CHAPTER 2

ACTIVITIES 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 protecting the public good. Accordingly, the Banking Supervision Department works to strengthen corporate governance, risk management and capital adequacy at the banks. This activity is constant and is based on the implementation of the proper conduct core principles of banking supervision as formulated and updated from time to time by the Basel Committee on Banking Supervision.

The Banking Supervision Department also strives to increase competition and efficiency in the system and to maintain fairness in the relations between banks and their customers. This is accomplished through setting out and enforcing legislation and directives concerning bank–customer relations, and by investigating public enquiries. All of the Banking Supervision Department's 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, as well as to strengthen public confidence in the banking system.

This chapter is composed of three parts: The first reviews in detail the main activities of the Banking Supervision Department in 2012 to strengthen the stability of the banking system and to increase its competitiveness and proper conduct. The second lists the supervisory activities that took place in 2012, and the third describes the organizational structure of the Banking Supervision Department.

1. PRINCIPAL ACTIVITIES OF THE BANKING SUPERVISION DEPARTMENT IN 2012

In 2012, the Banking Supervision Department continued to strengthen the stability of banking corporations and to promote competition and fairness in the banking system.

As part of these activities, the Banking Supervision Department put in place requirements regarding the level of the core Tier 1 capital adequacy ratio in the banking corporations, and assessed their capital plans and the measures that they adopted in order to meet the new requirements. These steps were taken together with measures intended to advance the implementation of international standards for risk management, capital and corporate governance set forth by the Basel Committee on Banking Supervision, primarily the implementation of the Basel III standards. (See Box 2.1).

In parallel, the Banking Supervision Department advanced significant measures intended to increase competition and fairness in the banking system and to strengthen retail customers' bargaining power. These measures were partially a direct result of the work of the Team to Examine Increasing Competitiveness in the Banking System, headed by the Supervisor of Banks. The Team's recommendations were published in order to receive reactions from the public, and these reactions were taken into account in the final report presented to the Governor of the Bank of Israel and the Minister of Finance (See Box 2.3).

During 2012, the Banking Supervision Department increased its monitoring of developments in the domestic and global economic environments. It required banks to conduct stress tests to assess focal points of risk in banking activities. It also focused on evaluating and measuring credit risk in respect of large borrowers, since this is a major focal point of risk on the banking corporations' balance sheets, and credit risk in respect of the construction and real estate sector. In addition, the Banking Supervision Department took actions to moderate the risks implicit in the bank credit portfolio following developments in the housing market. These included placing limits on the level of mortgage loan financing in relation to the value of the purchased home (LTV[1] limits).

Together with the assessment of risk focal points and how they are managed, the Banking Supervision Department also assessed the functioning of the institutions that make up part of the banking corporations' corporate governance structure. It also dealt with aspects concerning the banks' controlling shareholders, including the rules and principles concerning holdings of the controlling core interest of a bank and its dispersion. These rules were formulated in conjunction with the Capital Markets, Insurance and Savings Division at the Ministry of Finance, since it is formulating similar rules for institutional investors.

Against the background of the geopolitical risk and Operation Pillar of Defense, the Banking Supervision Department emphasized the continued preparedness of the banking system to provide services during emergencies. It also worked to improve the banking system's ability to deal with operational interruptions stemming from the realization of cyber risks, and continued to update the legal framework for handling a bank in crisis or failure and to promote the framework's coming into line with international standards.

a. Increasing the monitoring of developments and risks in the domestic and global environments, and assessing the banking system's preparedness

(1) Assessing the main focal points of risk and their impact

During 2012, the Banking Supervision Department continued working to strengthen the capital adequacy of the banking corporations, improve risk identification processes and develop a risk management infrastructure, and to strengthen corporate governance. The Banking Supervision Department constantly evaluates the activities of the banking corporations in light of their risk profiles against the background of developments in the economic environment, in order to have an effect on the banks' capital planning and risk management processes. Included in this, the Banking Supervision Department takes positions concerning the required capital adequacy and capital targets that the banking corporations have set for themselves, concerning weaknesses in the risk management processes and in the areas of corporate governance, and concerning the main challenges with which the banking corporations must deal in the future. The various findings were sent to the banking corporations by way of letters and designated meetings with the boards of directors and managements of the banking corporations.

The global slowdown—and particularly the continuing crisis in the eurozone—alongside the "Arab Spring" and increasing geopolitical threats, have made it necessary to strengthen and adjust the framework for managing stress scenarios both in banking corporations and in the Banking Supervision Department, in order to set adequate capital targets, among other things. Accordingly, Banking Supervision acted on three levels. First, it directed the banking corporations to independently conduct a stress scenario simulating a deterioration in the eurozone crisis, and to send it the results of the test. Following this, the supervision of the banking corporations' exposure to eurozone countries was tightened. In addition, the Banking Supervision Department directed the banking corporations to include the business effects of national emergencies in these scenarios.

[1] Loan to Value.

Second, the Banking Supervision Department itself conducted stress tests, in order to examine the resilience of the banking system as a whole and of the individual banks, and the ramifications of various stress scenarios on the capital adequacy ratios. Among other things, the banking system's resilience was tested against the background of the uncertainty concerning the ability of some European countries to repay their debts and the concern that, as a result, the financial sector would be negatively impacted. In addition, the Banking Supervision Department assessed the effect of various scenarios on bank losses in Israel due to their exposure to foreign financial institutions both in Europe and elsewhere.

Third, the Banking Supervision Department for the first time conducted a bottom-up stress test based on a uniform scenario, including a moderate security scenario on the domestic level and an extreme economic scenario on a global level. The Banking Supervision Department sent the banks a list of the macroeconomic characteristics of the scenario and the guidelines for carrying out the test. The banking corporations carried out the test using their own models, while the Banking Supervision Department conducted it with a uniform and consistent methodology. (See Box 1.1.)

The Banking Supervision Department assessed how the stress tests were carried out as well as their results, reviewed and evaluated the framework for managing stress scenarios in the banking system, and took actions to minimize the gaps that were found. These steps contributed to a better understanding of the focal points of risk to which the banking system is exposed, and to the formulation of steps to minimize exposure to high-risk activity.

(2) Credit to large borrowers in the economy

In 2012, the trend of a slowdown in the economy and in the GDP growth rate continued. As such, the Banking Supervision Department continued to closely assess the situation of large borrowers in the economy. It reviewed their corporate structure and their activity in the capital market, and assessed the banking corporations' level of compliance with the limitations that it placed on exposure to these borrowers.

The large borrowers in the economy attracted a lot of public attention, including discussion by the Committee to Increase Competitiveness in the Economy, among whose members is the Supervisor of Banks. During 2012, the Banking Supervision Department focused on the risk implicit in leveraged financing, including credit to holding companies and credit issued to finance the acquisition of means of control, against the background of volatility in the bond yields of those companies and the uncertainty concerning their ability to repay their debts and to roll them over in the capital market. The Banking Supervision Department examined banking corporations' policies and procedures, the quantitative limitations that they put in place and the processes being implemented in order to evaluate the risk associated with the holding companies, all while relating to their layered structure and the distance between the producing company and the company to which the banking corporation is exposed.

In addition, the Banking Supervision Department assessed the banking corporations' exposure to large borrowers who have large debts to the nonbank credit market, in addition to their debts to the banks. This assessment focused on the large borrowers whose bonds were traded at high yields on the capital market and which will be required to rollover large amounts of debt, and it was made in conjunction with other parties at the Bank of Israel, in the Capital Markets, Insurance and Savings Division of the Ministry of Finance, and at the Israel Securities Authority, among others. The Banking Supervision Department also assessed how the debts are classified and the credit loss allowances that the banks generated in respect of them. It also conducted sensitivity tests in order to assess the risk implicit in the exposures, while simulating a deterioration to the point of failure in the status of the borrowers.

(3) Housing credit

The Banking Supervision Department constantly monitors the development of risks in the housing credit portfolio, and takes action where it is called for. The Banking Supervision Department assesses the composition of the housing credit portfolio, its distribution in various segments, its risk characteristics, and its development over time. In 2012, the Banking Supervision Department conducted sensitivity tests and stress tests in order to understand how changes in various parameters—such as unemployment or the interest rate—affect borrows and banks.

In view of the continued rise in housing prices, the significant growth in the balance of credit for housing in recent years, and the concern over increasing risks implicit in the housing credit portfolio, the Supervisor of Banks took two additional measures. First, in November 2012, he published limitations on the maximum rate of financing—the loan to value ratio: in the case of an investment dwelling, the banking corporation shall not approve a loan of more than 50 percent of the value of the apartment. In other cases, the banking corporation shall not approve a loan for more than 70 percent of the value of the apartment, unless it is a first home. In such a case, the maximum loan to value ratio will be 75 percent.

Second, in March 2013, the Supervisor of Banks published guidelines concerning capital allocation and credit loss allowances in respect of housing loans. These guidelines are intended to increase the capital buffers and the allowances required in respect of the increase in the risk implicit in the housing credit portfolio.

(4) Credit to the construction and real estate industry

Against the background of the extended expansion in the domestic housing market, during 2012 the Banking Supervision Department continued to assess the banks' exposures to the construction and real estate industry. The Banking Supervision Department assessed their strategic plans and the composition of their activities, and focused on identifying and evaluating risk. In addition, the Banking Supervision Department evaluated the risk monitoring and minimization procedures in the banks' control mechanisms, and the quality of their corporate governance. In accordance with the findings, the banking corporations were required to improve their risk evaluation and management and the framework and reporting, including strengthening corporate governance.

(5) Market and liquidity risk

In 2012, the Banking Supervision Department continued to conduct audits intended to assess how the banks are managing liquidity risks. The Banking Supervision Department assessed existing liquidity levels, the structural risk in liquidity, how the risk is managed, and the various aspects of corporate governance. In addition, audits were conducted in the area of managing market risk, particularly the interest rate risk and the risks associated with the banks' securities portfolio activities. In this framework, the Banking Supervision Department also assessed the risks associated with the main activities and work processes of the management, supervision and control functions, and also reviewed the procedure for activities in derivatives in view of the high losses accumulated by the banks worldwide as a result of such activity. As a result of these steps, the banking corporations have been required to improve aspects of market and liquidity risk management.

(6) Cyber risks

During 2012, the Banking Supervision Department formulated a framework for its activity concerning cyber risks[2], since the realization of these risks could harm the proper functioning of the banking system. The regulatory framework is intended to assist the banking system in preparing to deal with cyber attacks by strengthening protective, security, monitoring and response measures at banking corporations and credit card companies and by improving employee, management and customer awareness.

