



State Comptroller Of Israel | Special Report: The State of Israel's
Coping with the Covid-19 Pandemic | 2021

Economic and Budget Topics

Financial Services, Credit and Stability of Financial Institutions during the Covid-19 Pandemic



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Background

The covid-19 pandemic outbreak caused a sharp downturn in the global economy and led to an economic crisis in Israel as well, reflected in a widespread liquidity shortage among households and businesses. The spread of the health crisis beyond the borders of China created panic in the financial markets, resulting in a steep drop in share prices at the end of February 2020 that undermined economic resilience. Israel's financial regulators – the Bank of Israel, the Capital Markets Authority, and the Israel Securities Authority – granted reliefs and extensive assistance to help the economy to contend with the crisis, including: the adaptation of financial services, expansion of the credit supply despite economic activity contraction, as well as steps to preserve the financial system's stability, through intervention in the financial markets to prevent market failures.



Key figures

**\$15
billion**scope of the Bank of Israel's swap¹ program vis-à-vis local banks**NIS 50
billion**

scope of the Bank of Israel's plan to purchase Israeli government bonds in the secondary market

**NIS 73.6
billion**

scope of loan applications in all state-guaranteed loan funds

**NIS 265.4
billion**

amount raised by the Accountant General in Israel and abroad in 2020, among other things, to fund government assistance during the Covid-19 pandemic

14.2%

percentage of loan applications submitted to state-guaranteed loan funds in the regular track and fully granted

12.4%

percentage of loan applications submitted to state-guaranteed loan funds in the amplified track, and fully granted

75.2%

percentage of loan applications approved by state-guaranteed loan funds, out of the applications recommended for approval, following a review by the coordinating bodies

113,589

total number of loan applications submitted to state-guaranteed loan funds

Audit Actions



From March to December 2020, the State Comptroller's Office examined the financial services and credit provided to the public during the Covid-19 pandemic and the resilience of the financial bodies in the course of the crisis. The audit was conducted at the Bank of Israel, at the Capital Markets, Insurance and Savings Authority (Capital Markets Authority), at the Israel Securities Authority, and at the Accountant General Department in the Ministry of Finance. Supplementary audits were carried out at the Israel Tax Authority.

¹ Transaction for the purchase of a financial asset against the forward purchase of another asset at a predetermined price and date.



Key findings



Cooperation between financial bodies – There was no cooperation between the Israel Tax Authority and the Attorney General Department in identifying vulnerable areas affected by the pandemic to improve the operation of the state-guaranteed loan funds and the Israel Tax Authority. Additionally, cooperation by the Bank of Israel with the Attorney General Department in making decisions that balance between the amount of the guarantees and the credit risk could have eased achieving the programs' objectives. The cooperation may create a more beneficial correlation between the interest rate on credit extended by the Bank of Israel to local banks in the framework of the programs, with the percentage of the guarantees provided by the government on the bank credit extended to businesses through the state-guaranteed loan funds.



High exposure of financial institutions to overseas derivatives – The exposure of financial institutions to overseas derivatives affected the liquidity of the portfolios managed during the crisis. Increased exposure of an investment portfolio requires ongoing controls. However, the Capital Markets Authority in January-February 2020, with the onset of the Covid-19 pandemic, did not instruct the financial institutions to analyze the risks relevant to the emerging crisis or prepare for the crisis by taking other measures to reduce their exposure to risks arising from their activity. Moreover, during the crisis, the Capital Markets Authority did not issue written directives to the financial institutions regarding risk analysis or the performance of other actions.







The low percentage of guarantees on the portfolio of state-guaranteed loans compared with similar programs around the world – The percentage of the guarantee provided by the government on the overall portfolio (12% for large businesses, 15% for small and medium-sized businesses, and 60% in the amplified track) is low, compared with the percentage in the government assistance programs of the majority of developed countries. The low level of guarantees on the portfolio harmed the loan approval process of the loan fund for small and medium-sized businesses. The negative effect was reflected by reducing the financing bodies' will to take risks and create incentives for actions inconsistent with the fund's stated purpose, and harm its image, notwithstanding its great importance during the crisis period.



Measurable criteria for the provision of loans in agreements in the regular track of the state-guaranteed loan fund – It was noted in deliberations held in September and October 2020 by the audit team with the fund managers in the commercial banks, that as the agreements did not set measurable criteria for the provision of loans, the credit that was granted in the regular track was used by some of the businesses to reduce their finance costs rather than to bridge cash flow gaps due to the crisis.



