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FROM SOCIAL PROTEST TO LEGISLATION: ISRAEL'S NEW CREDIT UNION LAW

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Preface

On December 22nd 2016 the Israeli Parliament passed The Supervision of Financial Services (Regulated Financial Services) Law, 5776-2016 – allowing the establishment of credit unions in Israel for the first time in half a century. The bill was brought as a governmental initiative – after a five years struggle of social activists who were determined to promote the idea of cooperative financial institution and its implementation.

This all started with the social protest of 2011 which evoked the need for a major change in the highly centralized and very expensive banking system. OFEK cooperative society was established in 2012 setting a goal of starting a cooperative bank. During the five years since then, governmental committees have risen and faded and many statements have been made in favor of the idea only to collapse into concrete decisions that would prevent it.

The former Supervisor of the Bank of Israel decided to prefer "stability" over "competition" – announcing the regulation of financial cooperatives would require equity capital of 75 million NIS (about 18 million €) prior to licensing and after expenses – which meant that the cooperative must raise about 40 million € from members - an impossible mission.

It was only when a new Supervisor of Banks was appointed that the barriers were lifted - as she announced that small financial institutions present no threat to the stability of the market, and should be supported by enforcing as little regulation as possible, in order to encourage them to operate.

A new challenge then began. This would be the first cooperative law ever enacted in Israel - the Cooperative Societies Ordinance was promulgated by the British Mandate. The challenge was how to make sure that the new law would be based on cooperative values and principles.

The Financial Market in Israel

The Banking Market in Israel is highly centralized. Five banking groups hold 93% of the market, three of which hold 72%. All those banking groups are conducted as profit maximization companies¹, their commission rates are suspiciously similar, and the customers' costs are dramatically higher than in other countries - on average the equivalent of about 800\$ a year for a household². The lack of competition has

¹ Even though one of the big banks' majority of stocks is owned by the state.

² The Trachtenberg Committee

had harsh ramifications, mostly on small businesses, who are struggling both with high commissions and limited access to capital.

The profits of the banks kept rising, the CEO's salaries became outrageous, and even though the Bank of Israel applied concrete restrictions on commission rates, and issued warnings against unlawful coordination, the system kept inventing schemes meant to gain profits at public expense.

In 2009 the 5 major Israeli banks had profits of 5.35 Billion NIS³; in 2010 6.6 Billion NIS; in 2011 7 Billion NIS; in 2012 5.9 Billion NIS⁴; in 2013 7.05 Billion NIS; in 2014 6.4 Billion NIS; and in 2015 8.24 Billion. On average the banks' revenues on commissions amounted to about 14 Billion NIS a year.

The salaries' costs of the banks' CEO's are between 4 and 9.5 Million NIS a year.⁵ It got to the point the Israeli Parliament decided on March 2016 to regulate banking CEO's salaries so that they would not exceed 44 times the lowest salary in the same bank. That would compel them to reduce annual salary to about 2.5 Million NIS.

Financial Cooperatives in Early Israel

When Israel was founded (1948) there were 2200 registered cooperatives serving a population of 650,000 and holding dominant positions in all sectors of the economy.

In pre-Israel Palestine, most of the social services given by the Jewish institutions to the public were provided by cooperatives: Healthcare services, employment agencies, and some educational institutions. The economy was based on producers' cooperatives in the agricultural and industrial sectors and on consumers' cooperatives.

Financial cooperative activities were registered in Palestine as early as the 1910's. During World War I, Palestine was going through a great famine⁶. The Jewish farmers – mostly small and new agricultural cooperatives – could not get credit from the banks that would allow them to hold up from one season to the next and they were on the verge of bankruptcy. The first wholesale cooperative in Palestine "Hamashbir"⁷, which was not a financial cooperative but considered itself a major instrument for

³ This paper is written in April 2015, in which 1\$ equals a little less than 4 NIS and 1Euro equals a little more than 4NIS. In the past six years the rates changes between 3.6-4.5 NIS =1\$ and between 5.5-4.25 NIS=1Euro.

⁴ a 50% drop of profits in National Bank.

⁵ The average salary in Israel 2014 was a little less than 9000 NIS a month, the minimum wage 4300NIS and the median salary in 2013 was 6500 NIS.

⁶ The Othman Rule over Palestine ended in 1917, when the British Army occupied the country.

