

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

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Digital Disruption in Financial Markets – Note by Israel

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This document reproduces a written contribution from Israel submitted for Item 5 of the 131st OECD Competition committee meeting on 5-7 June 2019.
More documents related to this discussion can be found at
<http://www.oecd.org/daf/competition/digital-disruption-in-financial-markets.htm>

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Israel

1. Executive Summary

1. The Israel Competition Authority (hereafter: "**the ICA**") takes an active role in creating a regulatory and legal environment that encourages the activity of FinTech companies in Israel. The current contribution presents two such activities.
2. The first activity is the role filled by the ICA in promoting the use of advanced payment services. The ICA was a key player in a number of governmental committees and inter-ministerial teams that examined the functioning of the Israeli banking and financial services sector. The ICA presented an overall analysis of the relevant sector, proposed structural and legal remedies to the problems identified and assisted in drafting bill proposals.
3. The second activity is a recent exemption issued by the ICA to the Israeli entity in charge of the clearing and settlement of Israel automated payment method. This exemption allows building a new system that would facilitate a faster and smoother transition between banks. Given that high switching costs have been identified as a barrier to entry of new banks, especially digital banks, the recent exemption increases the likelihood of digital banks introduction in Israel in the near future.

2. Introduction

4. Israel is known as the "Start-Up Nation". It is a hub for a flourishing FinTech industry with recognized local expertise in technologies such as cybersecurity, big data analytics and AI. For example, by the end of 2017 more than 430 Israeli FinTech companies were active with a total of USD 1.8 billion funds raised.¹ However, a significant majority of these start-ups target mainly US, European and East-Asian customers and essentially are not relevant for Israeli consumers.
5. The Israel Competition Authority (hereafter: the "**ICA**") believes that the FinTech industry can bring competition to the banking and finance sector by introducing technological solutions that will overcome the traditional barriers existing in this sector. Thus, the ICA views the entrance of FinTech companies as a way to promote competition and improve the functioning of the financial markets.
6. Over the recent years, the ICA has been active in different arenas aiming to enhance competition in financial markets. One of the purposes of the activities of the ICA in this regard was to create infrastructure that will allow the FinTech companies to enter the financial market and introduce new products. The purpose of this document is to present highlights of these activities. We first describe the endeavour to enhance efficiency and competition in advanced payment services. We then elaborate on an exemption given by the ICA that is aimed toward enhancing competition in the banking sector and to lower barriers to the introduction of digital banks.

¹ See <https://www.startupnationcentral.org/wp-content/uploads/2018/06/Fintech.pdf>.

3. Background: The State of the Israeli Banking and Finance Sector

7. The banking and finance sector in Israel suffers from high concentration, limited innovation and significant barriers to entry. Consumers tend to purchase a wide range of financial services solely from the bank in which they manage their current account. This behavior limits competition from non-bank players, while the barriers to transfer between banks remain high. These trends also characterize the payments market in Israel, which is for the most part controlled by a few leading banks and credit card companies, with high barriers to entry by additional players and limited innovation.

8. Deferred payment credit cards are the most common form of payment in Israel, especially for payments by households and small and medium businesses. There are three credit card companies in Israel. Until recently, all of which were held by the largest banks in Israel.² In addition, the use of cash and checks (especially delayed checks) is common in Israel relative to the western world, both in the business sector and in the consumer sector.

4. Enhancing Efficiency and Competition in Advanced Payment Services

9. In recent years, advanced payment methods have been slowly penetrating the Israeli payment system, including the use of digital wallets or E-wallets, contactless transactions and more. However, these technologies remain relatively rare compared to other developed countries and are not widespread enough to serve as an alternative to traditional payment methods.

10. One central reason for the slow adoption of advanced payment methods is the lack of regulation of the advanced payment services sector required to create the legal environment that facilitates the success of these payment services. This lack of regulation complicates the licensing process of potential FinTech entrants since it was not well specified what are the requirements needed to obtain a license. It also undermined consumer confidence. Furthermore, it complicated any attempts to require banks and central payment systems to cooperate with advanced payment providers.

11. In light of the above, the ICA identified the crucial need for measures that would promote the use of advanced payment services in Israel. These measures needed to simultaneously address the legal, technological and consumer aspects. The ICA's analysis led to the understanding that promoting advanced payment services is key to increased competition in the banking and financial market. This is the case, since developed advanced payment services make it easier for entrants to compete with incumbents by offering innovative payment methods that are cheaper, more convenient or have added value for consumers and merchants. The overall effects of using advanced payment services constitute not only from the competitive benefits mentioned above, but also from the macroeconomic effects of advanced payment systems including increased efficiency, decreased systemic financial risk and mitigation of the shadow economy.

12. The high degree of concentration in the Israeli banking and financial services sector has been a subject of great public and political interests. This led to the establishment of a

² The Law for Promoting Competition and Reducing Concentration in the Israeli Banking Sector 2017 obligates the two largest banks in Israel to sell their holdings in the credit card companies. As detailed below, the law was a product of the Committee to Increase Competition in Common Banking and Financial Services (the Strum Committee) in which ICA was a significant partner.

number of governmental committees and inter-ministerial teams examining these markets. The ICA was a key participant in these committees. It presented an overall analysis of the financial sector, proposed concrete remedies to the problems it identified and assisted in drafting bill proposals.

