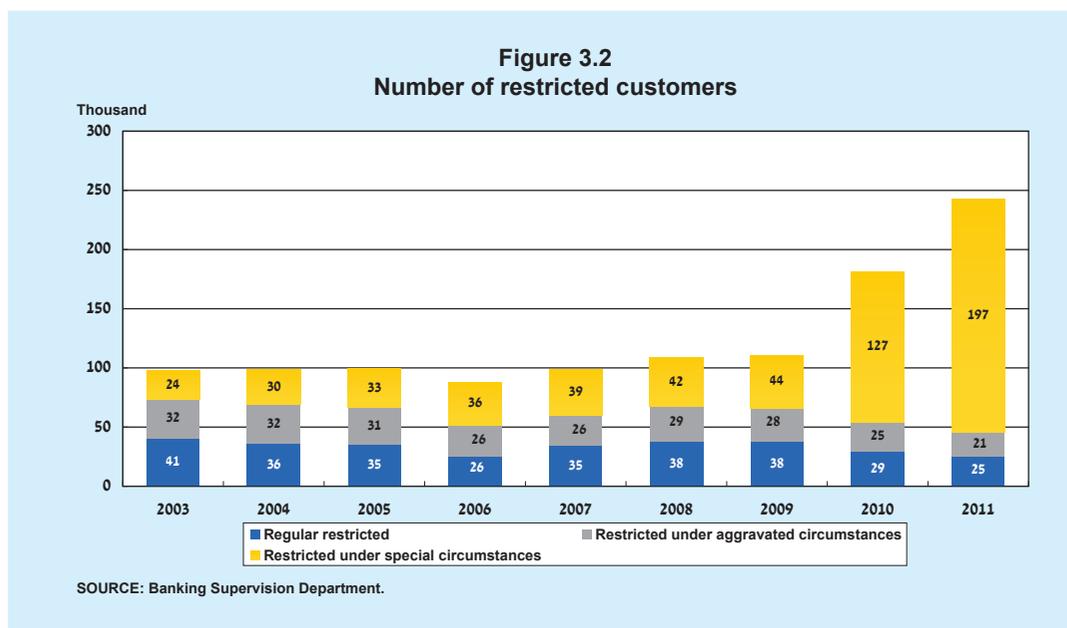
6. Restriction of accounts and customers

a. The number of restricted customers and restricted accounts

At the end of 2011, there were 242,880 restricted customers (compared to 181,043 at the end of 2010). Of those, 25,201 were restricted under “regular” circumstances (compared to 29,440 at the end of 2010) and 20,709 were restricted under “aggravated circumstances” (compared to 24,887 at the end of 2010). In addition, 196,970 customers were restricted under “special circumstances” (as compared to 126,712 customers at the end of 2010). This includes those who are restricted by the Execution Office, those who are restricted by the Official Receiver, and those who refuse to grant a divorce and are restricted by the

⁹ Shares and bonds.

¹⁰ The fee for management of a securities deposit is collected for the following services: operation of the technological and information security systems, monitoring of stock exchange announcements, reporting to customers and receipt of their responses, monitoring of changes in the company's capital and reporting to the customer, issue of ownership verification for participation in the company's shareholder meetings, monitoring of changes in mutual fund policy, distribution of dividends and bonus shares, etc.



rabbinic courts. (Most of the restrictions under “special circumstances” were imposed by the Execution Office.) (Figure 3.2).

The data also show that during 2011 the upward trend continued in the number of restricted customers and the number of restricted accounts in Israel (an increase of about 35 percent in the number of restricted customers and about 34 percent in the number of restricted accounts). This is in spite of the decrease in the number of customers who were restricted due to drawing checks without sufficient cover (“regular” and “aggravated” circumstances).