-  **Application processing times in state-guaranteed loan funds** – The agreement stipulated that the financing bodies must complete the processing of applications within seven business days led applicants to believe that this would be the case. However, it was found that the processing times in all the tracks (an average of 15 days) were significantly longer than the stipulated times. Following a change in the information transfer mechanism in the funds required the financing bodies to input the data again, which delayed responding to the businesses' loan applications.
-  **Rapid response by the regulators** – The Israel Securities Authority is not flexible enough in times of crisis to provide a quick and appropriate response to market fluctuations that enables efficient and effective supervision. In the course of the audit, the Israel Securities Authority advanced a law memorandum designed to expand its existing powers and allow it to issue directives on certain matters independently and promptly. The draft law memorandum was published on the Ministry of Justice website and the internet for public comments by July 23, 2020. Still, as of the audit completion date (December 2020), the process had not advanced further.
-  **The vital importance of activity by the financial regulators in an emergency** – Despite the essence inherent in the Israel Securities Authority (ISA) activities in its capacity as a financial regulator, this is not reflected in emergency regulations. The ISA has not been granted any easing of the restriction on the number of employees allowed in the workplace. The issue's importance takes effect given the sharp fluctuations in the financial markets, the intensification of the economic crisis, and the exclusion of the financial sector from the regulations. It was found that the scope of employment in the public sector in an emergency has not been methodically executed as part of early preparedness and by reference scenarios and the needs that arise from the crisis.
-  **Utilization of the state-guaranteed loan funds** – It was found that the category of businesses with a sales turnover of NIS 200–400 million preferred to submit applications for loans in the regular track, in the framework of the loan fund for small and medium-sized businesses, rather than submitting applications to the fund for large businesses. A high percentage of applications were canceled in both funds, especially in the fund for large businesses in which at least 33% of the applications were canceled in most of the months of its activity. Additionally, disparities were found in the regular track between Jewish and non-Jewish communities, in favor of the Jewish communities, both in the percentage of approved applications (3.1%) and the average percentage of approved (6.7%). Disparities were also found in the percentage of approved applications (estimated at 42%-67%) divided by economic sectors. Thus, according to the Israel Tax Authority data, in the three economic sectors, whose turnover was hardest hit (hospitality and food, art and entertainment, and education); the percentage of approved applications was lower than the average. Moreover, it was found that applications of micro-businesses were denied at a higher rate than applications in other categories of businesses (4%-11% higher rate of refusals) and that applications of larger businesses were denied the full amount required by them to contend with the crisis (the



average amount approved was 6%-22% lower than for the category of micro-businesses).



Publication of the easing and directives – The Bank of Israel and the Capital Markets Authority rapidly notified the public about the regulatory easing and the directives for expanding the scope of assistance during the crisis (among them: honoring charges beyond the customer's credit line, lowering of the minimum age for a "senior citizen" that entitles the customer to priority in the phone answering queue, freezing of insurance policies and automatic renewal of insurance policies without any charge), while maintaining the required balance to ensure the resilience of the supervised bodies.

Funding of the Government's activities – The Accountant General Department issued debt in 2020 on a scope of NIS 265 billion, among other things, to fund government assistance during the Covid-19 pandemic period.

Key recommendations

- 💡 It is recommended to optimize cooperation by the Accountant General Department with the Bank of Israel and the Israel Tax Authority to examine the overall assistance package granted to the public concerning the interrelationship between credit and grants given to sectors that were hit and the severity of the hit.
- 💡 It is recommended that the Capital Markets Authority charged with "protecting and safeguarding the interest of policyholders, fund members and clients of the supervised bodies," ensure that the actors in the financial markets understand the risks inherent in their activity. This understanding should be reflected in the risk management policies of the financial institutions, both concerning the Nostro investment portfolios, to ensure their stability, and concerning the managed portfolios, to secure the members' funds, especially ahead of an emerging crisis based on a forward-looking perspective. It is further recommended that the Capital Markets Authority issue written directives to the financial institutions to analyze risks associated with a crisis or take other actions to mitigate those risks.
- 💡 It is recommended that the Minister of Finance review the definition of the number of personnel of the financial regulators who are allowed to attend work in an emergency before submitting his recommendations to the Government, based on reference scenarios and the regulators' needs. This definition should be included in any future enactment of emergency regulations by the Government, thus ensuring the regular and orderly functioning of the regulators to maintain financial stability and deal effectively with the economic challenges posed by the emergency.