13. An important committee in this context is the Committee to Increase Competition in Common Banking and Financial Services (hereafter: the "**Strum Committee**").³ The mandate of Strum Committee, established in June 2015, was to examine ways to increase competition in banking services in Israel. It included representatives from the ICA, the Ministry of Finance, the Bank of Israel and the Ministry of Justice. A key point in the Committee's mandate was to examine the separation of ownership of credit card companies from banks. The ICA saw the need to combine this ownership separation with other measures needed to make the reform successful, and more importantly to lay the groundwork that would encourage entry of new players into the financial services market, especially by FinTech companies who excel in technological innovation.

14. The ICA's vision for transforming financial markets included unbundling different financial services instead of the common practice of purchasing a wide bundle of financial services from one bank. Such unbundling would allow a variety of service providers to compete against each other for the provision of a single financial service. Such a transformation requires the regulation to be focused on the nature of the service rather than the nature of the service provider. Furthermore, it requires the creation of operational technological interfaces that are needed to allow all players to access different financial systems and the relevant consumer data.

15. The ICA worked within the committee to convince the other members of the importance of the reform, while in parallel promoting the same recommendations within an additional inter-ministerial committee which operated at the same time - the Committee for Promoting Use of Advanced Means of Payment. In the end, the ICA succeeded in enlisting the support of the other agencies within both committees and both committees adopted the ICA's vision and the corresponding recommendations. The Strum Committee's final report recommended establishing an inter-ministerial committee to draft legislation to regulate advanced payment services based on the principles of the Payment Services Directive 2, Directive (EU) 2015/2366 (**hereafter: "PSD2"**).⁴

16. The ICA continued to be deeply involved in the details of the legislation drafted by the sectoral regulators, to help balancing between conflicting interests (e.g., consumer protection versus easing the regulatory burden on entrants) and to make the law as consistent with the PSD2 in order to encourage entry by international players.

17. The recommendations of the Strum committee were based on a version of the PSD2 adapted to the Israeli market: increasing competition in the payment services market by opening the market to non-bank players; maintaining the stability of the payments system; ensuring consumer protections; and promoting technological and business innovation. These principles formed the basis for two bills published for public comments in 2018. The first bill, drafted by the Ministry of Justice, regulated the consumer aspects of advanced payment services. The bill was brought before the Israeli parliament in 2018, and the ICA

³ The committee's website including the material used in its discussions and its products are available in https://www.gov.il/he/Departments/PublicBodies/banks_sevices_competitiveness_committee (Hebrew only).

⁴ See the Strum Committee Final Report, p. 72-73.

continued to be involved in changes to the language of the law, helping to ensure that protections given to the individual consumer were balanced with the need to open up the market for the benefit of the consumers as a whole. The bill was finally enacted into law at the end of 2018.

18. The second bill, drafted by the Capital Markets, Insurance and Savings Authority, regulated the licensing of payment service providers. The ICA is currently working with the other regulators to examine the bill and the issues raised by the public to help minimizing the regulatory barriers placed before potential entrants into the local payment services market. The bill is expected to be brought for the approval of the Ministerial Committee for Legislation soon.

19. The ICA believes that once this reform will be put into place it will create the appropriate platform for the entrance of FinTech companies.

5. Reducing Switching Costs between Banks

20. One of the recommendations of the Strum committee was focused on easing the process of customer's switching between banks. Such a reduction in switching costs is crucial for encouraging entry of new banks – traditional and digital alike - and other financial service providers and pushing existing banks to increase the quality of the services they provide. Following this recommendation, the Bank of Israel has recently issued a set of orders to modify the regulation of bank switching for a faster and smoother transition.⁵

21. The entity responsible for the schemes behind the clearing and settlement of Israel automated payment methods is named MASAV.⁶ It is jointly held by the five biggest banks in Israel and as such the ICA regulates much of MASAV's activity and oversees the lines of business in which it is authorized to operate in.⁷

22. MASAV has requested the ICA to extend its activity and to build a system that would support these orders. The ICA approved the request and acknowledged in its decision that the new system is likely to foster competition between banks rather than curbing it.⁸ Once implemented, the introduction of the new system will significantly reduce switching costs between banks. Such a reduction is key for a successful introduction of digital banks in Israel.

⁵ See section 5(b)(1) (pg. 8) in <https://www.boi.org.il/he/BankingSupervision/BankingLegislation/DocLib/150.pdf> for the new set of orders (Hebrew only).

⁶ See MASAV website, at <https://www.masav.co.il/>.

⁷ The Israeli Competition Law authorizes the General Director of the ICA to exempt parties to a restrictive arrangement from the duty to obtain the approval of the Competition Tribunal, under certain conditions are fulfilled.

⁸ See <http://www.antitrust.gov.il/files/35538/030980.pdf> (Hebrew only).