



Report of the State Comptroller of Israel |
November 2022

Bank of Israel

Digital Banking



Digital Banking

Background

In recent years, the financial system has undergone many structural changes originating in significant technological developments, encouraging digital transformation (digitization). Digitization allows various entities to provide financial services, which were previously mostly provided by banking corporations. Thus, the competition expands to various entities from multiple sectors, bringing innovation and streamlining to the banking industry.

Digital banking uses various tools and solutions to benefit consumers of banking services on digital channels – mobile phones and the Internet. The main benefits inherent in digitization are the improvement of convenience, speed, and accessibility to consumers, adjusting banking services to the consumer's preferred mode of consumption, utilizing a minimal structure of operations to lower tariffs, increase competition, efficiency and safety of the payment system, and possibly reducing the use of cash and the black economy.



Key Figures

1

one new bank corporation has been established since the 1970s. It is the only digital banking corporation operating in Israel

11.4%

the average annual profit growth of the five large banking groups net of credit losses in 2014–2021. The yearly profit increased from NIS 10.4 billion in 2014 to NIS 22.1 billion in 2021

only 2

number of entities expected to receive service from the Bureau of Bank Computing Services, established at the cost of NIS 105 million, to encourage competition in financial services by additional players' entry

16

the ranking Israel has received in the banks' digital services customers' satisfaction survey out of 28 leading markets. However, Israel's overall ranking was 27 – one place before last

47.2%

smart transactions¹ rate of all transactions in the Automated Banking Services Ltd. (SHVA) payment system in November 2021. The smart transactions rate of all debit cards worldwide is estimated at 88.6% in the second quarter of 2021

NIS 240 million

cost estimation of establishing a mobility system between banks from the banking system sources

69%

the average discount rate on tariffs for an action execution in the banking system through a direct channel, compared to its execution by a clerk


96%

requests for branch closure rate approved in 2016–2021 in the five big banks

¹ Transactions in smart debit cards that have a smart chip embedded in them containing information attributed only to the card on which it is installed.





Audit Actions

 From October 2021 to February 2022, the State Comptroller's Office examined various aspects of the development of digital banking, including barriers to new technologies integration and the entry of new players, particularly digital banks, and reforms promoted to increase competition in financial and banking services. The examination also focused on the effect of digitization on the public, its scope, the service provided, its accessing methods, and its cost. The examination was conducted at the Bank of Israel, especially at the Banking Supervision Department. Completion examinations were conducted at the Capital Markets, Insurance and Savings Authority (Capital Market Authority), the Securities Authority, the Budget Division at the Ministry of Finance, and the Agency for Small and Medium Business at the Ministry of Economy.





Key Findings



 **The Banking Mobility Reform** – the Banking Mobility Reform eases the transition between bank accounts and may increase the consumer's bargaining power and the ability of new players to enter the market. However, the documents used for its promotion did not indicate a distinct bureaucratic barrier in the transition between bank accounts, the rate in Israel is 2.5% compatible with the standard rate worldwide. Furthermore, the Ministry of Finance and the Bank of Israel promoted the reform without contending with various barriers that make it difficult for the public to use the mobility system, including psychological barriers, poor financial education, and the lack of significant differences between banks.

 **Establishment of Digital Banks in Israel** – it was raised that in 2017–2021 the cumulative volume of the world's leading digital banks increased from 5.25 million users to about 75 million users, and their cumulative income increased in 2018–2020 from USD 484 million to USD 1,570 million. By the end of 2021, no independent digital banks will operate in Israel. However, existing corporations have upgraded their systems to support various services and actions on their website and apps. In addition, in June 2017, a large banking corporation established a digital bank platform operating through an app under the permit for a digital branch received from the Banking Supervision. This platform mainly serves a young clientele in basic bank operations, but it is expected to be expanded to provide additional services and products later. It was further raised that establishing the new digital banking corporation was 24 months from the granting date of a limited bank license that was not in effect until the license was obtained in January 2022.