In order to advance this activity, the Banking Supervision Department established an internal function in 2012 for handling the issue of cyber attacks. The overall goal of the function is to strengthen the resilience of the banking corporations and credit card companies against cyber attacks. Within this framework, the Banking Supervision Department maintains ongoing contact with the banking system and with various people dealing with cyber protection, including external professional consultants, the National Cyber Bureau and the National Information Security Authority.

In addition, the Banking Supervision Department established a professional forum on cyber protection that includes the information security directors of the banking corporations and other parties. The forum is intended to serve as a platform for professional discussions of issues relevant to cyber protection.

Within the framework of monitoring warnings and cyber occurrences, and the planning of the required handling vis-à-vis the banking system, during the year, the Banking Supervision Department assessed the ramifications of various cyber events on the banking system and how to handle them.

The Banking Supervision Department instructed the banking corporations to take steps to improve their preparedness to deal with cyber attacks and to strengthen the security, control, monitoring and response mechanisms. Among other things, the banking corporations were required to take immediate action to reduce exposure: establishing a situation room that will operate during an event; conducting a cyber risk survey; and increasing the involvement of the board of directors and of senior management in handling this area. In addition, the Banking Supervision Department published guidelines requiring the banking corporations to report on information security risks and cyber incidents, and on their ramifications on the financial reports, in their reports to the public, as of December 31, 2012.

All of the steps taken during the year have enabled the Banking Supervision Department to formulate an evaluation of the banking system's level of preparedness for cyber threats. This evaluation, in turn, enables each of the regulated corporations to deal with its main weaknesses.

b. Main regulatory activity necessary for implementation of the international risk management standards

(1) Regulation of risk management

The Banking Supervision Department constantly tracks the development of the various risks that derive from the banking corporations' activities, and takes various measures to minimize the chances of their actual occurrence. Within this framework, the Banking Supervision Department published a series of directives regarding risk management, which present the Banking Supervision Department's overall view concerning the fundamental principles of risk management. The publication of these guidelines completes an overall process intended to bring Banking Supervision Department directives in line with the risk management

[2] Cyber risk is the risk associated with the realization of damage to the information technology array as a result of an attack on the computer systems. A more in-depth discussion appears in Box 2.2 of Israel's Banking System Annual Survey for 2011.

principles of the Basel Committee on Banking Supervision and with the accepted standards of leading regulatory authorities around the world.

One of the directives that was published establishes the principles of robust governance of risk management, including principles concerning the management and control functions in the risk management processes.[3] In addition, individual directives concerning various risks were published, including "credit risk management" and "operational risk management" directives, which set forth principles for the management of these risks and define the areas of responsibility and division of authority, as well as the rules for managing and measuring these risks.

(2) Regulation concerning interest rate and liquidity risks

The Banking Supervision Department continues to advance the implementation of the optimal risk management principles in the banking system. Accordingly, it is acting to improve liquidity risk management and interest rate risk management in the banking system.

January 2013, the Banking Supervision Department published an update to the directive on "Liquidity Risk Management", which set forth risk management requirements, specified new measurement and control indices and updated existing ones. The update is an interim stage toward the assimilation of the Basel Committee recommendations concerning liquidity that were published in January 2013.[4]

In May 2013, the Banking Supervision Department published a new Proper Conduct of Banking Business Directive regarding interest rate risk management. The directive is intended to strengthen interest rate risk management in general and the management of interest rate risk in the banking portfolio in particular. The directive lists qualitative requirements for risk management at the banking group level, proper supervision of the risk by the board of directors and senior management, and effective measurement, monitoring and control capabilities. In addition, the directive requires that there be an independent function tasked with managing the risk.

The directive is based mainly on a document published by the Basel Committee on Banking Supervision in July 2004 on interest rate risk management[5], and includes additional material and amendments on specific topics, which are based on publications by the regulatory authorities in the United States.

Box 2.1: Basel Committee recommendations – Basel III and strengthening capital adequacy

Among the lessons of the global crisis that began at the end of 2007, the Basel Committee on Banking Supervision reached the conclusion that Core Tier 1 Capital at the banks, which is comprised mainly of share capital and accumulated profits, must be the principal component of the banks' capital. Core Tier 1 Capital at the banks is the component that absorbs most of the losses during normal business as well. It is therefore essential that it be properly strengthened in order to maintain the stability of the banks as well as their ability to continue providing services to the economy and to the public while ensuring depositors' money.

3 A more in-depth discussion appears in the Annual Survey for 2011, Box 3.1
4 Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools.
5 Principles for the Management and Supervision of Interest Rate Risk.

In December 2010, the Basel Committee published an updated framework on capital adequacy, which is referred to as "Basel III".[1] This framework is focused on improving the quality and level of capital by increasing the Core Tier 1 Capital within total capital, and by improving the quality, consistency and transparency of the capital base. The framework also redefines the capital components that can be included in the capital base, and changes the calculation of the capital required against certain assets. The capital requirements complement recommendations to increase liquidity requirements.[2]

The Basel III framework sets out, among other things, minimum capital ratios that are higher than those that have been in practice until now. The minimum core capital requirement increased from 2 percent to 4.5 percent of weighted risk assets, and the Tier 1 capital ratio increased from 4 percent to 6 percent of weighted risk assets. The overall minimum capital requirement remains 8 percent, and it is achieved through a Tier 2 capital requirement of 2 percent.

The Basel Committee determined that the world must adopt the recommendations gradually starting in 2013. In view of the complexity of the recommendations and the actual situation, some countries had difficulty implementing the recommendations, leading to delays, while other countries such as Canada, Australia, Hong Kong, Singapore and India published final guidelines and assimilation began as planned on January 1, 2013.

The European Union published the draft CRD-IV[3] in July 2011, outlining how eurozone countries should adopt the Basel III recommendations. In April 2013, the final text was approved, and the start date for adoption was set for January 1, 2014.

The regulatory authorities in the United States published draft comments concerning the adoption of Basel III in June 2012. The final text has not yet been published, and due to criticism of the implementation's complexity, the publication date and the start of implementation have not yet been set.

In general, the countries set a more strict capital policy than what the Basel Committee set out. Countries set higher capital ratios, earlier implementation dates, or both. This stricter policy was set, inter alia, in view of continuing negative economic developments around the world and the increase in the level of risk.

The Israeli banking system is also preparing for the implementation of the Basel III recommendations. As part of the process, and in order to provide the banks with time to prepare for the change in the capital requirements, the Supervisor of Banks published new minimum core capital targets in March 2012, as detailed herein:

Banking corporations (that is: banks and credit card companies) must meet a minimum core capital ratio of 9 percent (instead of 7.5 percent) by January 1, 2015.

A banking corporation whose balance-sheet assets on a consolidated basis constitute at least 20 percent of total balance-sheet assets in the banking system (Bank Leumi and Bank Hapoalim have this characteristic), must meet a minimum core capital ratio requirement of 10 percent by January 1, 2017. For these banks, the core capital ratio of 9 percent by January 1, 2015 is an interim goal.

1 Basel III: A global regulatory framework for more resilient banks and banking systems, Basel Committee on Banking Supervision, December 2010 (rev. June 2011).

2 More details of the new requirements in Basel III appear in Box 2.4 of the Annual Review for 2010.

3 Capital Requirements Directive.

The changes in the minimum core capital ratio presented by the Israeli regulator, and spreading the timetable over a period of three to five years, were determined while taking the Basel Committee's recommendations and the guidelines by regulatory authorities in other countries into account. The decision was underpinned by the need to ensure the stability of the Israeli banking system and the banks' capabilities to increase their capital adequacy while continuing to provide credit and support economic activity and growth. Among the considerations guiding the Department were: the characteristics of the Israeli economy and banking system, including banking system concentration and the high level of concentration among borrowers and borrower groups, the actual level of the core capital ratio at Israeli banks, and the risk environment and structure in which the Israeli banking system operates.

Second, in June 2013, further to the publication of the new core capital targets, the Banking Supervision Department published guidelines relating to how the Basel III framework on capital adequacy is to be implemented. The main issues included in the guidelines are below:

All banks must meet the overall capital ratio of 12.5 percent. Banks that must meet a minimum core capital ratio of 10 percent will be required to meet an overall capital ratio of 13.5 percent.

In the first stage, the overall capital ratio will be comprised of core capital and Tier 2 capital only, without using additional Tier 1 capital. The Banking Supervision Department made this determination in view of the complexity implicit in the issuance of Tier 1 capital instruments, until their adjustment to the regulatory environment and the Israeli capital market has been assessed.

The start dates for meeting the overall capital ratio requirements are tied in with the start dates for meeting the core capital ratio requirement (January 1, 2051 and January 1, 2017).

Fitness criteria have been set for capital instruments classified as additional Tier 1 capital and as Tier 2 capital. Objective start dates (triggers) have been set for the conversion or reduction of these capital instruments as follows: For additional Tier 1 capital instruments, the trigger will be a decline from the core capital ratio of 7 percent, and for Tier 2 capital instruments, the trigger will be 5 percent. (The conversion criteria for Tier 2 capital is in addition to the criteria set by the Basel Committee on Banking Supervision.) In addition, conversion criteria for capital instruments have also been set for the point of non-fulfillment as defined by the Basel Committee.

The limitations on Tier 2 capital remain in place, until the other prudential limitations based on overall capital have been brought in line with the new requirements.

As part of the process of adopting Basel III in Israel, the manner of handling the regulatory capital adjustments and deductions have been changed, including the manner of handling deferred taxes, minority rights, collective credit loss provisions, capital allocation in respect of credit value adjustment (CVA) losses, and more.

The date of first implementation of these directives is January 1, 2014. The Banking Supervision Department is assessing what the effects of these directives will be, including the gradual transition directives. Accordingly, on January 20, 2012, the Banking Supervision Department sent a letter to the banks entitled "Preparedness for implementation of the Basel III directives—a quantitative impact survey (QIS)". In this letter, the department asked the banks to conduct a quantitative evaluation survey in order to estimate the impacts of the implementation of the Basel III directives on core capital.