⁷ Established in 1916.

developing the new Zionist society and economy, decided to provide farmers with small loans⁸ to enable them to keep their farms and develop⁹.

In 1921 the need for a financial institution for the working class was obvious, but the Histadrut – the major trade Union and workers' organization decided to establish "The Workers' Bank"¹⁰ whose role was to help the development of the workers' economy. It was not organized as a Cooperative Society, but as a joint stock company and although it was considered as owned by "the workers"¹¹ it was not a cooperative either by name or nature¹².

The first Credit and Savings Cooperative Societies were registered in 1925. They were organized on a geographical and occupational basis and provided limited services. By the end of 1930 there were 7 Credit and Savings Cooperative Societies that served only 5600 members,¹³ but by 1948 there were more than 80, with 125,000 members – about 20 percent of the population. That provided more than 20 percent of the market's financing. In the following years this number increased to 250,000 members in more than a 100 Credit and Savings Cooperative Societies¹⁴.

The decline started in the mid 1950's when the Bank of Israel applied regulation which favored big financial institutions. Within a decade most of the Credit and Savings Cooperatives were gone – absorbed into the big commercial banks.

Since then, there was no vital attempt to start a credit union, even though there was no legal barrier. In 1981 the Israeli parliament approved the Banking (Licensing) law 5741-1981 which provided that no financial institution could operate without a permit from the Bank of Israel. That closed the door on the legal structure enacted in the Cooperative Societies Ordinance.

⁸ In current terms we would consider this sort of loans as "Micro-finance".

⁹ "Hamashbir" had also bought a lot of the wheat the farmers grew, so black market merchants would not exploit the consumers. They kept enough wheat so the prices won't rise – which left them in a financial crisis after the British Army occupied the country and allowed import of cheap Australian wheat.

¹⁰ Incorporated in 1921 as a share holders company.

¹¹ Most of its shares were owned by "Hevrat Ha'ovdim" - "The workers Company" – which was a legal parallel of the "Histadrut" trade Union. "Hevrat Ha'ovdim" was the financial branch that owned the property – factories, stores, a newspaper, a publishing house etc.

¹² "Hevreat Ha'ovdim" considered itself as a mega cooperative – that is owned by all working class. Its lack of any cooperative conduct – no direct connection between workers and the place they worked at' or bought in, no democratic process (except elections to the Histadrut trade union once in 5 years) no economic involvement and so on. For many years "Hevrat Ha'ovdim" took a major part in Israel's economy, but as times and politics changed, it was very easy to diminish its power and its employees did not consider it their own, so had no reason to struggle in order to keep its different companies going.

¹³ Cooperative Palestine, Kurkland Samuel, The National Committee for Labor Palestine, New York, 1947, p. 248.

¹⁴ See Ziv, Neta, "Credit Cooperatives in Early Israeli Statehood: Financial Institutions and Social Transformation" Theoretical Inquiries in Law Vol. 11(1) 2010 (210).

The Legal Framework for Cooperatives

The legal framework for cooperatives in Israel is supposedly The Cooperative Societies Ordinance which was promulgated by the British Mandate in 1933. The Cooperative Societies Ordinance provides a vehicle for incorporation but it is deficient on the cooperatives' values front. There is no "values clause" and no direct reference to cooperative values and principles. The only clause suggesting a cooperative identity determines that an enterprise can be register as a cooperative society if it is "...a society which has as its objects the promotion of thrift, self help and mutual aid among persons with common economic needs so as to bring about better living, better business and better methods of production..."¹⁵

The lack of cooperative values and principles in what was supposed to be the Israeli cooperative law combined with the rise of neo-liberal regime eroded the cooperative notion in Israel. I would argue that out of 4200 cooperative societies registered in Israel, the number of societies with cooperative identity does not exceed a few hundred at best. Some are registered as cooperative societies only to be able to operate in opposition to cooperative values and principles and to be able to operate admission committees.

The cooperative Societies Ordinance grants the cooperative societies' registrar multiple powers, one of which is to announce different types of cooperative societies.

There are 29 types of Cooperative Societies according to the Cooperative Societies regulations – one of them is a credit union.

Since it has been forbidden to start a financial institution without a license from the supervisor of banks since 1981 and the supervisor of banks had no intention to granting such licenses the Credit Union category has existed in name only.