-  **Instant Payment System** – according to BIS (Bank for International Settlements), as of 2021, there are over 60 instant payment systems worldwide. Some countries plan to apply such systems in the coming years. It was raised that although the immediate payment system participants complied with the Bank of Israel order and prepared to receive payments through it, at the audit completion, 2 of the 11 banks operating in Israel allowed their clients to make payments through it. An instant payment system increases the redundancy in making fast and final payments in the economy. The system enables the clearing of billions of NIS in advanced payment means and increases the convenience, speed, and efficiency for the public while reducing the use of cash and supporting the payment of low amounts. Still, the use scope of the system is 3.62% of all activities in the "credits, charges and payments transfers" system, which is low compared to the potential of use thereof.
-  **EMV Technology** – EMV technology is used to secure transactions through smart debit cards and to replace old technology (magnetic strips). The implementation of EMV technology in Israel is relatively low compared to performance worldwide (a difference of about 54 percentage points from the world's average level as of the second quarter of 2021) even though entities within the Bank of Israel and outside have reported over the last decade that it should be promoted. Delays in implementing the technology have led to delays in implementing new payment technologies used for years in many countries and benefit consumers, especially using digital wallets. It should be noted that from March 2020, the gaps were reduced following an outline for accelerating the implementation of the standard published by the Banking Supervision Department. As of November 2021, about 73% of the EMV system transactions are smart transactions, and about 47% of transactions in the Automated Banking Services Ltd. (SHVA) payment system is smart transactions.
-  **Collection of Information in Digital Wallets and Payment Apps** – according to the SHVA Company data, the value of transactions carried out in digital wallets and payment apps increased from about NIS 2.4 billion in the first quarter of 2020 to NIS 5.4 billion in the third quarter of 2021. However, collecting information on customers and the use thereof is not regulated in all the entities operating digital wallets, especially those engaged in retail.
-  **Digital Literacy** – it was raised that a third of 20-year-old Israelis and up cannot perform banking operations on direct channels without the help of a bank clerk. Low success rates were documented among the older population (more than half of the 65-year-olds), in the Arab sector compared to the Jewish sector (a difference of 20 percentage points; more than half the Arab sector), and among women compared to men (a difference of 9 percentage points).
-  **Closing Branches in Commercial Banks** – closing branches is also typical in OECD countries. The decrease in commercial bank branches per 100,000 adults in the OECD countries has been going on longer than in Israel. Still, the number of branches in Israel



per 100,000 adults was low compared to the average amount of branches in the OECD countries throughout the past decade. Thus, in 2020 in Israel, there were 16.2 branches per 100,000 adults compared to 18.3 on average in OECD countries.



The Profitability of the Banking System and the Benefits to the Public – digitization has significantly improved the banking services' diversity and efficiency for consumers and reduced the costs of fees. Moreover, digitization reduced the banks' cost of salaries and associated expenses and increased the profits of the five largest banks by 10% in 2014–2021. Still, it did not decrease credit margins, and its earnings over the past few years have increased consistently from NIS 10.4 billion in 2014 to NIS 22.1 billion in 2021, according to the growth of the bank credit portfolio. This indicates centralization in the banking industry and a lack of sufficient competition, casting doubt on whether digital efficiency has benefitted the public. This requires the Bank of Israel and the Banking Supervision Department therein to increase competition in the digital age in the banking industry for digital efficiency to be more significantly expressed in reducing costs for the consumer.



Public Satisfaction with the Digital Services – the Israeli public is satisfied with digital services even in an international comparison, and in all banks, high satisfaction rates were documented (91% on average). Nevertheless, digital streamlining did not increase the fairness degree the public attributes to the local banking system. The public is still unsatisfied with it, as is evident from meager satisfaction rates with the bankers' initiative in proposing services to reduce costs (35.5% on average) and in creative solutions that suit customers' needs (33.5% on average.)



The State Comptroller's Office commends the Banking Supervision's initiatives for promoting open banking, identifying and removing entry barriers by adapting regulation to establish new banks, especially digital banks, and increasing financial education and digital literacy in the public through the banking system and promoting collaborations with various government entities.

Key Recommendations



It is recommended that the Ministries of Finance and Justice, the Bank of Israel, and members of the committees responsible for promoting competition and innovation in the banking industry, consider the range of measures the banking system is required to implement when deciding on new steps, and ensuring they integrate effectively. It is further recommended that the Banking Supervision Department formulate a comprehensive periodic plan with timetables to promote competition and innovation in the banking industry in collaboration with the banking corporations. The plan will be published, express the



legislative and regulatory requirements and support the preparations for the banking system.