According to the banks' estimations, full implementation of the Basel III directives is expected to lead to an average decline of 0.5 percentage points in the core capital ratio in the Israeli banking system. This estimation is significantly lower than estimates obtained in other countries, due in part to the relative conservatism in the measurement directives of the Israeli banking system. Estimates of the decline in the core capital ratio in each of the five major banking groups, as published in their financial reports to the public as of December 31, 2012, are: Bank Leumi—0.3 percentage points; Bank Hapoalim—between 0.3 and 0.5 percentage points; Discount Bank—1.2 percentage points; Mizrahi-Tefahot—0.3 percentage points; and First International—0.15 percentage points.

Further to advancing regulatory requirements regarding capital adequacy and bringing them in line with the Basel Committee recommendations, the Banking Supervision Department assessed the banks' preparedness for the new guidelines as well as their capital targets and capital planning for the coming years. Among other things, the Department assessed the new capital targets and bringing them in line with the new guidelines and the risk profile of each banking corporation; the closeness of correspondence between capital planning and the banking corporation's work plan and strategic plan; and the suitability of the assumptions implicit in the capital planning, including fundraising, profitability, the risk asset growth rate, the effects of the implementation of Basel III, the distribution of dividends, and more. Where necessary, the banks were required to present a contingency plan in order to ensure meeting these targets.

These steps to strengthen capital adequacy in the Israeli banking system are a continuation of the measures taken by the Banking Supervision Department in recent years with the goal of reinforcing the soundness of the banks in Israel.

c. Compliance risks and money laundering

(1) Regulation concerning compliance and money laundering

During 2012, the Banking Supervision Department worked on a number of levels in the areas of compliance risk management and the prevention of money laundering:

Parties that maintain contact with Iran—The Banking Supervision Department published an amendment to the Directive on "Prevention of Money Laundering and Terrorism Financing, and Customer Identification", in which it requires the banking corporations and credit card companies to set policies regarding the risks associated with the activities their customers conduct with parties that appear on the international list of those assisting Iran's nuclear program and its accompanying programs.

Illegal activity on the Internet—The Banking Supervision Department published a letter to the banking corporations and credit card companies, in which it asked them to set policies regarding the risks implicit in transferring money whose source or destination is bank accounts that appear on Internet sites and that allegedly serve for illegal activities. The guideline was issued following a request from the Israel Police, which is also the body that sets the relevant list of accounts.

Prohibition on money laundering—The Banking Supervision Department published a draft question and answer file regarding the prohibition on money laundering. The goal of the file is to gather positions and interpretations that were and are issued to the banking corporations regarding the implementation of the Prohibition on Money Laundering (The Banking Corporations' Requirement regarding Identification, Reporting and Record-Keeping for the Prevention of Money Laundering and the Financing of Terrorism) Order, 5761–2001, and concerning the implementation of the Proper Conduct of Banking Business Directive on "Prevention of Money Laundering and Terrorism Financing, and Customer Identification".

(2) Moneyval[6] audit

In recent years, the Banking Supervision Department has been working to advance regulatory directives in the field of prevention of money laundering and terror financing policy and to integrate them into the banking system. The department conducted audits of the banking corporations in order to assess whether they are fulfilling these directives, and also required the banking system to carry out a survey of gaps—again in order to ascertain that they are complying with the directives.

In March 2013, the Moneyval organization conducted a comprehensive international audit that assessed the legislative, enforcement and regulatory bodies dealing with this area, including the Banking Supervision Department and the banking system. The findings of the audit and the surveys of gaps that were conducted indicate that the banking system has come a long way since the beginning of the implementation of the Prohibition on Money Laundering Law in 2001. The banking corporations attribute great importance to the implementation of an organizational culture regarding compliance with the provisions of the law and of regulations, including regarding the prohibition of money laundering and the prohibition of terrorism financing, and are acting in accordance with criteria that promote optimal risk management. These activities are conducted by way of strengthening the commitment of corporate governance officials in the banks, setting policy and procedures in the matter, and investing in human resources, controls and automated infrastructure.

(3) Financial sanctions

Following audit reports by the Banking Supervision Department, in 2012 the Banking Corporations Sanctions Committee[7] imposed monetary sanctions totaling NIS 5.9 million in respect of contraventions of directives based on the Prohibition on Money Laundering Law, 5760-2000:

- Sanctions totaling NIS 3.8 million were imposed on Mizrahi-Tefahot Bank Ltd. in respect of the findings of an audit conducted by the Banking Supervision Department between 2007 and 2010.
- Sanctions totaling NIS 2.1 million were imposed on Union Bank of Israel Ltd. in respect of the findings of an audit conducted by the Banking Supervision Department between 2004 and 2009.

These sanctions were imposed, *inter alia*, due to various defects, the absence of reporting on irregular activities, reports that were sent late, and a lack of information sent to the Authority for the Prevention of Money Laundering and the Financing of Terror.

[6] Moneyval is an organization that is active within the European Council, and is intended to advance the struggle against money laundering and the financing of terror. The organization conducts audits in which its member countries prepare mutual evaluations concerning meeting the standards in the field. Israel has active observer status in the organization, and the audits promote recognition of its position and reputation as a country based on the rule of law and as a partner in the international struggle against money laundering and the financing of terrorism.

[7] The Banking Corporations Sanctions Committee is a committee established based on the Prohibition of Money Laundering Law, 5760-2000. The Committee is authorized to impose monetary sanctions on banking corporations in respect of contraventions of laws, orders, and ordinances concerning the prohibition of money laundering. The Committee is headed by the Supervisor of Banks.

Box 2.2: The impact of FATCA legislation on the Israeli banking system

Beginning in 2010, the US government has been acting, based on legislation called the Foreign Accounts Tax Compliance Act (FATCA), in order to expand the information base on accounts at financial institutions outside the United States, and deepen tax collection in respect of these accounts. The FATCA obligates financial institutions around the world to report to the tax authorities in the United States regarding accounts of US persons. Any financial institution not complying with the provisions shall be exposed to significant economic sanctions, particularly at withholding tax deductions reaching 30 percent on payments originating in the United States.

The Banking Supervision Department is involved in advancing the State of Israel's preparedness, particularly that of the banking system, for the implementation of the provisions, following the formulation of an understanding regarding the negative ramifications of a contravention of the provisions both at the banking system level and at the economy level.

The Banking Supervision Department participates in an inter-ministerial team led by the State Revenue Director at the Ministry of Finance. The team holds regular discussions and is advancing the handling of the matter. The purpose of the team is to recommend the optimal way to deal with the American legislation, and deals particularly with the question of whether to sign an intergovernmental agreement with the United States and what the preferred model for such an agreement is.

The banking system is prepared from legal and operational standpoints, including adjustments to the information systems.

d. Business continuity risks

(1) Enhancing the banking system's emergency preparedness

In 2012, the Banking Supervision Department formulated reference scenarios for the banking system, based on the national reference scenarios.[8] These outline possible developments and events that may cause operational and/or business damage to the banking system. The outline does not reflect a forward-looking forecast, but is rather intended to serve as a basis for preparedness and prevention planning by the banking system. As part of the actions taken by the Banking Supervision Department in order to strengthen the banking system's emergency preparedness, the Department made a comprehensive assessment of the protection of critical sites within the banking system, identified systemic risk points and, where necessary, required improvement of the protection, the closure of gaps and tightening of supervision and regulation.

(2) National drill

The National Emergency Preparedness Week took place from October 21–25, 2012, during which time the "Turning Point 6" drill was carried out along a developing path of a scenario in which Israel faces a powerful earthquake.

[8] The reference scenarios include general war, earthquake and plague.

In its role as a designated emergency economy authority, the Banking Supervision Department participated in the drill together with the banking system, along two parallel channels. In the first channel, the banking system carried out evacuation drills and field drills simulating functional continuity, including opening situation rooms and daily reporting during emergencies. In the second channel, each of the banking corporations carried out a business executive game based on a uniform event scenario. The game ended with a round-table discussion with the participation of the CEOs of seven banks, the Supervisor of Banks and other senior Bank of Israel officials.

(3) Guidelines for banks and tracking their activities due to operation Pillar of Defense

On November 15, 2012, as a result of operation Pillar of Defense and the declaration of a special home front situation for a range of 40 kilometers from Gaza, the Supervisor of Banks published a series of guidelines relating to bank branches located within the threat range, including guidelines containing leniencies for the population.

The banks were directed to avoid limiting accounts and limiting account holders to whom the bank had returned checks without cover. The Supervisor of Banks thus used his authority pursuant to the Checks Without Cover Law, 5741-1981. In addition, the Supervisor temporarily removed the limitations on granting credit to bank customers at these branches, and determined that a deviation from the line of credit would be at the business discretion of the bank managers. Finally, the Supervisor made it easier for customers to enroll for the service to provide instructions by telephone. In accordance with this leniency, customers were able to confirm their agreement to provide instructions by telephone via the banks' telephone call centers, and confirmation of their enrollment for the service was sent to the customers through channels such as SMS, electronic mail, or telephone message.

During the operation, the Banking Supervision Department tracked the behavior of the banking system, including touring branches in the south. Upon the conclusion of the special home front situation, all of the leniencies were immediately cancelled, except for the leniency allowing a deviation from lines of credit. This leniency was extended until December 31, 2012.

(4) Regulation

As part of the response to the need to track the banking system's activities during emergencies, a draft directive on "Daily Reporting During Emergencies" was formulated. This document details what data the banks must send to the Banking Supervision Department, at its special request, upon the declaration of an emergency.

e. Strengthening corporate governance

(1) Examining the internal audit function at the bank

Toward the end of 2011, the Banking Supervision Department published the Proper Conduct of Banking Business Directive on "The Internal Audit Function", which is parallel to the recommendations of Basel III. The new regulations take into account the developments and changes that took place in the risk management field and the adoption of the three lines of defense, which hold that the internal audit constitutes a third control circle.

During 2012, the Banking Supervision Department held a round of audits to assess the internal audit function in the banking corporations relative to the new directive and relative to the updated international standards. Among other things, the Department assessed the characteristics and roles of the internal audit function, its management and control processes, its performance, and the corporate governance environment. The findings of the audits were sent to the banking corporations accompanied by a demand to correct the defects that were found.