Regulators

Up to 2016 there were three regulators that were relevant for a Cooperative Bank or Credit Union in Israel: the Cooperative Societies Registrar, the Director of the Capital Market and the Supervisor of Banks, in the Bank of Israel.

The Cooperative Societies Registrar is in charge of registration of Cooperative Societies. As mentioned earlier, the Banking (Licensing) law 5741-1981 granted prior supervision powers regarding financial cooperatives to the Supervisor of Banks, yet it left the registration process, including approval of the cooperative society's bylaws in the hands of the Cooperative Societies Registrar.

Israel's Securities Authority - According to the Israeli law, an offer to sell more than 35 shares to the public, demands a preliminary submission of a prospectus. A prospectus and the bureaucratic procedures derived from it are designed to protect minority share holders. Submitting a prospectus is usually very expensive, but it's not only the early submission – the ongoing operation according to prospectus' bureaucracy is complicated and expensive.

¹⁵ The Cooperative Societies Ordinance, no. 50 of 1933. (section 4).

Since there is no core control in a cooperative and the shares are not tradable – it is possible to ask for an exemption from the prospectus submitting demand. Ironically, in order to achieve an exemption, in many cases the organization must submit a prospectus.¹⁶

The main regulator is the Supervisor of Banks. Its functions are supervising the stability of banking corporations by avoiding excessive risks to their stability to protect depositors' money. It is also required to ensure that banking corporations are managed properly and to maintain fairness in bank/customer relations.

The Social Protest and Committees Followed

The social protest that swept the streets of Israel in 2011 was the outcome of a thirty year process in which neo-liberal governments allowed the gaps between the rich and the poor to increase, the middle class to deteriorate and capital and power to be concentrated in the hands of the few. It started as a protest against unaffordable housing costs and developed into a wide range of demands. The banking system was one of the focal points of the protest due to its centralized nature¹⁷, high commissions and enormous profits, amounting to billions of NIS.

One of the main outcomes of the social protest was a new wave of cooperatives in Israel, in different fields, including the financial market, in which there were two groups that started operating. One declared its main goal as starting a cooperative bank¹⁸.

In response to the protest, the government appointed a public committee. The committee pointed out that the banking market was highly centralized and harmful¹⁹. To follow the committee's conclusions, the government appointed another committee, of public officials, headed by the Supervisor of Banks. One of this committee's recommendations was, surprisingly, to "promote the establishment of credit unions".

A draft regulation was published in June 2014. It was then clear that what had seemed to be comprehensive support had translated into an impossible practical demand. The Co-operative Banks or

¹⁶ When the cooperative bank initiative approached the Israel's Securities Authority it took it 9 months to decide that the prospectus submitted by OFEK – the Cooperative bank initiative is entitled for an exemption. Only then – on November 2013 - the cooperative could legally ask members to join. The one thing the authority required was to change the cooperative's bylaws, so to eliminate the option of allocation of dividends to its members.

¹⁷ Only 5 banks hold 93% of the market, 3 hold 72% of the market.

¹⁸ The OFEK Cooperative Society was registered in 2012. The undersigned was one of its founders and is now an elected board member in charge of regulation and governance.

¹⁹ The Trachtenberg committee dealt with different aspects of social and economic policies in Israel. It was appointed while the protesters were still on the streets on August 2011 and submitted its findings to the government on 24 September 2011. It was headed by an economics professor, who used to work in the Finance Ministry and its 14 members were public officials, academics and private experts. The leaders of the social protest did not accept this committee as relevant to their demands and started an alternative committee in which had about 140 members – academics and civil society experts. The alternative committees worked for almost a year and in July 2012 published their findings and recommendations – later published in a book: "To do things Different – A Model For A Well-Ordered Society: The Social Protest 2011-20012", Yossi Yonah, Avia Spivak (Editors), Kakibutz Hameuchad Publishing House Ltd., Tel-Aviv, 2012.

the Supervisor of Banks decided not to follow any existing method of operation or criteria. Even a new name “bank union” rather than “credit union” was used²⁰.

The draft regulation lacked any co-operative concept and limited the democratic nature of the new model. However it was the requirement of 75 million NIS (18 million euro's) of capital as a pre-condition for registration and the effective need for any group wishing to set up a financial co-operative to raise about 40 million euro before it could even apply for a licence that prevented the establishment of such enterprises²¹.