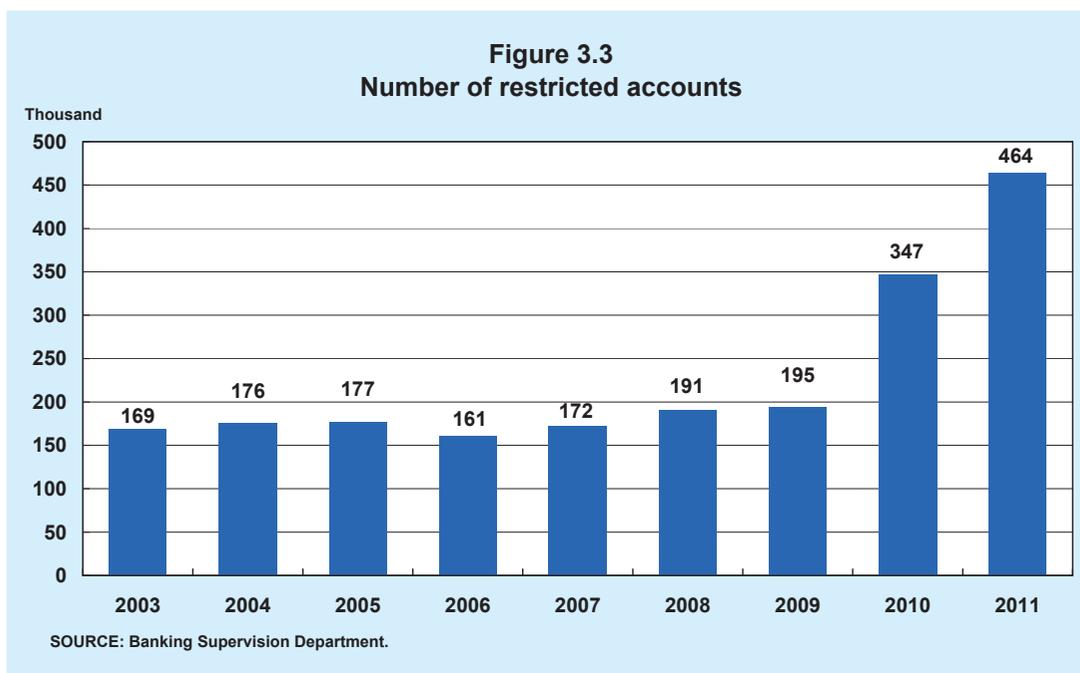
The increase in the number of customers restricted under “special circumstances” by the Execution Office is due to the change in legislation regarding debt collection processes, which was introduced through Amendment 29 to the Execution Law¹¹ that went into effect in 2009. The amendment specifies, among other things, that the Registrar of the Execution Office has the authority, under certain conditions, to impose a “special restriction” on a debtor who has been classified as solvent who avoids the payment of his debts.

There were 463,854 restricted accounts in 2011 (compared to 346,637 at the end of 2010). Of those, 119,430 had been restricted as a result of the Checks Without Cover Law and the rest, i.e., 344,424, as a result of restrictions under “aggravated” and “special” circumstances that were imposed on their owners (Figure 3.3).

b. Enquiries and appeals of restrictions

In the course of 2011, the Checks Without Cover Section handled about 3,000 written enquiries and more than 1,000 received by email. Some of them requested information on being restricted, its meaning and implications, and others requested that a restriction be cancelled or that a restriction be reconsidered. In addition, the Section handled 18,529 telephone enquiries.

¹¹ The Execution Law (Amendment 29), 5769–2008.



The Section monitors banks' execution of court decisions and verdicts on an ongoing basis. During the year, 720 appeal files were opened and 746 were closed after they were discussed and dealt with during the course of the year. About one-third of the appeals submitted to the courts were accepted and the restrictions placed on the customers in those cases were cancelled.

c. Publishing of data

On June 1, 2011, the files that included details of the restricted accounts were removed from the Bank of Israel's website as were the identifying details of customers restricted under "aggravated circumstances". Left on the website were files that contain information on corporations (all entities not defined as "individuals") restricted under "aggravated" circumstances", as well as files containing the details of their restricted accounts. A procedure was put in place for making a request to the Bank of Israel to obtain files containing full information on all the accounts and customers that are restricted under "aggravated circumstances".

d. Amendments of relevant laws

Towards the end of 2011, the Center for the Collection of Fines, Fees, and Expenses Law, 5755–1995, was amended. The amendment sets the legislative basis for imposing of various sanctions on debtors, including restriction under "special circumstances". This amendment went into effect in March 2012 and is expected to bring about an additional increase in the number of customers restricted under "special circumstances".