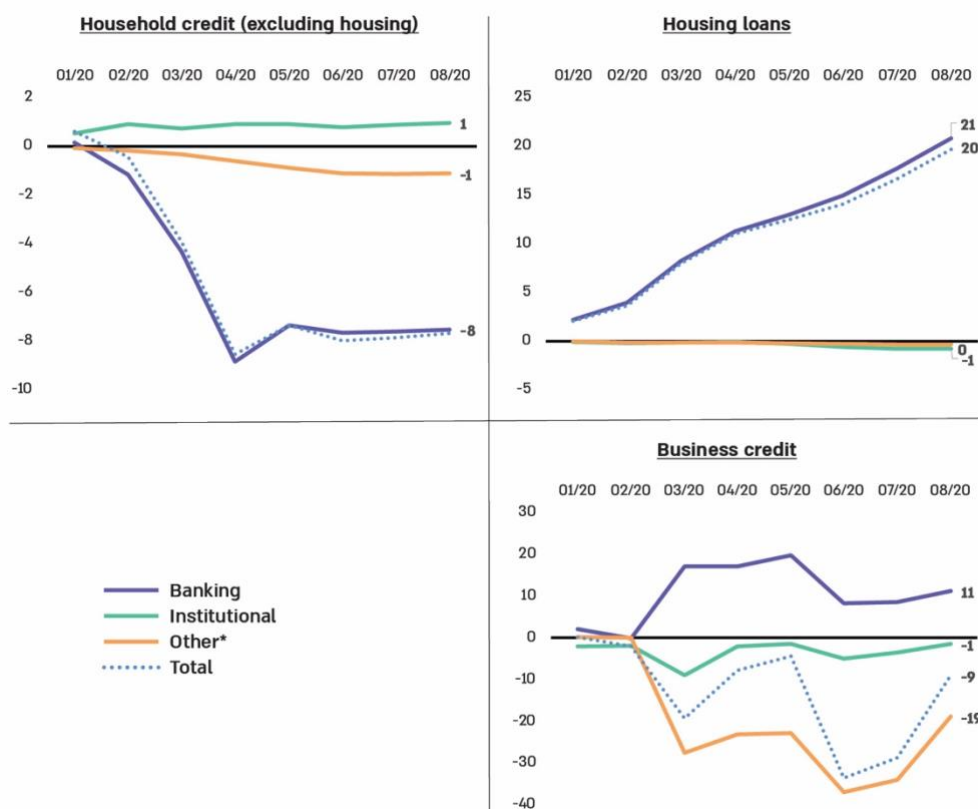
It is recommended that the Accountant General present to the Government in future discussions on the budgeting of one-time amounts ("boxes") for any off-budget expenses that require funding, all the implications of this mechanism for funding those expenses, including the expected impact on the deficit, on the level of government debt and Israel's credit rating.



It is recommended that the Accountant General examine together with the financing bodies the processing times of the loan applications submitted to the state-guaranteed loan funds, the various barriers created in the process, and possible ways of reducing the timeframes. The public should also be informed about the timeframes for dealing with the applications not to avoid frustration by the protracted process. Given the desire to expand the supply of credit to high-risk businesses, as reflected in the establishment of the amplified track, and considering its limited utilization along with the potential solution offered by nonbank entities, it is recommended that the Accountant General consider granting a state guarantee to nonbank entities at commercial terms defined between the parties. It is further recommended that the Accountant General analyze the mode of operation of the fund for large businesses and the high rate of cancellations in the funds to improve their function and the provision of assistance to the business sector.



Change in credit balances in the central economic sectors, January-August 2020 (NIS in billions)



Bank of Israel data, as processed by the State Comptroller's Office.

* Including credit from credit card companies, foreign residents, households, and the Government (directed credit).



Summary

The audit found that Israel's financial regulators quickly assisted and supported the economy's resilience. In this context, they adapted the financial services provided to the public during the crisis, expanded the credit supply, and monitored the Israeli economy's financial activity risks. Nevertheless, deficiencies were found, among others, in the cooperation by all the relevant entities, in defining the vital importance of the financial regulators' activity in times of emergency, in dealing with the high exposure of the financial institutions to overseas derivatives, in defining measurable criteria for the provision of loans and in setting timeframes for the processing of loan applications. Furthermore, based on an international comparison, the guarantee amount on the portfolio of state-guaranteed loans is below international levels. Accordingly, it is recommended to examine the assistance mechanisms offered to increase efficiency and effective use of the credit provided to businesses for bridging the cash flow gap caused by the crisis and enable them to get back on track and resume growth once the crisis has passed.