(2) Survey of work plans

The work plans are the translation into action of the vision and goals of the banking corporation, and constitute an inseparable and main part of the management processes. The plans are carried out in a cross-organizational (horizontal) procedure, and are structured, for the most part, during the last quarter of the calendar year. The plans define main goals and operative indices for achieving them, and assist in improving the management processes and streamlining while enabling the banking corporation to deal in parallel with both ongoing matters and future plans. As part of the ongoing tracking, the Banking Supervision Department makes an in-depth assessment of these plans and conducts a series of meetings with the senior management ranks at the banking corporations. The Department reviews the process of formulating the plan, the ability to achieve the targets and the definition of the actions and means required to achieve them. It also reviews the current and future activity markets, the potential risks to which the corporation is exposed, improvement and streamlining processes, milestones and control mechanisms, the bank's ability to make the changes in a planned and controlled way, and more. The findings of the review lead to improved work practices, strengthening of infrastructure and control processes toward achieving the targets and, where necessary, changing the path.

(3) Control structure

Until the amendment to the Banking (Licensing) Law, 5741-1981 was made in 2004 (the "Marani Amendment"), there was one single ownership structure at the banks—through a controlling group. Following the amendment, decentralized ownership became possible—a structure in which there is no controlling group and the public has dispersed holdings of the bank's shares.

In view of the fact that there are currently two possible ownership structures, and it is possible to move from one structure to the other, the need arose to clarify the principles for transferring from one to the other. These clarifications were issued in March 2012, once the amendments to the banking laws, including amendments intended to strengthen the proper management mechanisms of banks with no controlling group, were completed.[9]

During 2012, the Banking Supervision Department initiated an additional update, which was done in conjunction with the Commissioner of Capital Markets, Insurance and Savings at the Ministry of Finance. The cooperation was intended to create harmony in the principles that apply to institutions that manage the public's funds, and to strengthen general financial stability, among other things. Within this framework, a draft document of principles was jointly published for public comments by both regulators regarding criteria for granting control permits. In addition, each regulator separately published for public comments a detailed document regarding the granting of control permits, based on the joint document of principles. The aim was to improve transparency vis-à-vis potential investors, and to express readiness to receive comments from the public in order to conduct a critical re-assessment.

[9] More details appear in the Banking Supervision Department's Annual Survey for 2011, Chapter 3, Section 1(f).

In parallel, a document of principles for decentralizing a controlling group at a bank was published for public comments. The aim of the document is to ensure that following the cancellation of the control permit, previous holders of control would not continue to actually control the bank. Such a document is needed because while it is necessary to allow for a transition period in order to sell the shares, during this period former controlling owners may still hold significant parts of the means of control of the bank.

f. Strengthening the legal infrastructure for handling a bank crisis

The global financial crisis that began at the end of 2007 exposed the global economy to many failures among financial corporations, some of which were financial corporations with systemic importance. The assistance provided by governments was intended to mitigate the damage, but it increased the budgetary burden, and in some countries—mainly in Europe—it led to further damage to the real economy. With this in mind, various countries, central banks and regulatory authorities understood that a change was required in the legal framework for handling failing financial corporations.

Toward the end of 2011, a delegation from the International Monetary Fund visited Israel. During the visit, IMF economists assessed, among other things, the framework in use in Israel for handling failing banking corporations (a framework which is set forth in the Banking Ordinance), and recommended amending the existing legislation, which was enacted in 1969. Among their recommendations, the IMF economists suggested expanding the authorities and tools available to the regulatory authorities both in the stages preceding a failure and when handling a failure. In addition, they recommended the early establishment financing mechanisms for use in case of a failure.

The Banking Supervision Department, with the assistance of the Bank of Israel's Legal Department, is currently formulating an initial draft of an amendment to the Banking Ordinance regarding the handling of a failing banking corporation. This is being done in line with legislative changes around the world, and takes into consideration the International Monetary Fund's recommendations. The draft is being written in consultation and conjunction with government ministries and other regulatory authorities in Israel.

g. Strengthening cooperation with regulators in Israel and abroad

The Banking Supervision Department maintains ties with various regulatory authorities in Israel and around the world with the goal of exchanging relevant information. This is essential in view of the developments in the financial system, and is required by the international standards formulated by the Basel Committee. The Department also holds regular meetings with international ratings agencies and with foreign institutional investors in order to enhance transparency and understanding regarding the operation and strength of the Israeli banking system.

During 2012, officials from the Banking Supervision Department participated in a number of working groups, including the OECD's Committee for Financial Markets which examined supervisory policy, regulatory changes and global developments in the financial sector. The Department also participates in the European regional advisory group within the FSB.[10]

[10] Financial Stability Board.

Box 2.3: Recommendations of the Team to Examine Increasing Competitiveness in the Banking System

The Inter-ministerial Team to Examine Increasing Competitiveness in the Banking System (hereinafter: "the Team") was appointed by the Governor of the Bank of Israel, Prof. Stanley Fischer, and the Minister of Finance at the time, Dr. Yuval Steinitz. The Team focused its efforts on a target population of the household and small business sectors. The Team was tasked with assessing how to improve the terms granted by the banking system to these customers, including lowering prices and improving the quality, accessibility, and variety of services. These sectors conduct their financial activity—including business financing—mainly through the banking system, and basically have no alternative to this system in most sectors of financial activity and services.

On July 16, 2012, the Team published its interim report, which included its main recommendations, and invited the public to express its views. After hearing the public's opinions, the Team decided to keep the recommendations published in the interim report in place, and to add and develop issues which are critical to their implementation. On March 19, 2013, the Team submitted its concluding report to the Minister of Finance and the Governor of the Bank of Israel. The report was published on the Bank of Israel's website at http://www.boi.org.il.

The Team reviewed the aspects of competition in the Israeli financial system and characterized the system's activities with the aim of identifying impediments to the development of competition in the system. It also reviewed the developments in the Israeli credit market in the past decade, and conducted an international comparison of the costs of managing a current account.

The Team found that competitiveness can be enhanced, the bargaining power of the retail customer can be reinforced, and his situation can be improved by enacting measures in three different spheres: structural measures intended to increase the number of players inside and outside the banking system in the medium and long term; measures to increase competitiveness among the existing players, including reducing switching barriers and information gaps and increasing transparency and fairness; and complementary measures, including regulatory intervention to solve market failures by way of price supervision and increased enforcement. As part of the complementary measures, the Team placed special focus on the small business sector.

The main recommendations of the Team are below (the full text of the recommendations appears in the summary report):

- **To enable institutional investors to conduct activity in bank credit products** – A retail credit team was established, led by the Capital Markets, Insurance and Savings Division at the Ministry of Finance, with the aim of assessing the issues associated with providing retail credit from pension savings sources.
- **To encourage the establishment of an Internet bank** – In the report, the Team noted the potential contribution of establishing an Internet bank, in addition to the banks currently operating in Israel. In the report's appendix, the Team published the licensing process required to establish such a bank.
- **To encourage the establishment of credit unions** – The Team welcomes the social initiative to establish credit unions, since they can contribute to competitiveness in the banking system.

The Banking Supervision Department will provide guidance to such initiatives and will assess whether the regulatory structure is appropriate for them.

- **To support Internet banking as a lever for competition** – to enable opening a bank account via the Internet; to make the process of closing a current account and transferring activity to a different bank easier; to publish information on the Internet regarding the interest rates actually given on credit and deposits; and to enhance the accessibility of banking information for sites that use the information for comparative purposes.
- **To provide information to customers through a banking "ID" card** – to create a document (a banking "ID" card) that will enable bank customers to obtain information about their banking activity and about their credit rating with the bank in a centralized fashion.
- **To enhance the information on borrowers (credit bureau)** – to expand the information collected by credit bureaus; to transfer information to the credit bureaus that would enable the formulation of a statistical credit rating model; to send information to customers, at their request, by technological means.
- **To regulate aspects of the non-bank credit market: to update the interest ceiling mechanism and to apply the update to the banking system as well** – to update the mechanism by which interest rates are determined: The interest rate ceiling shall be calculated by the late payment interest rate determined by the Accountant General, plus 12 percentage points. The amendment shall apply to banking corporations as well. In addition, the Team recommended determining that the provision of credit at a higher interest rate should be considered a criminal offense.
- **To enhance competition over short-term household savings** – to cancel securities management fees in respect of *makam* and in respect of money market funds.
- **Recommendations regarding the regulation of fees** – to cancel the fee for an information printout, for a cash withdrawal printout, and for changing the charge date on credit cards; to regulate the fee for sending notices to the customer; to raise the amount above which it is permitted to collect fees for handling credit and collateral from NIS 50,000 to NIS 100,000; and to reduce the number of fees concerning foreign exchange activity.
- **Recommendations regarding bank customers' activities in securities** – to enhance transparency concerning securities fees, to reprice the services and to make it easier to move between the banking system and the non-banking system.
- **Recommendations concerning the small business sector** – To apply the retail price list to a larger group of small businesses, in accordance with the new definition that will be formulated for this purpose, and to cancel the "small business account management fee"; to expand the existing arrangement regarding the early repayment of housing credit, and to apply it, with necessary changes, to the early repayment of business credit as well; and to regulate the fee for early repayment of non-housing credit.
- **To maintain the benefits and discounts on credit and deposits** – To leave the benefits in place throughout the deposit or loan period.

