Times are Changing

an Overview of the Changes in Israel's Finance and Regulatory Environment

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“Come gather 'round people
Wherever you roam
And admit that the waters
Around you have grown
And accept it that soon
You’ll be drenched to the bone
If your time to you is worth savin’
Then you better start swimmin' or you’ll sink like a stone
For the times they are a-changin’.”

(Bob Dylan, "The Times They are A-Changin'")

The times are changing. The financial markets are changing too. Similar to other nations worldwide, Israel is struggling to mitigate the consequences of these past few "Corona months". In their actions to prevent a potential recession, Israeli regulators are taking a direction different from the one taken during the pre-Corona days. Instead of putting the emphasis on regulating the different financial market participants, Israeli regulators are now more concerned with the risks of a credit crunch worsened by the hesitation of local credit providers to provide credit in a volatile environment and rising interest rates.

The restart of quasi-normal business activity in Israel is a good opportunity to list some of the main changes in the Israeli finance and regulatory environment during recent months and identify changing trends.

In the past decade, consumer credit in Israel has grown dramatically, fueled mainly by the financial blossom in Israel's economy and low interest rates, but also by the enhanced availability of credit. This change was caused partially by the entry into the market of new non-bank credit providers, diversification of the credit market and enhanced competition amongst credit providers.

However, the increase in the Israeli consumer credit volumes was a reason for concern for different regulators. Dr. Hedva Ber, the current Supervisor of Banks at the Bank of Israel (whose retirement was planned for April and was postponed due to the Corona crisis) was quoted saying: "Credit is like salt – too much is untasty and unhealthy". These concerns led to various guidelines and directives aimed at regulating the credit market, of which key were:

- **The licensing procedure for regulated financial activities** - the Capital Market, Insurance and Savings Authority published a directive setting forth the licensing and procedural requirements applicable to non-bank credit providers applying for a license (as required under The Financial Services Supervision Law (Regulated Financial Services) , 2016). This directive originally published in August 2019 was widely criticized for creating a barrier to entry into the market. Therefore a revised "lighter" form of the directive was re-published in November 2019 (although still viewed by many as cumbersome).

- Draft guidelines imposing **unified standards for the activity of banks, payment card companies and non-bank credit providers regarding the provision of consumer credit** - Among other regulatory requirements, these standards restrict banks and other credit providers from extending loans without receiving adequate financial information on the potential client and limit aggressive marketing of credit (see our separate update on these guidelines: link).

In parallel and although not tied directly to the provision of credit, other important legal changes took place strengthening the position of credit consumers and non-financial creditors over banks and financial services providers. These include:

- **The entry into force of the Insolvency and Economic Rehabilitation Law**, 2018 (the "**Insolvency Law**"). Entered into force in September 15, 2019 the Insolvency Law introduced a modern and consolidated set of insolvency laws. Amongst the various changes, the Insolvency Law created a limitation on recovery from floating charges to 75% of the realization proceeds. This change negatively affected the position of secured creditors.

- **The entry into force of the Payment Services Law**, 2019, expected in October 2020, regulating the contractual relationship between clients and payment services providers (including banks, credit card companies, payment applications, etc.) and affording clients wider consumer protections.

The Corona times have catalyzed a change in trends and the effort by Israeli financial regulators is now on opening and injecting cash into the financial markets. We now see the regulators "changing hats" joining the effort to increase the supply of credit. Among the different changes introduced by regulators in this respect we would note the following:

- **Decreasing capital requirements** – capital requirements for banks were decreased by 1%, so that the minimum Tier 1 capital ratio is now 9% for large banks and 8% for small and medium sized banks, while the aggregate capital requirement is 11.5% and 12.5%, respectively. This decrease was implemented in order to increase credit sources for the banking industry and the business sector. Additionally, the Bank of Israel clarified its expectation that the banks will use capital surplus in order to increase credit in the economy, and not for other purposes, such as dividend distributions or share repurchases. This easement is in force (with certain limitations) until September 30, 2022.

- **Central bank loans** – the Bank of Israel will provide loans to the banking system over three years at a 0.1% fixed interest rate, in order to increase the supply of bank credit for small businesses. The size of the plan is five billion NIS.

- **Loans backed by pension funds and other savings** – in an effort to encourage the public not to withdraw its savings the Capital Market, Insurance and Savings Authority has granted easement to pension funds and insurance companies allowing the granting of loans backed by pension funds and other savings spread over a more comfortable repayment schedule of up to 15 years (instead of 7 seven years).

- **State Credit fund** – the State of Israel will guarantee bank loans (each, in an amount of up to NIS 20 million to be repaid within 5 years) for businesses with a turnover of less than NIS 400 million to support liquidity needs. Under the approved scheme, the interest of such loans will be paid by the state in the first year of the loan and thereafter the borrower will enjoy low interest rates.

- **Increasing credit/overdraft facilities in current accounts** – the banks are permitted to allow their customers to borrow aggregate debt in their current account that exceeds their approved credit facility, as long as the exceeding amount will not pass NIS 5,000 per household and NIS 100,000 per business.

- **"All purpose loans" secured by a mortgage** – the banks are permitted to provide all purpose loans backed by an existing housing mortgage of up to 70% of the asset value (instead of the previous 55% limit), provided that the financing increase is not to be used for the purchase of additional real-estate.

It may well be that the measures described above signify a merely temporary period that will end together with the much hoped for diminish of the COVID-19. However, the length of the impact of COVID-19 remains unclear and temporary has the tendency of becoming permanent and we may well find that near future will be characterized by a looser credit environment.

We are at your disposal should you require any clarifications or assistance on the matters discussed herein.

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