

Stanley Fischer: Corporate governance in Israel

Summary of the address by Professor Stanley Fischer, Governor of the Bank of Israel, to the general assembly of the Association of Publicly Traded Companies, Jerusalem, 23 December 2010.

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I would like to talk of three issues relating to corporate governance in different economic entities in Israel.

The Bank of Israel will soon undergo a significant change in the way it makes its decisions. Till now, the Governor has had sole responsibility for interest rate decisions. That situation was the result of, among other things, the generally accepted practice around the world when the Bank of Israel was established, and also of the outstanding personality of the first Governor, Mr. David Horowitz. There are still today several central banks in which the Governor formally makes the decision alone. However, I do not know a single Governor who actually does decide entirely by himself. In the Bank of Israel, for example, there is a set mechanism of the monetary discussion in a narrow forum, in which a discussion is held at the highest professional level. Research has shown that on average group decisions are better than decisions taken by one person. The fact that, till now, one person makes operational decisions in the Bank of Israel, and that there is no board of directors as there is in public companies, is certainly not the ideal situation.

The new Bank of Israel Law states that the Bank of Israel will have a Monetary Committee that will make the policy decisions and an Administrative Council that will make the operational decisions. As well as managers from the Bank of Israel, the Committee and Council will have representatives of the public. The Government has appointed a search committee under retired Judge Winograd charged with putting forward a list of candidates for these entities. The search committee is required to consult with the Governor about the proposed members of the Committee and Council, but the final decision is that of the government. I hope that members of the two bodies will be appointed soon, and I am sure that the decisions they will take in the new system in the Bank of Israel will be better.

The second subject I would like to speak about is corporate governance in the banking system. The crisis greatly deepened our understanding of the need to strengthen corporate governance in banks. The main measures introduced in Israel in this context are based on the Basle Committee on Banking Supervision and on the Financial Stability Board. The most important topic on which our attention is focused is an update of Directive No. 301 in the Proper Conduct of Banking Business, which deals with several aspects of the work of the board of directors:

- Clarifying the role of the board of directors and emphasizing the difference between the functions of the board and those of management;
- Strengthening the composition of the board, and the independence and professionalism of the outside directors;
- Raising the level of director's qualifications, and clarifying expectations regarding their functions;
- Improving the board's working practices.

The Bank Supervision Department has drawn up the principles regarding the existence of a main risk management function in banks, and all banks have appointed a chief risks officer. The principles of a proper compensation policy have also been formulated, and changes in this sphere are becoming evident world wide.

My third subject is what is known as the shadow banking system. The practical significance of this term is that it deals with aspects of the financial system that the regulators do not know how to supervise. In the US and the UK, and to a lesser extent in Europe too, a large part of the credit market is now outside the banking system. In Israel the banking system currently covers slightly above 50 percent of total credit, credit from abroad accounts for some 18 percent, so that nonbank credit has increased to more than 30 percent of the total, mainly as a result of the pensions reform and the Bachar Committee reform. No system of regulation can be perfect, but it is essential that we find a way to supervise nonbank credit. It is no coincidence that many of the companies affected by the crisis belonged to one industry, the real estate industry, and that tells us something. The Securities Authority is responsible for transparency, but it does not regulate due diligence in new issues. In the final analysis, it is the institutions that manage the public's money that must take the investment decisions. These areas have advanced and improved recently, but we must continue to enhance the quality of supervision over the conduct of these entities, and the quality of corporate governance in companies.