After publishing the interim report and hearing the public's positions, the Banking Supervision Department acted to implement the recommendations under its authority or that of the Governor of the Bank of Israel, and began advancing a main legislative amendment required to implement other recommendations.

h. 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 in the banking system, and to strengthen the customer's position vis-à-vis the bank. These activities include the formulation, implementation and enforcement of legislation and directives in the area of bank–customer relations, providing consumer information and financial education to the banks' customers, investigating complaints and enquiries from the public, identifying and correcting systemic irregularities, and dealing with bank fees and restricted accounts and restricted customers. This section reviews each of these areas:

(1) Legislation and regulation for the protection of bank customers

In 2012, the Banking Supervision Department amended the Proper Conduct of Banking Business Directives, published circulars and letters to the entire banking system, and was an active participant in legislative processes in the area of bank-customer relations. Within this framework, the Banking Supervision Department presented the Bank of Israel's position in Knesset committees and ministerial committees on banking consumer issues, and provided professional opinions concerning proposed laws, some of which were formulated into legislation that came into force during 2012. A summary of the Banking Supervision Department's regulation in the banking consumer area is below:

i. Directive regarding project finance

This Directive relates, inter alia, to the banking corporation's requirement, when financing a construction project under the project finance method, to produce a payment coupons booklet in respect of every apartment in the project which the contractor will sell, with the payment coupons to be used for every payment which the purchaser will pay in respect of the apartment. There were two amendments made to this Directive. The first was intended to create confluence between what is written on the payment coupon and the bank's duties as detailed in the Directive. The second was intended to bring to the attention of apartment purchasers that in accordance with the law, the bank must act to provide a surety within 14 business days from the date of payment of the coupon.

ii. Directive regarding debit cards

An amendment was made to this Directive dealing with cards that were cancelled or the use of which was restricted. The aim of the amendment is to prevent the printing and sending of statements relating to continuing transactions carried out prior to the cancellation or restriction. Regarding such cases, it was set forth that when the issuer continues to charge the customer for such transactions, it must continue to send him transaction statements around the first and last charge dates that apply after the cancellation or restriction, and in any case at least once every three months.

iii. Circular regarding the requirement to publish the name of the supplier on the monthly statement to the customer

In 2011—as part of Proper Conduct of Banking Business Directive 470, which deals with debit cards—the issuer was required to list on the monthly 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 circular was published in 2012, and lists the extenuating circumstances in which this obligation does not apply.

iv. Letter regarding the implementation of Supreme Court rulings

In the past, the Banking Supervision Department appealed to the court for standard contracts, and initiated a process intended to remove depriving conditions from the housing loan contract of the First International Bank Ltd. The First International Bank appealed to the Supreme Court, and in 2012, a ruling was handed down, as a result of which the Supervisor of Banks instructed all banking corporations to implement the ruling both in their customary housing loan contracts and in other contracts that include similar provisions to those discussed in the ruling. A preparation period was set out for amending the contracts in accordance with the Supreme Court ruling. The Supervisor of Banks also instructed the banking corporations to publish information regarding their fulfillment of the ruling on their Internet home pages, with a link to the ruling, and to direct customers' attention to it on their annual account statement.

(2) Providing consumer information and financial education

i. Information program regarding youth accounts

In 2011, the Banking Supervision Department launched a financial education program for youth via Facebook, and in 2012, it continued running the program. This information program is intended to enrich teenagers' financial knowhow and to provide them with tools for proper financial conduct. The program presents banking content in a clear and interesting manner, and contains calculators and tools to assist teens in understanding various issues. During 2012, many teens actively participated in the program, visiting the Facebook page, asking questions, and responding to the content presented there.

ii. The Bank of Israel's Internet site

As part of the renewal of the Bank of Israel's Internet site, the Banking Supervision Department improved and expanded the content in the area of service to the public. Among other things, the Department reorganized the content in the bank–customer relations area, making it more user-friendly and easier to find. Various forms intended for customer use were created and prepared, and new links were added to external sites in order to expand the information available to customers.

(3) Dealing with bank fees

In 2012, the Banking Supervision Department continued using its legal authority to increase transparency regarding the prices of banking services, and did so mainly through legislative amendments and guidelines to the banking system, as detailed below.

On November 28, 2012, the Supervisor of Banks published an amendment to the Banking Regulations (Customer Service) (Fees), 5773–2012, together with accompanying guidelines to the banking system. This was an initial comprehensive step as part of the implementation of the recommendations of the Team to Examine Increasing Competitiveness in the Banking System (see Box 2.3).

The amended rules reflect the recommendations of the Team to Examine Increasing Competitiveness in the Banking System. They provide tools to enable customers to efficiently compare the various banking services and products, reduce the information gaps between the banks and their customers, provide customers with a more varied selection of possibilities, make it easier to move from bank to bank, and increase the customers' bargaining power vis-à-vis the banks.

In the area of securities, it was decided to require the banks:

- To cancel securities management fees in respect of *makam* and in respect of money market funds.
- To differentially price securities activity in the various channels (a transaction via the Internet or a transaction via a teller).
- To set maximum fees for the purchase or sale of securities.
- To cancel the minimum fees for managing a securities deposit.
- To reprice the fees for securities activity.

In addition, the Banking Supervision Department decided to expand the regulation of the fees for transferring a securities deposit to include the transfer of a customer's deposit to outside the banking system.

The Department also changed the fees for handling credit and collateral. It increased the exemption ceiling for non-housing loans from NIS 50,000 to NIS 100,000, and cancelled the following fees:

- The fee for an information printout and for a cash withdrawal printout.
- The fee for changing the credit card charge date.
- The small business management fee.

In addition, the Department amended the definition of a "senior citizen" in the Banking Regulations (Customer Service) (Fees), 5768-2008, with the goal of granted senior citizens automatic rights to obtain four transactions per month from a teller at the price of a direct channel transaction[11]; required the banks to publish a direct link to the fee price lists on their Internet sites; and declared that service provided by a clearinghouse to a deduction services provider is a service that is subject to regulation regarding the fees collected.

(4) Handling public enquiries and complaints

i. Introduction

The Banking Supervision Department's role in maintaining fairness in the relations between banking corporations—the banks and credit card companies—and their customers is performed through the Bank–Customer Division.[12] The Public Enquiries and Bank Fees unit operates within this division. Its role is to investigate customer enquiries and complaints against the banking corporations and to derive lessons from the information obtained in handling complaints. This activity includes, among other things, deciding on complaints and providing suitable relief, supplying information to the banks' customers in order to reduce the knowledge and 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 upon the Supervisor of Banks the authority to investigate public enquiries regarding their activities with the banking corporations. The unit is comprised of economists, lawyers and accountants, and serves as an objective, external body for deciding disputes between the banks and their customers in accordance with legal principles and in view of the value of fairness in bank–customer relations.

[11] In accordance with the amendment, a customer who is a senior citizen shall no longer be required to present a senior citizen's card to the bank in order to be entitled to obtain four transactions by a teller each month at the price of a direct channel transaction. Instead, such a customer is automatically entitled to this.

[12] Other banking consumer protection activities are also carried out through the On-Site Examination Division of the Banking Supervision Department.

ii. Handling public enquiries and complaints—general data[13]

In 2012, the Banking Supervision Department processed 6,095 written enquiries and complaints from customers of the banks and credit card companies, and answered about 16,400 telephone enquiries.

Out of 6,095 written enquiries and complaints, 1,253 were complaints and the rest were enquiries and requests. A position was taken—the complaint was justified or the complaint was not justified—with respect to 898 complaints. No position was taken regarding the remaining complaints, mainly because the bank agreed to accede to the customer's request before a decision was made. In 510 cases of complaints and requests, the banks and credit card companies acted to benefit the customer even though it was not determined that the complaints were justified, and the total amount paid to customers in these cases was about NIS 1.4 million. In other cases, no position was taken due to the inability to decide between contradicting verbal claims, or due to concurrent legal proceedings.

As a result of the Banking Supervision Department's intervention in individual complaints, the banking corporations paid their customers a total of about NIS 2.4 million.

Eighty-nine percent of the enquiries and complaints submitted to the Banking Supervision Department in 2012 were processed within six months. Enquiries regarding requests for information were answered shortly after they were received. Handling complaints takes longer, as the activity is conducted vis-à-vis the banks and credit card companies. A number of clarifications are sometimes necessary in order to make a decision on a complaint, depending on its scale and complexity.

The table below presents the distribution of enquiries and complaints, the handling of which has been completed, by the length of time spent in processing them by the Public Enquiries Unit:

Up to 3 months	**3–6 months**	**6–9 months**	**9–12 months**	**More than 12 months**
81%	8.0%	5.0%	4.0%	2.0%

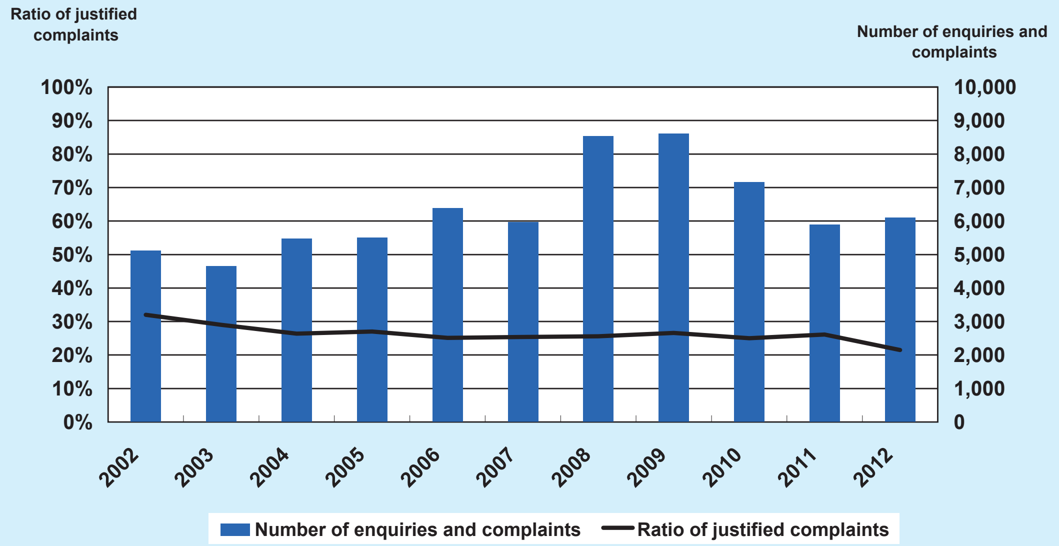
Figure 2.1 shows that in 2012, 21.5 percent of complaints regarding which a position was taken were found to be justified, compared to 26.1 percent in the previous year. There are two main reasons for the decline in the rate of justified complaints:

- A sharp decline in the rate of justified complaints against Mizrahi-Tefahot bank (from 34.8 percent in 2011 to 20.1 percent in 2012)[14], and a significant decline in the rate of justified complaints against First International Bank (from 25.8 percent in 2011 to 16.7 percent in 2012). The other banks maintained a similar rate of justified complaints in 2012 compared to 2011.
- An increase in the rate of complaints in which the banks acceded to the customers' requests beyond the letter of the law—even though it was not determined that the complaint was justified. At Bank

[13] A detailed presentation of the data on the banking corporations based on the information drawn from handling public enquiries and complaints appears in a separate survey published on the Bank of Israel's website on April 10, 2012.

[14] In the estimation of the Banking Supervision Department, this decline derives from the broad systemic handling of the bank carried out as a result of defects identified by the Department. See Section 5a below, as well as the survey of Banking Supervision Department activities in the area of handling public enquiries and complaints for 2011, Section 5.1 (http://www.boi.org.il). In addition, this decline apparently also derives from an increase in the bank's preparedness to solve disputes beyond the letter of the law.

Figure 2.1
Number of complaints and enquiries, and ratio of justified complaints, 2002–12



SOURCE: Banking Supervision Department.

