

## BOOK REVIEWS

### **Banking Regulation in Israel: Prudential Regulation versus Consumer Protection**

Ruth Plato-Shinar

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The 2008 financial crisis tested the modern financial regulatory systems across the globe, and prompted regulators, academics, and practitioners to question some of the policies that those systems had traditionally adopted and promoted. As a result, scholars and contributors have produced a great deal of post-crisis financial literature on banking regulation, analyzing and reviewing the different macroeconomic and microeconomic aspects of financial regulation in the hope of presenting new insights. Many of those studies focused on prudential regulation and the risk management of financial institutions — an academic focus that included research regarding the extent to which financial institutions need to be subject to certain requirements and restrictions in order to maintain the stability of the financial system. Other studies focused on what constitute good practices in consumer protection, and how consumer protection laws can improve efficiency, transparency, competition, and access in the financial markets.

Given the massive amount of writing on financial regulation since the onset of the 2008 financial crisis, any additional intellectual contribution must overcome at least one primary challenge. Namely, any new study must do more than merely criticize the pre-crisis or even current regulatory systems and their deficits. A new study must instead focus on the financial doctrines and policies that can increase financial stability and development, and thoroughly explain those doctrines and policies. It must also articulate which tools or methods can and should be employed, locally as well as internationally, in order to better regulate the financial markets and their key relevant institutions. Indeed, institutional structure is critical in shaping financial regulation and maintaining financial stability.

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*Banking Regulation in Israel — Prudential Regulation versus Consumer Protection*, which focuses on the Israeli financial system that coped well with the 2008 global financial crisis, successfully overcomes this challenge in an extremely well-balanced fashion. This book does so while examining prudential regulation in Israel as well as the country's consumer protection laws, which the book refers to as part of a bigger umbrella of regulation that it titles "Conduct of Business Regulation". In particular, the book focuses on the interrelations between prudential regulation and consumer protection, and the different issues that arise from the delicate task of attempting to find a balance between them.

The book provides a detailed and comprehensive analysis of the prudential regulation system in Israel, which views stability as the ultimate objective. The book examines Supreme Court of Israel rulings that stress the importance of the market's stability, and also studies the Israeli Supervisors of Banks' approach, which has shown great importance regarding prudential regulation in working to implement the Bank of International Settlements' (BIS) Basel Accords. Similarly, the book assesses the country's prioritization of the objective of stability over the consumer objective, in various laws such as the Bank of Israel Law 5760-2010; the Class Action Law 5766-2006; and, the 2011 amendments of the Restrictive Trade Practices Law 5748-1988. But although the Israeli legal framework focuses on stability, the book demonstrates that certain pieces in the Israeli prudential regulation system are lacking. A notable gap relates to the existing arrangement that applies in the case of an insolvent bank: the current Israeli law is limited, rigid and not suited for modern realities. Some key features the law is lacking include a recovery process in the special resolution regime for banking corporations, and a winding-up or liquidation process that caters the unique characteristics of banks. Likewise, in particular, Israel is still behind in terms of adopting enhanced risk management procedures for recovery and resolution planning of systemically important financial institutions, such as those procedures the *Dodd-Frank Act* mandates in the United States, enacted following the 2008 financial crisis and which have become globally accepted in various forms. This lack is far from ideal, because while there is no explicit deposit insurance in Israel, and there is no state obligation to cover the public's losses when an Israeli bank goes bankrupt, there is a public expectation that the government will intervene to save a failing bank.

Following the discussion of deposit insurance, the book continues by providing an examination of the consumer protection regulation in Israel. The justifications for a wide-ranging regulation include general reasoning, such as the disparity of power, which arguably is exacerbated in Israel given the unique authority conferred on banking corporations to deal simultaneously with receiving deposits from the public as well as providing credit. It also includes customers' confidence in the banks, and more critically, customers' dependence on the banks due to the wide discretion that is conferred upon banks to agree or refuse to carry out various banking transactions that a customer requests.