The supervisor of banks claimed that although they were in favor of promoting competition and credit unions could contribute to that goal, it was more important to secure the stability of the system, thus requiring the pre-requisite capital.

New Regulator – The Great Breakthrough

The new Supervisor of Banks that was appointed in August 2015 had a different approach. She had announced that she does not consider small Credit Unions as any threat to the stability of the system, more than that, she decided small credit unions should not be under the supervision of the bank of Israel.

At the beginning of 2016 new government initiated legislation was brought to the Israeli Parliament, founding a new regulator – within the Finance Ministry – who would be in charge of supervising all non-banking financial institutions. The supervision of banks decided small credit unions would be supervised under the new regulator – with as few obstacles as possible – up to a limit of 1.5 Billion NIS (app. 400 million €) in lending and investing. If and when a Credit Union would grow and develop – it could apply for a license to become an actual Bank.

²⁰ The definition of: "A “Bank Union”" is a cooperative financial association owned and controlled by its members, not operating for profit. A "Bank Union" is intended to provide its members with bank account management services, savings, obtaining loans, and obtaining other basic banking services."

²¹ The second draft was published a year after, and looked more or less the same. The OFEK Cooperative Society, which at that point had about 3700 members (that purchased a member' share for 800 € each) had to make a dramatic decision – to declare defeat or to continue. A new board was elected on May 2015 , making its first major decision to no longer linger on the one and only complete desirable outcome – the permit to start a bank. Instead it took upon a comprehensive re-evaluation of the market and the original goals of the cooperative – trying to dissect the concrete problems of the Israeli financial market.

At the beginning of December 2015 OFEK's general assembly decided to adopt a new operating method that would allow OFEK to provide financial-non-banking services, presumably in a matter of months. The plan designed to start by constructing a Peer to Peer lending mechanism that would be based on a low interest loans , for lenders and borrowers, and would include a social added value – creating preference for lending to cooperatives, social businesses and businesses that promote environmental goals. OFEK's P2P services started operating in November 2016.

The Supervision of Financial Services (Regulated Financial Services) Law, 5776-2016

The legislative process of the new credit union law took 10 months of deliberations. The Equity pre-requisite capital was dropped to 200,000€ - 800,000€ depending on the scope of its operation. Most banking services can be provided by the credit union, limited mostly in size.

As it was the first Cooperatives law ever to be legislated in the Israeli parliament, it was a challenge to assure that cooperative values and principles would be a part of it.

The form of the law dictated some compromises. It was not brought as a separate bill, but as an added chapter to the Supervision of Financial Services Law, so there was no place for initial clauses that would refer to Recommendation 193 of the ILO or to the UN guidelines.

The values and principles would have to be addressed in concrete wording. The public officials' team responsible for writing it was surprisingly willing to accept suggestions²² and it ended up with requiring a democratic organization, in which every member has one share and one vote. An elected body must be appointed – as must a professional CEO. The law allows the Finance Minister to announce special requirements for members of the elected board, but unlike in earlier drafts they should not be pre-approved.

Only members could receive services from the credit union and the shares are of nominal value. There are wide transparency requirements. The law determines that a cooperation between credit unions would be allowed in specific fields, thus creating an unspecified exemption from antitrust law.

The one major theme the legislating team would not accept was regarding the corporate members. The bill suggested corporate members would be only up to small size – while we wanted to allow all Not for profits and all cooperative societies to be eligible to become members. That was settled only in the parliament committee – allowing membership – limiting only the scope of operation.

Concluding Remarks

On June 1st 2017 the new regulator can issue the first license to a Credit Union. There are many unknowns yet to be determined by the regulator, but it seems that there is a favorable environment but with a huge lack in knowledge. The greatest challenge after a license is issued will be to persuade people to join. The banking market suffers from a grave public distrust so it would be up to the credit union to put its cooperative identity up front and to emphasise the differences between it and commercial banks.

At the same time it would have to provide good quality and inexpensive services – not an easy task for a small enterprise in a market of giants. The next year should determine whether the Israeli public is willing to take the next step and become a part of the change it asked for 6 years ago.

²² OFEK sent 6 position papers to the team and appeared before it three times, one of which was a meeting with the chairperson of ICBA, Jean-Louis Bancel.



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