Hapoalim, the rate of such complaints increased from 25.5 percent in 2011 to 31.8 percent in 2012, at Mizrahi-Tefahot the increase was from 24.9 percent to 31.4 percent, and at First International Bank, the rate increased from 27.7 percent to 38 percent.

Complaints and enquiries also help in identifying and correcting system-level deficiencies in the banking system. Details of the handling of system-wide problems are provided in Section 5 below.

A plurality of complaints (22 percent) were recorded regarding bank accounts, which is not surprising since the current account brings together many and varied activities, and may have various characteristics. For instance, it could be a joint account, an account through which business transactions are managed, a company's account, and so forth. At the same time, most of the complaints regarding bank accounts still concern the processes of opening or closing an account.

(5) Handling systemic issues

Complaints and enquiries are also used to identify and correct system-level deficiencies in the banking system. Based on the information that they yield, the Department identifies matters that require regulation by means of Proper Conduct of Banking Business Directives from the Supervisor of Banks, as well as issues that entail the provision of information to the public.

In 2012, there were 63 instances examined, in which there was concern of the possible existence of a system-wide deficiency. The Banking Supervision Department required banks and credit card companies to take various measures, such introducing or revising working procedures, improving processes or services, improving technological systems, and refunding money to groups of customers. The Department is monitoring the implementation of these measures.

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

i. Early repayment of housing loans

Many deficiencies in the area of early repayment of housing loans were found at Mizrahi-Tefahot bank, and were published in the survey for 2011. As a result of dealing with them, the bank conducted a long series of processes intended to prevent the recurrence of similar deficiencies in the future, including the revision of working procedures, updating systems and bringing them in line with the requirements of the Banking Supervision Department, improving work processes at branches, revising documents and forms, monitoring the collection of fees, training workers, and more. In addition, the bank was required to identify customer accounts regarding which there is concern of damage as a result of the contravention of Banking Supervision Department directives, and to act to correct these damages. The Banking Supervision Department is monitoring the completion of the process.

As a result of deficiencies that were identified during the handling of public enquiries, the bank was audited concerning early repayment.[15] The number of justified complaints in this regard declined significantly during 2012, due among other reasons to these processes, and as detailed in Section 4b above.

ii. Charging current account fees on an account that was opened only for issuing bank guarantees

An investigation of a complaint against Bank Leumi showed that the bank charged current account fees on an account that was opened only for the purpose of a deposit to serve for the issuance of a bank guarantee as a security while a mortgage was reassigned to a new property. There was no activity in the subject account. The bank acted contrary to Banking Supervision Department directives, which set out that an account with no activity, the aim of which is to manage a loan or deposit only, shall be defined as an exchange account, meaning an account that is not charged current account fees. The bank was required to identify accounts that were opened for the purpose of issuing a guarantee, and would then credit these accounts with the amounts of the fees that were collected. The Banking Supervision Department is monitoring the completion of the process.

iii. Charging a fee for a lawyer's warning letter

An investigation of a complaint showed that Bank Hapoalim charged a fee for a lawyer's warning letter before the letter was sent, based on the bank's working procedure, which is supported by its technological systems, according to which the charge is made before the letter is sent. Complaints received by the Department showed that the customer is occasionally charged the fee even though the letter was never sent. The bank corrected the procedure and the technological systems, and as of January 1, 2013, the charge for the fee is made only after the letter is sent. In addition, the bank was required to identify accounts where there was a concern that they had been charged the fee contrary to the Banking Supervision Department's position, and to credit such accounts.

iv. Collecting a conversion fee for transactions made via the Internet with a business that is resident in Israel

In the past year, a number of complaints were received from holders of debit cards issued by CAL. The customers complained that the company charged their account a currency conversion fee for a transaction made via the Internet, in Israeli currency, with a business based in Israel.

[15] The audit was conducted by the on-site examination unit of the Banking Supervision Department.

After the Banking Supervision Department examined the issue, it decided to prohibit the banking corporations from collected such currency conversion fees. This position was reflected in an amendment to the Banking Regulations (Customer Service) (Fees), 5768–2008, which set out the list of services for which the banking corporations are allowed to charge their customers a fee.[16]

The reason underlying the amendment is the concern that when a customer orders a product via the Internet from a business located in Israel, he is not expecting his account to be charged a conversion fee in addition to the transaction amount, while in the case of a foreign transaction, customers do expect this. In view of the high quantity of such transactions, it has become necessary to improve the transparency of the conditions for their execution.

v. Disclosure of interest rate benefits for a deposit made via the Internet

Following complaints against Bank Discount, it was found that when putting funds into a deposit via the bank's Internet site, the deposit screen does not show the interest rate on the deposit separately from the benefit rate, but only displays interest rate tables. Following the Banking Supervision Department's intervention, the bank was required to correct the Internet site in order to fulfill the Department's requirement to display the benefit rate separately on the deposit screen. The Banking Supervision Department is monitoring the completion of the correction.

vi. Error in the calculation of interest on a daily deposit made via the Internet

A customer of Bank Discount put funds into a daily deposit via the bank's Internet site due to the offer of an interest rate benefit for deposits of this type, but found that he did not receive the benefit on the interest rate. As a result of handling the complaint, it was found that the error resulted from a failure in the bank's systems—they classified the deposit as having been made through a branch and not via the Internet. Following the discovery of the error, the bank corrected its systems, identified the deposits that had been harmed by the deficiency, and credited the customers with the differentials. The Banking Supervision Department continues to handle the additional ramifications of the deficiency and is monitoring its correction.

vii. Overcharging in respect of a fee for depositing money or paying a coupon via the service box

Due to the investigation of a complaint, it was found that Bank Discount charged a customer a fee for a transaction via a teller in respect of the deposit of money or the payment of a coupon via the service box, instead of charging a lower fee—for a transaction via a direct channel—as required by the Banking Regulations (Customer Service) (Fees), 5768–2008. The bank refunded money to the customers who had absorbed the over-charge. The Banking Supervision Department continues to monitor the correction of the deficiency.

viii. Liens on bank accounts belonging to senior citizens and Holocaust survivors

At a July 2011 meeting of the Knesset Economics Committee, representatives of the Ministry for Seniors Affairs claimed that they had been made aware of cases where liens or offsets had been placed on money deposited in bank accounts protected against liens and offsets, including pension payments to victims of the Nazis.

[16] The amendment, which came into force on January 1, 2013, states that it is not allowed to collect a currency conversion charge for a transaction carried out in the Israeli currency with a business located in Israel.

Despite the fact that no specific cases of liens on pensions made in contravention of the law have been brought to the Department's attention, in view of the importance of the issue, the Banking Supervision Department approached the banking corporations to ascertain that they are acting in accordance with all laws that place protections from liens and offsets on pensions and benefits transferred to the bank accounts of those entitled.

The banks confirmed to the Department that they are meticulous in acting in accordance with the relevant laws. Procedures were refreshed or updated at some banks with the aim of including all of the relevant sections of the law.

During 2012, no justified complaints were received by the Banking Supervision Department regarding liens or offsets on benefits or pensions of victims of the Nazis made in contravention of the law.

ix. Exemption from exchange rate differential fees for those receiving pensions

On September 18, 2011, Bank Discount published a notice of its intention to grant an exemption from exchange rate fees on cash withdrawals in foreign currency from an account where pensions paid as compensation from the German government or the Claims Conference are deposited. Following an investigation of a complaint, it was found that, despite the announcement, the bank charged this fee from its customers—recipients of compensation and pensions for victims of the Nazis—because it hadn't updated its systems regarding the exemption. The bank made refunds to its customers who had absorbed the over-charge up to October 25, 2011—the date the bank's systems were updated.

(6) The Section for the Restriction of Accounts and Customers

i. The number of restricted customers and restricted accounts

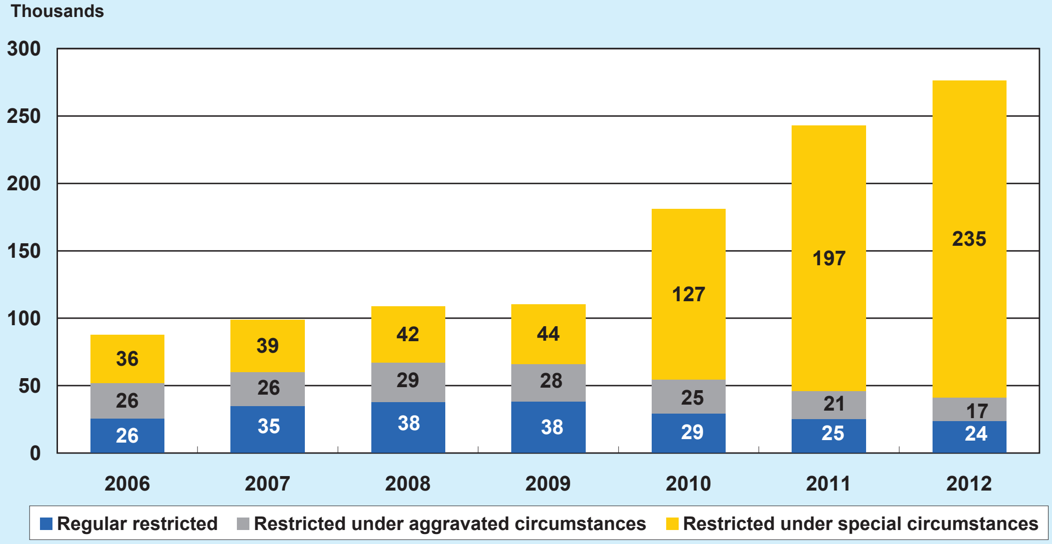
At the end of 2012, there were 276,297 restricted customers (compared to 242,880 at the end of 2011). Of those, 23,290 were restricted under "regular" circumstances (compared to 25,201 at the end of 2011), 17,257 were restricted under "aggravated circumstances" (compared to 20,709 at the end of 2011), and 235,120 customers were restricted under "special circumstances" (as compared to 196,970 customers at the end of 2011). 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 rabbinic courts. These data show the increase in the number of restricted customers continues as a result of the increase in the number of customers restricted under special circumstances during Execution Office proceedings, despite the decline in the number of people drawing checks without cover (Figure 2.2).

There were 521,730 restricted accounts in 2012 (compared to 463,854 at the end of 2011). Of those, 123,352 had been restricted as a result of the return of checks due to "insufficient funds"—the Checks Without Cover Law-—and the remaining 398,378 were restricted as a result of restrictions under "aggravated" or "special" circumstances that were imposed on their owners (Figure 2.3).