In addition and in accordance with the amendment of the Credit Data Services Regulations (Amendment), 5772–2011, the Bank of Israel will also provide, beginning in August 2012, information to license holders on customers who have appealed their restriction in the courts. This is in addition to the information that has been provided to them since 2004, which includes information on restricted customers and those restricted under "aggravated circumstances".

a. The Off-Site Evaluation Division

The division collates and compiles the Banking Supervision Department's period appraisal of the stability, robustness and management of the banking corporations, including auxiliary corporations, banking subsidiaries and overseas branches of the Israeli banks.

The evaluation units

The institutional evaluation units' responsibilities are divided up by banking groups. The units are charged with monitoring the banking groups, assessing the risks of each bank and collating the SREP process, which ensures that each bank maintains the necessary level of capital adequacy relative to its risk profile. The units are also responsible for the current processing of enquiries from the banking corporations, and for monitoring implementation of the Supervisor of Banks' directives. The risk assessment process makes it possible to determine operational arrangements for assisting in the early detection of negative and unusual developments in the activity and risk exposure of the banks. This process is carried out under the risk-focused supervision method: The overall evaluation of the banking corporation is based on an appraisal of corporate governance, the quality of risk management, and the level of the bank's risk exposure and the capital which it holds for the purpose of supporting the overall risk profile. Evaluation processes include an analysis of the bank's exposure to risk, and an assessment of the characteristics and performance of the management and control functions.

b. The On-Site Division

The division carries out in-depth and comprehensive on-site examination processes at the banking corporations and the credit card companies.

The purpose of this audit activity is to identify and assess the banking risks inherent in the entire range of the banking corporations' activities and to examine the propriety of the bank's risk management and the processing of matters that are audited, with an emphasis on conformance to laws and to the Supervisor of Banks' directives and guidelines. Audit reports that warn of deficiencies and malfunctions present requirements and timetables for their rectification. Audit findings and audit policy are used in compiling an assessment of the banking corporations' stability, and in promoting regulatory arrangements for the banking system.

Auditing activity is carried out via five auditing units that specialize in the following areas: credit risks; market risks and liquidity risks; operational risks; compliance risks; and corporate governance risks.

(1) The Credit Risk Audit Unit

The unit's principal function is to identify and assess the risks inherent in the extension of credit at the level of the single transaction and the level of banking corporations' overall credit risk management. The unit examines credit policy and the manner in which this policy is implemented, credit approval and credit operation processes, control over these processes, processing of the detection and classification of problem loans, and compliance with the Supervisor of Banks' directives.

(2) The Market Risk and Liquidity Risk Audit Unit

The unit's principal function is to identify and assess market and liquidity risks. The unit's audits are centered on risk management policy, and its assimilation and implementation in the management of the banking corporation's assets and liabilities. An emphasis is placed on the management of market risks

(interest-rate risks, indexation-basis risks and inflation risks), liquidity risks, risks deriving from dealing rooms' activity, and risks deriving from the activities of the banking corporation's customers in the capital markets.

(3) The Operational Risk Audit Unit

The unit's principal function is to examine the banking corporation's management of operational risks and to assess these risks. An emphasis is placed on IT risks, including information security risks, risks deriving from material processes and changes in the area of information technology, potential risks deriving from the link-up of the banks' systems to external networks, and outsourcing risks. The unit also examines the propriety of the controls which the banks operate over each of these forms of activity.

(4) The Compliance Risk Audit Unit

The unit's principal function is to examine the banking corporation's compliance with directives concerning the prevention of money laundering and financing of terrorism—matters that are likely to expose them to regulatory and legal risks and to reputation risk—and the observance of Proper Conduct of Banking Business Directives in the consumer area. In the course of the unit's audits, examinations are made of the propriety of policy, the implementation of policy and the operation of efficient control mechanisms.

(5) The Corporate Governance Risks Audit Unit

The unit's principal functions are to identify weak points in the bodies managing the banking corporations, including internal auditing. In the course of the unit's audits, examinations are made of the efficiency of the functioning of the board of directors, the senior management, the risk management network, the internal auditing department and the compliance officer.

c. The Policy and Regulation Division

The division is responsible for determining supervisory policy, regulatory arrangement of banking activity, measurement principles, disclosure and reporting, while examining and analyzing developments in risks and banking activity. This activity is carried out via four units: The Regulation Unit, the Reporting to the Public Unit, the Information and Returns Unit, and the Economics Unit.