Given the continuation procedures for regulating payment services, the delay in publishing the Committee conclusions from the Financial Supervision Structure Examination (currently operating and tasked, among other things, with addressing this matter), alongside the lag compared to the status worldwide, in the arrangement of the operations of payment providers and the arising implications from aspects of competition, innovation, and the payment system efficiency, it is recommended that the Ministry of Finance promote the regulation.



It is recommended that the Banking Supervision Department remove barriers to establishing new digital banks in Israel and examine, in cooperation with the relevant regulators, the Money Laundering and Terror Financing Prohibition Authority, the foreign digital banks, the regulatory barriers that prevent the latter from entering Israel and the ways to reduce them, to expand competition in the domestic market.



It is recommended that the Bank of Israel promote the integration of the EMV standard in the economy in coordination with the Ministries of Finance and Economy to reduce the gaps between Israel and other countries and support the entry of advanced payment methods.



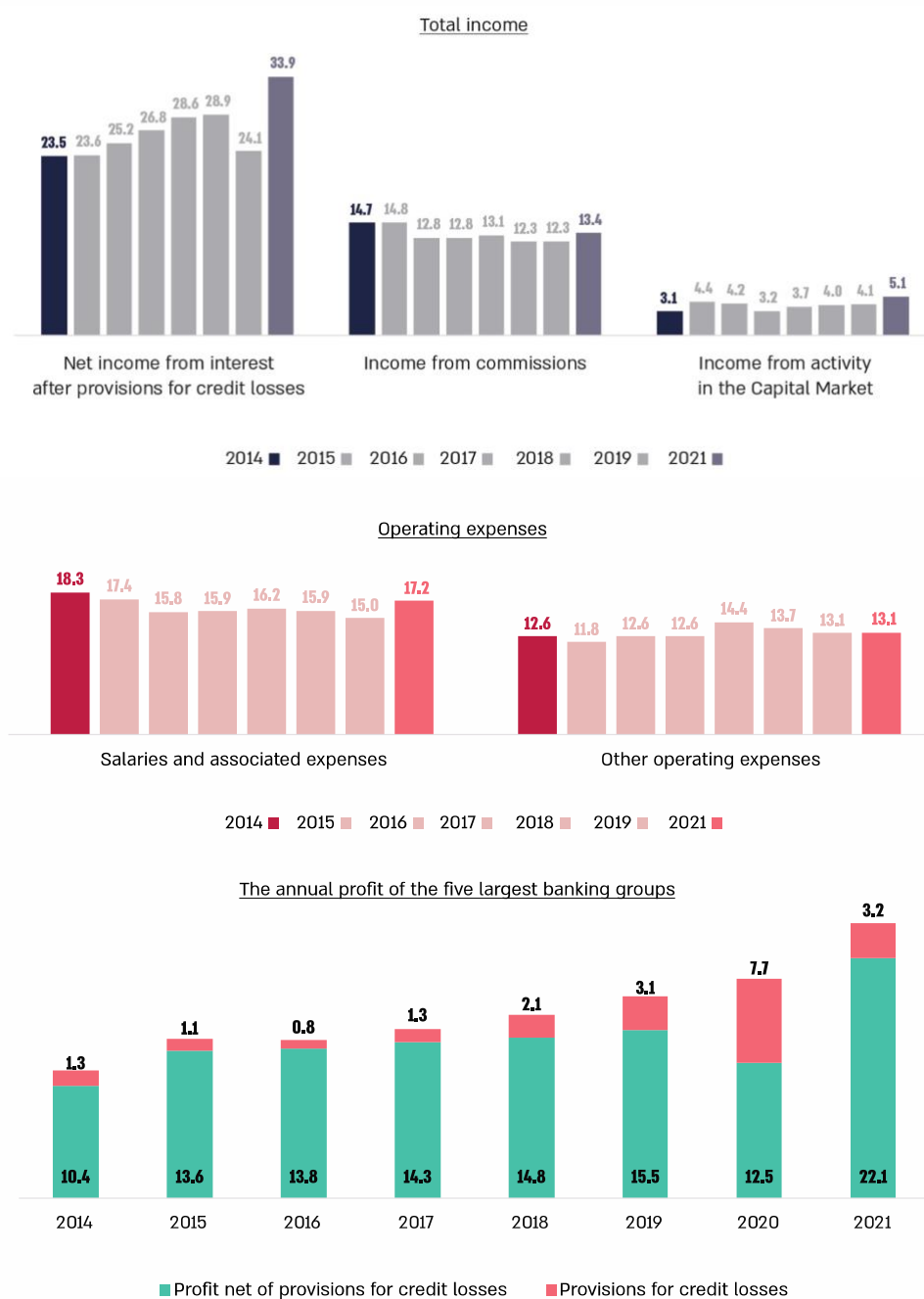
It is recommended that the Ministry of Finance and the Capital Market Authority promote financial education in Israel through a comprehensive solution – a detailed plan including the resources available to the regulating body. Given the high rate of those having difficulty in executing actions in direct channels (31%) and the rate of digital illiteracy among adults in Israel (16%), it is recommended that the Banking Supervision Department examine, in collaboration with the banking system, the barriers preventing them from carrying out these actions and instruct the banks to provide targeted assistance to clients having difficulties. Verifying that the performing systems are user-friendly and easy to operate is recommended, even for those with only partial digital literacy.