The increase in the number of customers restricted under "special circumstances" is due to the change in legislation regarding debt collection processes as part of Execution Office proceedings (Amendment 29 to the Execution Law[17]) 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.

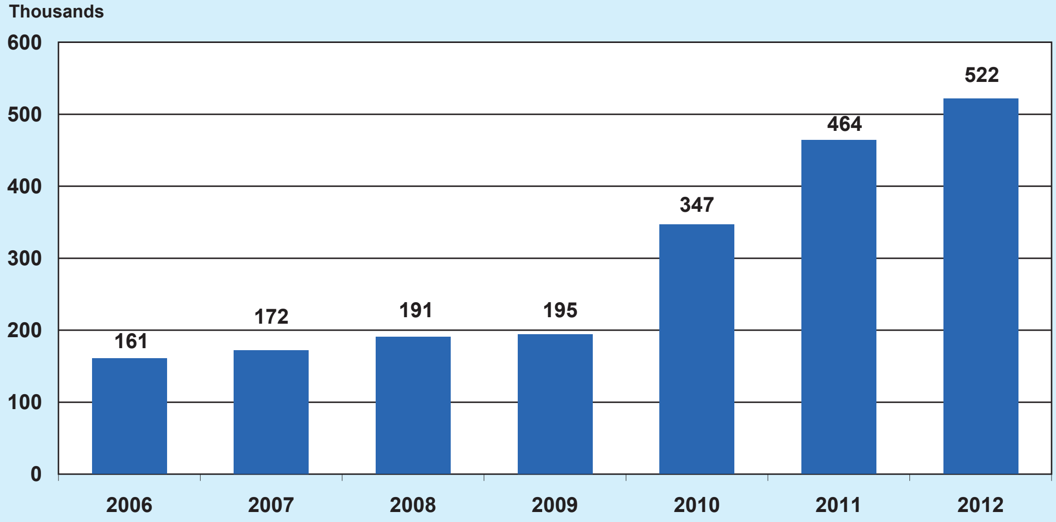
[17] The Execution Law (Amendment 29), 5769–2008.

Figure 2.2
Number of restricted customers



SOURCE: Banking Supervision Department.

Figure 2.3
Number of restricted accounts



SOURCE: Banking Supervision Department.

ii. Enquiries and appeals of restrictions

In the course of 2012, the Section handled about 4,110 written enquiries and more than 15,400 telephone enquiries. Some of them requested information on being restricted, its meaning and implications, and others requested that a restriction be cancelled or that the propriety of a restriction be examined.

The Section monitors banks' execution of court decisions and verdicts on an ongoing basis. During the year, 787 appeal files were opened, and 718 were closed after they were discussed and dealt with during the course of the year. About one-third of the appeals were accepted and the restrictions placed on the customers in most of those cases were cancelled.

iii. Changes in activity as a result of amendments to 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 various sanctions on debtors, including restriction under "special circumstances". This amendment went into effect in March 2012 and, as of January 1, 2013, the Bank of Israel has begun recording these restrictions.

In addition and in accordance with the amendment of the Credit Data Services Regulations (Amendment), 5772–2011, as of November 1, 2012, the Bank of Israel started providing 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 concerning restricted customers and those restricted under aggravated circumstances.

2. TABLE OF EVENTS IN 2012

January 29	**Risks in transferring funds from accounts for illegal gambling purposes** The banking corporations were required to set policies regarding the risks implicit in transferring funds whose source or target is bank accounts that appear on Internet sites and which allegedly serve for illegal gambling activities.
February 14	**Proper Conduct of Banking Business Directive 350 "Operational Risk"** As part of updating the Proper Conduct of Banking Business directives and bringing them in line with the Basel recommendations, a directive was set out regarding operational risk management. This directive sets forth basic principles for managing operational risk, which relate to corporate governance and the risk management environment.
February 14	**Clarifying the criteria for determining the currency of operation of banking extensions abroad** In view of the implementation of international financial reporting standards regarding the effect of changes in the foreign currency exchange rates, the criteria for determining the currency of operation of banking extensions abroad were clarified.

March 18 **Clarifying how to handle put options on rights that do not grant control**

In view of the implementation of international financial reporting standards regarding financial and consolidated reports, the accounting handling and the handling for purposes of minimum capital ratio of put options on rights that do not grant control were clarified.

March 25 **Expansion of disclosure of credit quality of debts and credit loss allowances**

Following the revision in the US, the disclosure requirements for credit quality of debts and for credit loss allowances—as included in the directives for reporting to the public—were significantly expanded.

March 28 **Preparedness for the adoption of Basel III guidelines in Israel**

As part of the preparedness for the assimilation of the Basel III recommendations in Israel, minimum core Tier 1 capital ratio requirements that must be met by the banking corporations and credit card companies were set, as follows:

A minimum core Tier 1 capital ratio of 9 percent by January 1, 2015.

A banking corporation whose balance sheet assets on a consolidated basis total 20 percent or more of the total balance sheet assets of the entire banking system is required to reach a minimum core Tier 1 capital ratio of 10 percent by January 1, 2017.

April 29 **Amendment of Proper Conduct of Banking Business Directive 417 –Activity of a Banking Corporation in a Closed System**

Following the amendment to the Prohibition on Money Laundering Order (Identification, Reporting and Record Keeping Requirements for Banking Corporations to Prevent Money Laundering and the Financing of Terror), 5761–2001, and its expansion to include partnership units, Proper Conduct of Banking Business Directive 417 regarding the Activity of a Banking Corporation in a Closed System was amended.

May 7 **Diminution of financial assets in securitization transactions and consolidation of entities for a special purpose**

The United States published accounting standards that significantly changed the accounting handling of transactions where financial assets were transferred in general, and particularly the conditions required for a banking corporation to diminish financial assets in securitization transactions and consolidation of entities for a special purpose. Following this action, the directives for reporting to the public were amended.

May 15 **Proper Conduct of Banking Services Directives – Market Risk, Securitization, and Handling illiquid positions**

Following the Basel Committee publications, which include amendments to the Basel II Framework:

a. Proper Conduct of Banking Business Directive 208 – Market Risks was amended.

b. Proper Conduct of Banking Business Directive 205 – Securitization was amended.

c. Proper Conduct of Banking Business Directive 209 – Handling Illiquid Positions was promulgated. This Directive provides guidelines regarding a cautious and conservative estimate of all positions measured by fair value, in accordance with accepted accounting rules.

July 30 **Amendment of Proper Conduct of Banking Business Directive 326 – Project Finance**

In order to provide apartment purchasers with relevant information concerning collateral that they should obtain upon payment of a coupon, Proper Conduct of Banking Business Directive 326 on Project Finance was amended.

August 20 **One-time reporting on wage data recorded in 2011**

As part of the directives on reporting to the Banking Supervision Department regarding (yearly) profit and loss, the banking corporations are required to report on the number of workers and expenses by yearly wage level. In order to assess the proper reporting framework, the banking corporations were asked to submit a one-time report on wage data recorded in 2011.

September 19 **Amendment of Proper Conduct of Banking Business Directive 470 – Debit Cards**

In order to save the unnecessary printing and mailing of statements relating to continuing transactions made before the cancellation or blockage of a debit card, Proper Conduct of Banking Business Directive 470 regarding Debit Cards was amended. The issuer is now required to send a statement of transactions around the time of the first and last charges applying following the cancellation of blockage, and in any case at least once every three months.

October 15 **Clarifications regarding the duty to publish the supplier's name on monthly statements**

Following the amendment of Proper Conduct of Banking Business Directive 470 regarding Debit Cards, which required the issuer of a debit card to note on the monthly statement the supplier's name as it appears to the customer, the extenuating circumstances under which this obligation would not apply were set out in a circular.

November 1 **Placing limitations on housing loans**

In view of the continued increase in new housing loans, and in view of the risk implicit in taking out housing loans with high financing rates, it was set forth that banking corporations would not approve or make housing loans with rates exceeding those detailed in the Directive.

November 11	**Update of directives on reporting to the public regarding adjustments from the translation of financial reports** Following the publication of circulars affecting how changes in the foreign currency exchange rate are presented, directives on reporting to the public were updated, and a disclosure requirement was added to the sample format of financial reports and explanatory notes regarding adjustments from the translation of the financial reports.
November 13	**Requirement to amend housing loan contracts following a Supreme Court ruling** Following a ruling by the Supreme Court in an appeal of a ruling by the court for standard contracts on a request initiated by the Supervisor of banks to cancel or change depriving conditions in the housing loan contract of First International Bank Ltd., the Supervisor directed all banking corporations to implement the ruling in their housing loan contracts and other contracts that include similar language to that discussed in the ruling.
November 20	**Update of directives on reporting to the public regarding the measurement and disclosure of fair value** Following publications in the US that expanded and clarified the measurement and disclosure requirements regarding fair value, the directives on reporting to the public on the matter were amended.
December 3	**Update of the FAQ file regarding impaired debts** In view of experience accumulated in the implementation of directives on reporting to the public regarding impaired debts, credit risk and credit loss allowances, the FAQ file on this matter was updated.
December 5	**Disclosure requirement regarding information security and cyber attacks** Disclosure guidelines were published in the US regarding information security and cyber attacks, following which the banking corporations are required to include disclosure based on these guidelines in their reports to the public as of December 31, 2012.
December 9	**Update of the directives on reporting to the public: requirement to submit a separate report on total profit** Following publications in the US and other countries, the directives on reporting to the public were updated, and banking corporations are now required to present a separate report on total profit immediately after the profit and loss statement.
December 12	**Clarification of directives on reporting to the public regarding offsetting assets and liabilities** Following amendments in the US and other countries regarding disclosure requirements on offsetting assets and liabilities, the directives on reporting to the public were clarified in this matter, and the disclosure requirements on offsets and collateral in transactions in derivative instruments were expanded.

December 23 **Adjustment of directives on reporting to the public regarding measurement of interest income**

In view of the update of the profit and loss statement format and the adoption of the accounting rules accepted around the world regarding the measurement of interest income, the directives on reporting to the public regarding the presentation of income and expense rates in the third addendum to the executive summary were brought in line with the accepted manner of presentation around the world.

December 27 **Proper Conduct of Banking Business Directive 310 – Risk Management**

Following the crisis in the financial markets, the need to include proper risk management that supports the ability to identify and respond to developing risks as a necessary element in the banking system increased. As a result, a Proper Conduct of Banking Business directive on risk management was issued, and is based on the principles set forth by the Basel Committee.