(1) The Regulation Unit

The unit is responsible for the regulatory arrangement of banking activity, principally via Proper Conduct of Banking Business Regulations and circulars from the Supervisor of Banks, and also by means of legislation. The purpose of these activities is to assure proper and cautious management of the banking corporations, to provide regulatory coverage for the activity of the bank's board of directors and management, and to strengthen internal risk management and control systems.

(2) The Reporting to the Public Unit

The unit is responsible for determining principles for the measurement of the banking corporations and their disclosure and reporting to the public. In addition, the unit conducts audits for the purpose of examining the banking corporations' adherence to the measurement and disclosure principles that have been determined.

(3) The Information and Returns Unit

The unit is responsible for the receipt of the banks' reports to the Banking Supervision Department, processing and characterizing these reports, and turning them into readily available information for serving the department's purposes. The unit also publishes data on the banking system on the Bank of Israel's web site.

(4) The Economics Unit

The unit is responsible for analyzing and examining the risks and threats to the stability of the banking system, which are inherent in the activity of the banks and in the development of credit risks. In addition, it is responsible for constructing tools for analyzing the state of the banking system and the risks within it (stress tests and other tests), and also compiles and publishes period reviews as well as the annual survey of the banking system.

d. The Bank-Customer Division

The unit is charged with maintaining fairness in the relations between the banking corporations and their customers while protecting the rights of the banking consumer; applying and enforcing bank-customer related legislation and directives; encouraging competition in the banking system; and increasing the public's awareness of their consumer rights in the area of banking. In order to achieve these objectives, the division operates via two units and a section: the Public Enquiries and Commission Fees Unit, the Regulation (Bank-Customer) Unit and the Checks Without Cover Section.

(1) Public Enquiries and Bank Fees Unit

The unit examines customers' complaints against the banking corporations (banks and credit card companies), and makes decisions regarding disputes that are presented to it. The unit also supplies information and answers the public's questions on banking and consumer matters. The information accrued from complaints is used as a means for detecting and remedying deficiencies at the banking corporations. In addition, the unit applies and enforces provisions of the law concerning commission fees, including measures for increasing the transparency of the prices of banking services and the ability to compare between them.

(2) The Regulation (Bank-Customer) Unit

The unit provides regulatory coverage in the area of banking consumer related legislation and Proper Conduct of Banking Business Regulations. The unit monitors the observance of the Supervisor of Banks' directives and the provisions of the law in the bank-customer area, and tests compliance to consumer directives. In addition, the unit engages in consumer-related explanatory activity to customers in order to increase their awareness of their rights and to reduce information gaps on banking matters.

(3) The Checks Without Cover Section

The Checks Without Cover Section is charged with the management of the drawers of checks without coverage system. The department collates all the information contained from the banks on the matter of restricted customers and restricted bank accounts, as well as information on special restrictions imposed by the executioner's office, rabbinical courts and bankruptcy courts. The section deals with clarifications concerning restricted accounts and customers, and customer enquiries on these matters.

Apart from four supervisory divisions, three independent units operate in the Banking Supervision Department. These are:

e. The International Relations Unit

The unit manages current contact with supervisory authorities worldwide. This contact is necessitated by globalization, Israeli banks' increased international activity, the interest shown by foreign investors in the Israeli banking system, and by the recommendations of the Basel Committee, which emphasize the need for cooperation and information exchange between worldwide supervisory authorities.

f. Central Services Unit

The Banking Supervision Department Staff engages in the systemic planning of the work of the Banking Supervision Department and in the promotion of cross-organizational projects. The staff's areas of responsibility include the development of information infrastructures, the compilation of work programs, budgetary planning, procurement activity and the cultivation of human resources, including the construction and application of instructional programs. The staff is also responsible for deployment for business continuity in a state of emergency: In its capacity as the banking financial authority, it is responsible for preparations in a state of emergency and the emergency operation of the commercial banks, the credit card companies, the Shva automatic banking services company and the Masav Banking Settlement Center—bodies whose routine and other activities are supervised by the Bank of Israel.

g. The Licensing Unit

The unit processes applications that under the law require licensing from the Governor of the Bank of Israel or from the Supervisor of Banks. The unit's activity includes examination of candidates for the control or holding of means of control in banking corporations, a fit and proper test for senior office-holders at the banking corporations, licensing for branches and the activity of foreign banks in Israel.