Given the importance of consumer aspects in the banking system, including fairness towards customers, it is recommended that the Banking Supervision Department determine timetables for implementing the fairness assessment project throughout the banking system. It is further recommended that the Banking Supervision Department contacts the entities that collect data and information on consumer issues concerning the banking system and examine the integration of this information in the assessment to optimize the process.

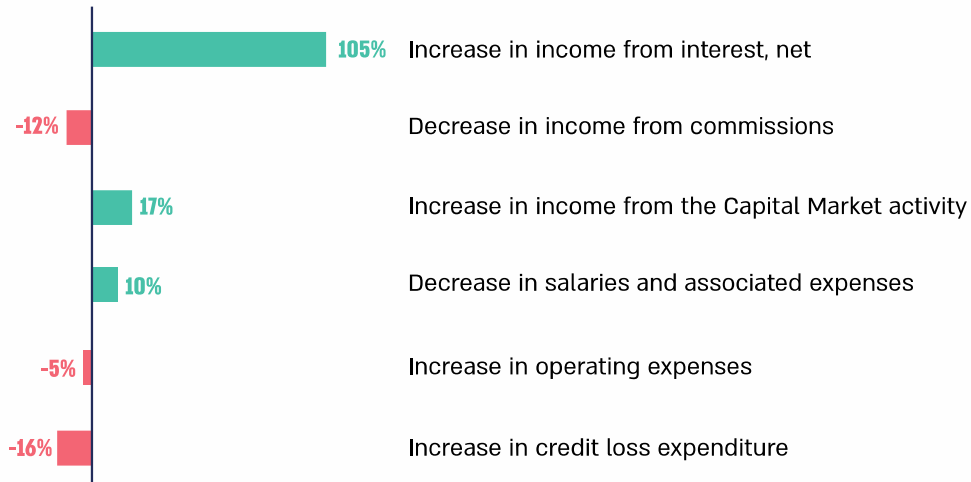


The Change in Income, Expenses, and Profit of the Five Major Banking Groups Together and Their Effect on the Change in Cumulative Profit in 2014–2021 (in NIS Billion)





The factors affecting the change in profit accrued throughout the period



According to the Banking Supervision Department data processed by the State Comptroller's Office.

Summary

Digital banking includes various tools and solutions to benefit consumers by accessing banking services comfortably, quickly, and securely on digital channels. Therefore, it should be ensured that digitization considers populations deserving of support, with no literacy required to navigate the financial and digital world. The frequent changes in the financial system, originating in significant technological developments, require adaptation of the regulation. The regulation should be comprehensive, relevant, and flexible to promote innovation, remove barriers and create certainty. Digital banking facilitates increasing competition in a conservative and centralized market and reduces the black economy. It is recommended that the Bank of Israel and the Ministry of Finance direct it to encourage the entry of local and international entities to streamline the industry, benefit consumers, and further contribute to reducing the cost of living in Israel.