In order to better protect and serve consumers, Israel has several consumer regulators that are actively looking after the interests of consumers. Surprisingly enough, however, especially given the somewhat socialist nature of Israeli society, the consumer regulators' authority in the field of banking — if it exists at all — is limited. Among the existing agencies operating to help consumers is the recently founded Israeli Consumer Protection and Fair Trade Authority in the Ministry of Economy and Industry, which was established in 2006. This authority operates by virtue of the Consumer Protection Law 5471-1981, but excludes banks from its scope. Other key regulators include the Israeli Antitrust Authority, which is responsible for promoting competition, and the Israeli Securities Authority, which is responsible for protecting the interests of the public when investing in securities. But, because these somewhat consumer-protection driven regulators have limited powers in the field of banking, the consumerist role of the Supervisor of Banks takes on great importance. Indeed, in recent years, the Supervisor has been more willing to deal comprehensively with the consumer field. Additionally, the Knesset, the Israeli parliament, has significantly intervened in the field of conduct of business over the years, passing a number of significant laws. Israeli courts have also advocated for a consumer activist approach. The courts have even imposed additional behavioral norms on the banks such as a sweeping fiduciary duty on the banks.

Explaining these two areas of the Israeli financial regulation, i.e. prudential regulation and consumer protection, their strengths and their shortcomings, this book presents optional models of banking regulation and discusses their effectiveness in terms of achieving their goals. The book then discusses the preferred model for Israel and presents its thesis — that although there is often a conflict between preserving market financial stability, and fairly and adequately protecting consumers, ideally, the Supervisor of Banks could successfully carry out both goals without tasking additional regulatory agencies with the efforts. Plato-Shinar explains that the main difficulty in fulfilling two functions at the same time relates to the question of the desirable balance between them. But such a balance does not require giving equal weight to each of the conflicting interests. Additionally, the required balance is dynamic, varying from time to time as a result of market conditions and existing circumstances. Finally, in the event of any conflict, where it is necessary to prioritize one objective over the other, that balancing must be undertaken proportionally, with care not to damage the opposing interest beyond what is actually required, and with constant supervision and monitoring. This approach is well articulated and is highly relevant, especially in the years following the financial crisis, as many governments are struggling to find the right balance between the two areas of financial regulation.

Lastly, although the book focuses on the supervisory system in Israel, and provides a historical, cultural and rich legal background to the various aspects of the Israeli banking regulation, it still manages to be highly relevant to academics, regulators and practitioners from all jurisdictions. That relevance stems from the

fact that the book's examination of the Israeli case is done from a broad, global perspective, as it discusses universal structures and developments in financial regulation, in addition to local ones that are unique to Israel and impact the country's financial markets.

An interesting example of distinctive Israeli capital market characteristics illustrated in the book is the concentration and lack of competition in the Israeli banking system. The concentrated structure illustrates the country's historic banking ownership model, which in 1983 — due to the bank shares manipulation scandal — went through nationalization, but during the 1990s underwent a privatization process. The five major Israeli banking groups, all of which are public companies whose shares are traded on the Tel Aviv Stock Exchange, control 94% of the commercial bank assets in the country, while two of them alone control 58% and constitute a duopoly. While the transfer of control into private hands has not drastically improved the banks' operating efficiency, the controlling owners also failed to make it a priority to strengthen the banks' capital base, encouraging distribution of large dividends. But, as Plato-Shinar explains, recognizing the Israeli banks as quasi-public bodies — although not necessarily accurate given the lack of required nexus to the government — makes it possible to impose obligations on them from the arena of public law, including fiduciary duty towards customers and even third parties.

The discussion of the status of the Israeli banks as quasi-public bodies raises key questions that go beyond the scope of the Israeli capital market, and are relevant worldwide. For example, should quasi-public body status characterize banks in all aspects, or only with respect to specific matters? Similarly, it is not clear which public law obligations should be applied to the banks and with what intensity. Plato-Shinar argues that powerful organizations such as banks should indeed be subject to tight government regulation, but that defining them as quasi-public bodies, rather than by creating specific regulation, might not be the right way to do so.

The book concludes with suggestions regarding the way forward. It focuses on what presently appears to be the main challenge in Israel, which is maintaining stability while also developing effective competition in the field of banking, as it relates to separation of the credit card companies and the banks; competition in the field of clearing; retail lending; bond issuance by non-bank lenders; fair credit bill and data sharing systems. Plato-Shinar closes by expressing hope that the initiatives she describes will ripen into binding legislation in the near future, be implemented in practice, and that the banking system will, as a result, increase its efficiency and services. This improvement in the efficiency of the banking system, however, has to happen simultaneously with the Supervisor of Banks devoting more efforts to developing effective competition in — and by — the banking sector.

In summary, *Banking Regulation in Israel — Prudential Regulation versus Consumer Protection* is an important book that will surely generate interest among academics, practitioners that are interested in the Israeli financial market,

and policy makers around the world that face issues, which are similar to the Israeli ones, in their own jurisdictions.

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