3. TABLE OF EVENTS IN 2011

January 12th: The risks implicit in the execution of illegal credit card transactions

As a result of the large number of illegal transactions on the Internet, such as illegal gambling and transactions that are used in money laundering, clauses were added to Proper Conduct of Banking Business Directive 411 that deal with "Management of Risks Implicit in the Execution of Illegal Credit Card Transactions".

January 30th: Management of risk in the information technology system

As a result of recent technological developments that have an impact on risk management in the information technology realm, Proper Conduct of Banking Business Directive 357 concerning "Management of Information Technology" was amended.

January 30th: Questions and answers on impaired debts, credit risk and allowance for credit losses

In view of the questions that arose regarding the implementation, for the first time, of the new directives regarding impaired debts, credit risk and allowance for credit losses, a collection of questions and answers on this subject was published, with the goal of achieving consistent and precise implementation of the new directives.

January 30th: Issue of Proper Banking Management Directive 420 concerning the submitting of information by electronic means

A Proper Conduct of Banking Business Directive was issued whose goal is to regulate the issue of disclosure of information by the banks using electronic means. The Directive deals with notifications that are permitted to be sent by email or through the bank's website, instead of by mail, and it anchored the aforementioned in Supervisor of Banks Bulletin 2291–06.

March 27th: Guidelines for banks that have significant liabilities as a result of employees' rights

In view of past experience, guidelines have been published for banks with significant commitments as a result of employees' rights, with the goal of improving the internal control of financial reporting measurement and disclosure of this information.

March 30th: Revision of the directives for reporting to the public as a result of the revision of the Basel II working framework

Following the updates of the Basel II working framework, including an update of the disclosure requirements of Pillar 3, the directives for reporting to the public were also updated.

April 3rd: Revision of the directives for reporting to the public in view of the new auditing standards in the US

In view of the new auditing standards in the US issued by the PCAOB, the Proper Conduct of Banking Business Directives were updated in order to apply these standards to the accountants that audit the banks.

April 12th: Cancellation of Proper Conduct of Banking Business Directive 456 concerning "Text of the Guarantee Document" according to the Sales Law (Housing) (Ensuring the Investment of House Purchaser), 5735–1974.

On February 20, 2011, Regulations for Sale (Housing) (Ensuring the Investment of House Purchasers) (Bank Guarantee), 2010, went into effect. Since these regulations specify a uniform text for a bank guarantee according to the Sales Law, Proper Conduct of Banking Business Directive 456, which provides the text of this guarantee document, was cancelled, in order to prevent unnecessary duplication between the directives.

May 1st: Requirement to submit information regarding the collective allowance for credit loss

In view of the developments in the housing loan market, a letter was distributed for the purpose of receiving information from the banks on the collective allowance for credit loss and to verify that the collective provision for housing loans takes into account the recent developments in the market for these loans.

May 3rd: Limits on variable-rate housing loans

In view of the increase in the volume of variable-rate housing loans and the possible implications of an increase in interest rates in the economy, it was decided that a bank will approve and provide a housing loan only if the ratio of the variable-rate portion of the housing loan to the total value of the housing loan does not exceed one-third. The aforementioned will apply to:

- a. Loans approved in principle from May 5th 2011 onward.
- b. Loans for which the bank has approved recycling starting from that date, apart from recycling in which the weight and amount of the variable-rate portion of the housing loan has been reduced.

May 4th: Revision of the directives for reporting to the public with regard to the accounting treatment and disclosure of the allowance for credit losses and of impaired debts

The directives for reporting to the public were updated when the directives for the accounting treatment and disclosure of the loan-loss provision and impaired debts and the measurement of fair value and alternative fair value for financial assets and financial liabilities went into effect.

May 8th: Updating of limits regarding the indebtedness of a borrower and group of borrowers

As part of the effort to reduce the concentration risk in the banking system, the limits imposed by Proper Conduct of Banking Business Directive 313 concerning “Limits on the Indebtedness of a Borrower and a Group of Borrowers” were updated.

