

Stanley Fischer: The banking and financial system in Israel

Address by Professor Stanley Fischer, Governor of the Bank of Israel, to the Knesset Committee of Enquiry on Bank Fees, (within the framework of the Knesset Economics Committee), Jerusalem, 4 June 2007.

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In recent months the Bank of Israel has conducted professional and comprehensive work into the field of competition in the banking system. This work is being held on two plains:

- a) In-house teams of economists are discussing recommendations on ways to enhance competition in the financial system in general, and in the banking system in particular. In this framework, methods are being examined of bringing in new players into the banking system.
- b) The Bank of Israel has drafted a legislative bill that would grant the Supervisor of Banks the authority that he currently lacks to regulate banking fees.

Competition in the banking and financial systems

The financial system has undergone many changes since the late 1980s. These refer to the government's cessation of massive intervention in the capital market; the removal of barriers and liberalization, changes in the taxation system, and the recent separation of provident and mutual funds from the banks (the Bachar reform). These changes were manifold and important.

However on the retail side, competition between banks should be strengthened.

At present, as I mentioned, we at the Bank of Israel are examining new ways to boost competition in the banking system, with an emphasis on the household sector.

Why is the level of competition low? In Israel there are only a limited number of banks, and in effect two large banks capture most of the banking market. On many occasions I meet international financial bodies, including foreign banks, in order to interest them in entering the local retail banking market. Foreign banks have operated in Israel for some years now, but most of their activities are in the corporate sector. One of the reasons for the fact that the foreign banks almost entirely ignore the household sector is that the local banks have a widespread branch network, and the local banks offer financial services based on advanced technological systems. This places a high barrier to entry to any potential newcomer in the market, whether local or foreign. Furthermore, it is important to remember that the fact that the Israeli economy is small, does have an influence on the decision by a financial institution to set up in the Israeli market.

Against this background, we are examining the possibilities of bringing in a new type of player into the banking market, for example, an Internet bank, or converting the Postal Bank into a true bank as part of the postal privatization.

Regulating prices, in this case banking fees, is generally not the ideal method and we would prefer not to have to take this path. However, as competition in the banking system – and in particular in the household sector – is low, and that it could take some time before our efforts to increase competition bring results, then we have drafted legislation that would grant the Supervisor of Banks the authority to regulate banking fees. We hope that when competition strengthens, and competitive prices follow, then there will be no need for this supervision.

The legislative bill allows the Supervisor of Banks to regulate those fees that reflect an uncompetitive price. The bill also allows for the reduction in the number of banking fees and to create a closer connection between the fees and the services offered. This bill is currently in discussion in the inter-ministerial committee on legislative matters and I hope that the bill will shortly be presented before the Knesset.

The need for a strong and competitive banking system

The Knesset has made several suggestions in this field recently, such as several proposals of private legislation covering the regulation of banking fees, the supply of financial advice, the sale of credit

card companies, the banks' credit policy for buying controlling stakes, paying interest on checking accounts, as well as setting up and operating this committee of enquiry into the subject of banking fees.

I can understand the reasons for these proposals, but I must point out the following two points:

- a) The need to allow the relevant supervisors to carry out their specific roles in improving the functioning of the financial system, as well as the need for stability in the supervision system and the regularization of banking activity. The banks and other financial institutions could not operate efficiently under conditions where the legislation, supervision and regularization systems keep changing too often. It is important that dealing with this topic remains in the hands of the supervisory authorities – the Israel Securities Authority, the Supervisor of the Capital Market and Insurance, and the Supervisor of Banks. One could consider making a change here or there in the supervisory structure of the financial system, but it is not advisable, really not advisable, to transfer regulation – or even part of it – to the Knesset.
- b) The need for a strong and robust banking and financial system. For the Israeli economy to be able to operate efficiently, the banking system must be stable. We must maintain a healthy banking system through supervision and competition, while understanding that the banks operate in order to earn a return on their capital.

In this context, I would like to refer to the banks' profits. It is quite natural to regard the banks' profits in nominal terms of billions of shekels, but one should also examine the banks' profits in relation to their capital, in other words, one should look at their return on capital. In these terms, the return on capital for the Israeli banking system is not particularly high, and even low in international comparison. The return on capital for the banking system in 2005, for example, was 14.5 percent, compared to an average 15.4 percent globally.

Finally I would like to ask the Knesset to push forward with government-sponsored legislation on the supervision of banking fees by the Supervisor of Banks as soon as the bill is presented, which I hope will be soon. This is an important bill, and every effort should be made to have this legislation passed.