

# STUDIES ON REGULATION

Volume 8

THE HETH ACADEMIC CENTER FOR RESEARCH OF  
COMPETITION AND REGULATION  
THE COLLEGE OF MANAGEMENT, ACADEMIC STUDIES  
January 2024

# STUDIES ON REGULATION

**Chairperson**

Justice (ret.) Dr. Iris Soroker

**Chief Editor**

Justice (ret.) Dr. Iris Soroker

**Academic Management**

Dr. Tamir Shanan

**Editor**

Adv. Noa Mozes Zrihan

**Hebrew Linguistic Editor**

Adv. Dvorit Harkavi

**Academic Language Experts**

Adv. Susan Doron

**Editorial Staff**

Eden Hadida Barzilai

Ido Debby

Meytal Barel

Gal Sudai

Gal Elkabetz

## TABLE OF CONTENTS

Iris Soroker	<i>Editor's Introduction</i> .....	7
Avi Ben-Bassat	<i>Opening Remarks</i> .....	9
Yair Avidan	<i>Opening Remarks</i> .....	11
Anat Guetta	<i>Opening Remarks</i> .....	15
Iris Soroker, Dana Nayer	<i>The Structure of Financial Regulation in Israel: A Position Paper</i> .....	19
Ruth Plato-Shinar, Maayan Perel	<i>AI in Consumer Credit Underwriting: Opportunities, Challenges and Proposed Regulation</i> .....	47
Moshe Gelbard, Yehuda Adar	<i>Regulating Banking Contracts: Empirical and Normative Analysis</i> .....	113
Hadar Y. Jabotinsky, Michal Lavi	<i>Verifying and Unmasking Cryptocurrencies Users' Identities</i> ... ..	147
Israel Klein	<i>An Institutional Analysis of the General Assembly in the Era of Online Voting</i> .....	221
Esther Eliash-Gelkop	<i>An Empirical Examination of Local Institutional Investors' Behavior in Light of Israel's Securities Law</i> .....	245
Dana Nayer	<i>Is it Possible to Compete with Banks? Attitudes of SMEs toward Non-Bank Credit</i> .....	287
Iris Soroker, Hilit Katz	<i>A Wealth Fund for Digital Platforms</i> .....	329

STUIDES ON REGULATION 8 2024

# Abstracts

Iris Soroker, Dana Nayer, *The Structure of Financial Regulation in Israel: A Position Paper*

This position paper discusses the structure of the supervision of Israel's financial markets. The financial markets are central to the Israeli economy: for the economy to perform well, the financial markets must function properly. It is frequently argued that supervision of the financial markets aims to strike a balance between the two competing goals of maintaining financial institutions' stability and promoting competition based on free market principles approach. The purpose of such a balance is to encourage the growth and development of the financial markets and the real economy; to achieve it, an appropriate supervisory system is needed. This position paper examines the subject from both an academic and a practical perspective and identifies issues regarding competition that the supervisory structure needs to consider. We recommend establishing a new, internal position at the Bank of Israel— a Competition Aspects Commissioner. In our opinion, this position can help financial regulators better understand and incorporate issues involving competition as an integral part of the decision-making process in the financial system. It can also mitigate gaps between the regulatory authorities operating in the field.

We open the paper by reviewing the structure of financial supervision in Israel and discussing its advantages and disadvantages. We then present common models of financial market regulatory supervision in the second part of the paper. In the third part we examine problems in the existing supervision structure in Israel. The fourth part will be devoted to global trends in this field and to attempts to change the structure of financial supervision in Israel. In the fifth part we analyze aspects of competition in the supervision of the financial markets. In the sixth and last part, we present our recommendation to enhance the supervisory structure by creating a new position at the Bank of Israel dedicated to issues of competition.

Judge (ret.) Dr. Iris Soroker is the director of The Heth Academic Center for Research of Competition and Regulation, where Dr. Dana Nayer served as a researcher. This opinion paper was submitted to Mr. Daniel Hahiashvili, the Israeli Supervisor on the Banks, and to Adv. Michal Cohen, the Supervisor of the Israeli Competition Authority in June 2023.

Ruth Plato-Shinar, Maayan Perel, *AI in Consumer Credit Underwriting: Opportunities, Challenges and Proposed Regulation*

There has been considerable growth in the use of Artificial Intelligence (AI) and Machine Learning (ML) for the purpose of assessing creditworthiness, both worldwide and in Israel. Lenders increasingly use non-financial data about consumers to improve the accuracy and overall efficiency of their underwriting models. Among the advantages AI-based underwriting offers lenders is the potential for healthy market competition, innovation, and social inclusion. At the same time, however, it may endanger users' privacy and generate erroneous and even biased predictions

This paper explores the legal and regulatory framework in Israel that applies to the use of AI in consumer credit underwriting. In particular, it examines the extent to which this framework adequately addresses the serious risks this practice poses to borrowers' rights. Concluding that the current legal and regulatory framework is not suitable for the task of protecting borrowers in this new environment, this paper suggests adopting comprehensive, risk-based legislation that addresses the legal and ethical risks of using AI technologies in different industries. Given that no such legislation is currently planned, the paper calls on Israeli financial regulators to actively regulate the use of AI in credit underwriting, either as part of a regulatory initiative that broadly addresses the use of AI by financial entities, or as part of a narrower initiative focusing specifically on consumer credit underwriting. The paper also advocates an interactive approach, using regulatory sandboxes and innovation centers to help better train both regulators and credit providers.