May 15th: Expansion of the disclosure of housing loans

In view of the growth in the volume of activity and of the risk implicit in the provision of housing loans, banks were required to expand the disclosure of these loans in order to assist the users of financial statements in understanding and benefiting from the exposure of banks to this activity.

September 20th: Amendment of the directive concerning the investment of customers in financial assets via portfolio managers

Proper Conduct of Banking Business Directive 462 concerning “Investments of Customers in Financial Assets via Portfolio Managers” was revised in accordance with the law regulating the practice of investment advising, marketing of investments and management of investments (Amendment 14), 5770–2010.

October 1st: Amendment of Proper Banking Management Directive 431 concerning checkbooks

On October 1st, 2011, the amendment to the Banking Law (Customer Service), 5751–1981, went into effect, which led to the amendment of Proper Conduct of Banking Business Directive 431. The amendment specifies that the checks issued to a bank’s customers (individuals who are not corporations) will be crossed and will have text printed on them to say that they are not negotiable, unless the customer requests otherwise.

October 3rd: Requirement to report on corporate responsibility

Due to the importance attributed by Banking Supervision to the activity of the banks in the area of corporate responsibility, a requirement was added to the directives for reporting to the public according to which a bank must publish a report on corporate responsibility.

October 27th: Expansion of disclosure regarding exposure to foreign countries

In view of developments abroad, the banks were required to expand disclosure of their exposure to foreign countries and to provide additional disclosure of their exposure to certain foreign countries.

November 6th: Amendment of the directive concerning the board of directors

As a result of Amendment 16 to the Companies Law, which deals with, among other things, the members of the Audit Committee, Proper Conduct of Banking Business Directive 301 regarding the “Board of Directors” was amended.

November 8th: Disclosure of activity in the branches

As a result of the recent growth of activity in branches of external banks, it was decided to provide the public with certain information on the activity of these branches in Israel.

November 8th: Provision of verification of a customer's balances directly to the auditing accountant

In view of the importance of the financial statements of bank customers, guidelines were published for banks with regard to the provision of verification of customer balances directly to the auditing accountant.

November 8th: Requirement to provide information on significant exposures to borrower groups

Due to the increasingly negative trends in the global financial markets and the fear of its possible effects in the future on the Israeli economy, banks and credit companies were required to provide information on significant exposures to borrower groups in their report to the board of directors.

November 15th: Additional information on types of securities

In accordance with accepted practice among banks in the US and in order to enable users of financial reports to better differentiate between types of securities, the directives for reporting to the public were updated with a requirement to include additional information on various types of securities in their financial statements.

November 30th: Modification of directives for reporting to the public to make them consistent with international standards of financial reporting

The directives for reporting to the public were modified to be consistent with international standards of financial reporting in certain areas that are not within core banking activity.

December 25th: Directives concerning business continuity and the internal audit function

Updating of Proper Conduct of Banking Business Directive and their modification to be consistent with the Basel working framework:

A directive was issued on business continuity, which is aimed at ensuring the adoption and implementation of appropriate procedures for the management of business continuity by the banks and their assimilation within supervisory activity. Its goal is to strengthen the management of operational risk and preparedness of the banks for emergencies.

A directive was issued on the internal audit function, which is aimed at reinforcing the principles of corporate governance.

December 26th: Measures taken as part of the effort against Iran's nuclear program

Following the government decision to continue the measures against Iran's nuclear program and accompanying programs, it was requested of the banks that they be alert to the risk implicit in relations with, or transactions on behalf of, entities that appear on international lists of those involved in Iran's nuclear program and accompanying programs or in assisting them. Thus, the banks were asked to perform a preliminary survey that would assess their exposure to such entities.

December 27th: Amendment of Proper Conduct of Banking Business Directive 470 concerning debit cards

As part of the amendment of Proper Conduct of Banking Business Directive 470, it was required of banks that issue debit cards to provide additional information on their monthly statements. Thus, in addition to the details of the transaction that currently appear, the banks are to also state the name of the business, as it is presented to its customers, as well as whether the debit card of the customer was presented at the business when the transaction was carried out.

December 29th: Presentation of the measurement of interest rate income

Directives for reporting to the public were modified to be consistent with the manner of presentation in the profit and loss statement of banks in other countries and with the accepted accounting practices in the US for measuring interest rate income.