December 27 **Publication of Proper Conduct of Banking Business Directive 311 – Credit Risk Management**

As part of the update of Proper Conduct of Banking Business directives and bringing them in line with the Basel recommendations, a directive was issued regarding credit risk management. Among other things, the directive defines the structure required of banking corporations for managing credit risk and the division of authorities among the various officials at the banking corporation.

December 27 **Amendment of Proper Conduct of Banking Business Directive 315 – Supplementary Provision for Doubtful Debts**

Following the update of directives for reporting to the public concerning the calculation of credit loss allowances on a group basis, Proper Conduct of Banking Business Directive 315 regarding Supplementary Provision for Doubtful Debts was amended. The banking corporations are required to ascertain that the balance of the group provision is not less than the total amount of the general, supplementary and special provisions for doubtful debts.

December 31 **A draft Proper Conduct of Banking Policy directive was published regarding the calculation of capital adequacy pursuant to Basel III**

As part of assimilating the Basel III recommendations in Israel, a draft amendment to Proper Conduct of Banking Business directives was published, dealing with the calculation of the banking corporations' capital adequacy ratios. Regarding the minimum capital targets, the amendment set forth that the total capital ratio should not be less than 12.5 percent for the entire banking system, and not less than 13.5 percent for the two largest banks in Israel.

3. STRUCTURE OF THE BANKING SUPERVISION DEPARTMENT

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 Division is also responsible for preparedness for business continuity during emergencies. Since the Banking Supervision Department serves as the banking financial authority, it is tasked with ensuring that the bodies under the Bank of Israel's routine supervision—the commercial banks, credit cards companies, Shva and Masav—operate during emergencies as well.

The institutional evaluation units

The institutional evaluations units' responsibilities are divided up by banking groups. The units are charged with assessing the risks of each bank. 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 its overall risk profile. (The banks' capital adequacy relative to their risk profile is assessed through the SREP.[18]) The 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. In addition, 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

b. The On-Site Division

The Division carries out in-depth and comprehensive on-site examination processes at the banks and the credit card companies. The purpose of these audits is to identify and assess the banking risks inherent in the entire range of the banking corporations' activities and to examine the quality of the bank's risk management and the processing of matters that are audited, with an emphasis on compliance with the laws and to the Supervisor of banks' directives and guidelines. Audit reports warn of deficiencies and malfunctions, present requirements and set 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 each specialize in a particular risk area:

(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 at 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, the problem loan detection and classification processes, and compliance with the Supervisor of Banks' directives.

[18] Supervisory Review and Evaluation Process.

(2) The Market Risk and Liquidity Risk Audit Unit

The unit's principal function is to identify market and liquidity risks and assess the quality of their management and control processes. The unit conducts in the following areas: the management of market risks (interest rate risks, indexation basis risk), securities portfolio management, liquidity risk management, the management of risks deriving from dealing rooms' activity in derivatives, and risks deriving from the activities of the banking corporation's customers in the capital markets. The audits include an assessment of the relevant risk management policies, their assimilation in the management, monitoring and control processes, an assessment of the models that serve in risk estimation, and various aspects of corporate governance.

(3) The Operational Risk Audit Unit

The unit's principal function is to examine the banking corporation's operational risks and to assess the management of these risks. An emphasis is placed on IT risks, including information security risks, risks deriving from material 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 to directives concerning the prevention of money laundering and financing of terrorism, 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 Risk 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 effectiveness and efficiency of the board of directors, the senior management, the risk management system, the internal auditing department and the compliance officer.

c. The Policy and Regulation Division

The Division formulates directives for the regulation of supervisory policy, regulates banking activity, and draws up measurement, disclosure and reporting principles, while analyzing developments in risks and banking activity. This activity is carried out via four units:

(1) The Regulation Unit

The Unit is responsible for the regulatory arrangement of banking activity, principally via Proper Conduct of Banking Business Directives 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 Financial Reporting Unit

The unit is responsible for determining principles for measurement, disclosure and reporting to the public by the banking corporations. 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 Reporting Unit

The unit is responsible for receiving the banks' reports to the Banking Supervision Department, processing and editing 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 website.

(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 and analyzing the state of the banking system and the risks within it (stress tests and other tools), and also compiles and publishes periodic reviews as well as the annual survey of the banking system.

d. The Bank-Customer Division

The division 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:

(1) The 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 information accrued from complaints is used as a means for detecting and remedying deficiencies at the banking corporations. The unit also supplies information and answers the public's questions on banking and consumer matters.

(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 Directives. 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 with consumer directives. 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. 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 Section is charged with the management of the checks without cover system. The department collates all the information received from the banks regarding restricted customers and restricted bank accounts, as well as information on special restrictions imposed by the Executioner's Office, the Official Receiver, rabbinic courts and bankruptcy courts. The Section deals with clarifications concerning restricted accounts and customers, and customer enquiries on these matters.

Apart from the four supervisory divisions, three independent units operate within the Banking Supervision Department:

e. The International Relations Unit

The unit maintains regular 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 supervisory authorities worldwide.

f. The Central Services Unit

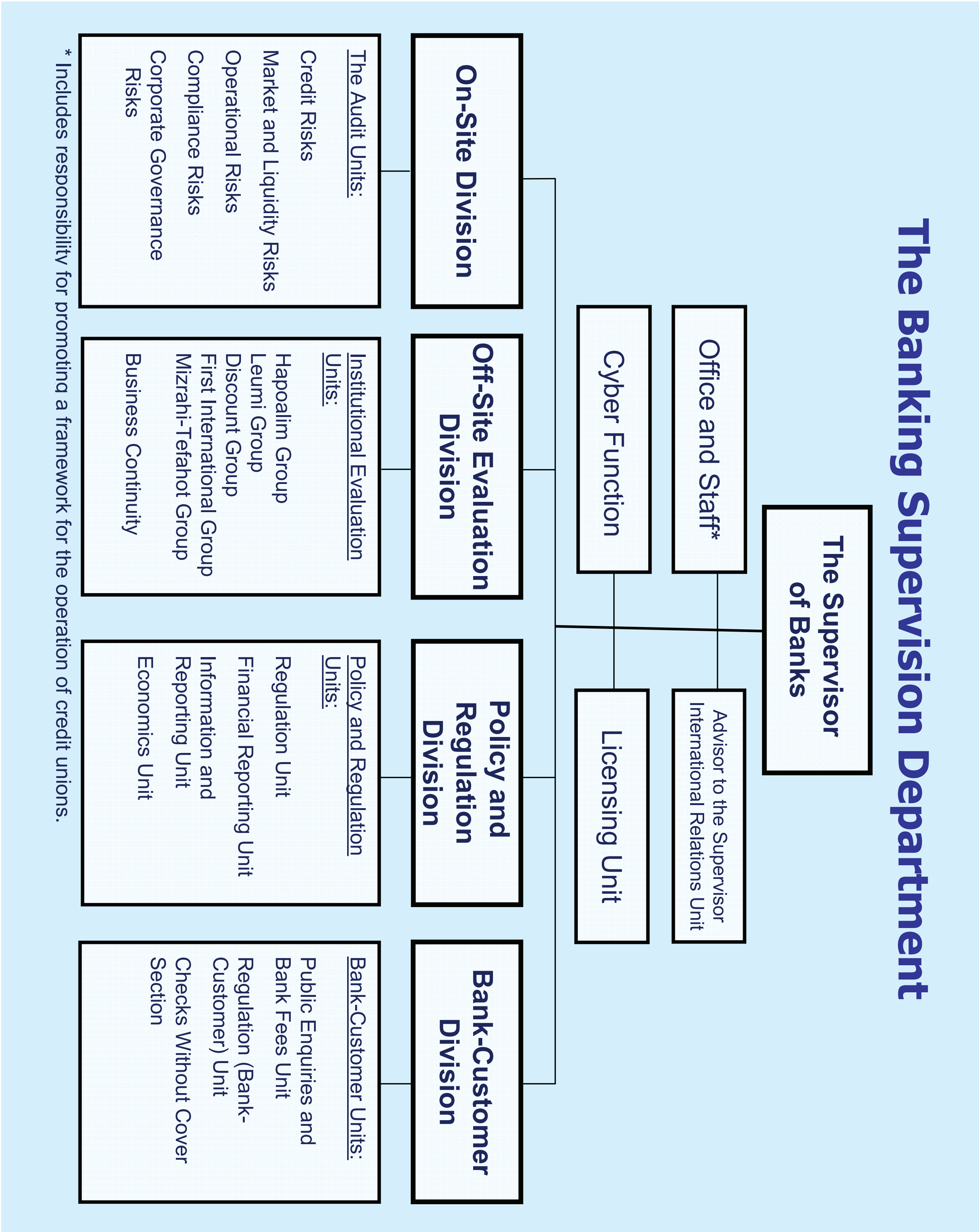
The Central Services Unit engages in the compilation and monitoring of the Banking Supervision Department's work programs, and in the promotion of cross-organizational projects. The Unit's areas of responsibility include the promotion of frameworks for the operation of credit unions, the development of information infrastructures, the preparation of work plans, budgetary planning, procurement activity and the cultivation of human resources, including the construction and application of instructional programs.

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 the examination of candidates for the control or for 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.

h. The Cyber Function

The main role of the cyber function is to strengthen the ability of the banks and credit card companies to withstand cyber attacks. As part of its activity, the function maintains regular contact with the banking corporations, external consultants, the national cyber headquarters and the state information security authority.


The Banking Supervision Department
The Supervisor of Banks
Office and Staff*
Advisor to the Supervisor
International Relations Unit
Cyber Function
Licensing Unit
On-Site Division
The Audit Units:
Credit Risks
Market and Liquidity Risks
Operational Risks
Compliance Risks
Corporate Governance Risks
Off-Site Evaluation Division
Institutional Evaluation Units:
Hapoalim Group
Leumi Group
Discount Group
First International Group
Mizrahi-Tefahot Group
Business Continuity
Policy and Regulation Division
Policy and Regulation Units:
Regulation Unit
Financial Reporting Unit
Information and Reporting Unit
Economics Unit
Bank-Customer Division
Bank-Customer Units:
Public Enquiries and Bank Fees Unit
Regulation (Bank-Customer) Unit
Checks Without Cover Section
* Includes responsibility for promoting a framework for the operation of credit unions.