Finally, the paper recommends a principle-based regulatory approach, whereby the principles of deference to human rights, fairness, transparency and accountability, explainability and human intervention, should govern the use of AI by consumer credit providers.

Moshe Gelbard, Yehuda Adar, *Regulating Banking Contracts: Empirical and Normative Analysis*

Standard form banking contracts are central to the bank-customer relationship. Notwithstanding their obvious advantages in terms of economic efficiency, these consumer contracts often incorporate exploitative and one-sided contractual terms that are either unfair to the consumer or inefficient, or both. Under Israeli law, banking contracts have traditionally been subject to supervision by the ordinary civil courts and by a special tribunal known as the Standard Form Contracts Tribunal (hereinafter the "Tribunal"). Drawing on pertinent legislation and case law, this empirical study

examines the extent to which banking contracts used by Israeli banks comply with Israeli law covering standard forms.

The first part of this study thoroughly analyzes two types of consumer contracts used in banking: mortgage contracts and account agreements (general terms and conditions). The study shows that most banks usually comply with applicable law, adapting and updating their standard forms to reflect any legislative or judicial changes regarding the legality or fairness of certain terms. Over time, however, the level of compliance with the courts' and the Tribunal's rulings in this area has eroded. Furthermore, we detected a significant level of deviation from applicable statutes in forms that have expanded to cover additional subjects not examined by the courts or the Tribunal (such as issues concerning the provision of technological services).

The second part of this article offers a normative analysis of the enforcement problem in the field of banking contracts. Drawing on a previous theoretical study, we recommend supplementing the current supervisory mechanisms (mainly the courts and the Tribunal) with a robust system of permanent administrative oversight of banking contracts' content. Expanding the current authority of Israel's Banks' Supervisor to include enforcement of standard-form law may help the State maintain and improve compliance with the substantive law on standard forms.

### Hadar Y. Jabotinsky, Michal Lavi, *Verifying and Unmasking Cryptocurrencies Users' Identities*

Terror attacks pose a serious threat to public safety and national security. New technologies facilitate and magnify these attacks, and render them even deadlier. The more funding terrorist organizations succeed in raising, the greater their capacity to recruit members, organize and commit terror attacks. Since the September 11, 2001 terror attacks, law enforcement agencies have increased their efforts to develop more anti-terrorism and anti-money laundering regulations, which are *inter alia* designed to block the flow of financing meant to fund terrorist organizations. For example, in Israel, special legislation was enacted to regulate the obligations of financial institutions in order to prevent illegal transfers of money: the Anti-Money Laundering Act 2000, and the Anti-Terrorism Act 2016.

However, traditional regulatory measures to meet the terror threat have focused on transfers of fiat currencies, and thus were meant to apply to traditional financial intermediaries. With the growing success of efforts to prevent terrorism by regulating traditional financial intermediaries, terror organizations found the use of cryptocurrencies increasingly attractive. Cryptocurrencies are electronically generated

and stored tokens that can be exchanged, usually anonymously, via a decentralized payment system, thus facilitating a high volume of transactions. Using cryptocurrencies, terrorists are able to engage in extensive fundraising and to manage and transfer funds to support illegal activities without relying on banks or other central financial intermediaries. Given the nature of cryptocurrencies, traditional regulation directed at conventional financial intermediaries is not suitable for regulating their use. This despite the major national security threat posed by terror organizations and their financiers that can use cryptocurrencies to mobilize activities and attacks. As cryptocurrencies gain in popularity, and the scope and effectiveness of their use in funding terrorism increases, the issue of regulating them becomes more urgent and demands a coherent legal response.

The article proposes a reform in cryptocurrency regulation that would require cryptocurrency issuers, wallet providers, and exchangers to verify users' identities. The courts could then issue warrants requiring cryptocurrency companies to reveal cryptocurrency users's identities when there is probable cause to believe that their activities support terrorism or other money-laundering schemes. More and more regulators around the world, including in the United States, the EU, and Israel, are concerned about the use of cryptocurrencies for illicit activities such as terrorism financing and money laundering. Regulations have been enacted worldwide to limit anonymity in cryptocurrency transactions. However, regulation at the national level does not provide a comprehensive solution to the threats posed by such anonymity, as terrorists use cryptocurrencies globally and do not limit their financial activities to a single country. Since the use of cryptocurrencies crosses borders, we believe that there is an urgent need for global regulations that combat money laundering and terrorism financing by targeting cryptocurrencies. This can be done by expanding international conventions, which require states to cooperate to advance criminal investigations and procedures. Such global regulation should impose legal obligations on cryptocurrency issuers, exchangers and companies that develop crypto wallets, and thereby establish Know-Your-Consumer procedures along the blockchain.

We believe that such reforms would stifle terrorism and other types of criminal activity financed through cryptocurrencies, curb harmful activities, and promote national security. In recognition of the legal challenges this solution poses, the article also addresses substantive objections that might be raised regarding the proposed reforms, such as threats to innovation, freedom of expression, and privacy that the erosion of anonymity may pose, as well as other concerns regarding cost and information security.



Israel Klein, *An Institutional Analysis of the General Meeting of Shareholders in the Era of Online Voting*

The general meeting of shareholders is a key element of any joint-stock company and plays a vital role in corporate governance. Various company law provisions, particularly those tailored for the unique characteristics of the Israeli capital market, where companies with controlling shareholders are prevalent, rely on effectively functioning general meetings. For optimum results, general meetings must be attended by shareholders who are unbiased by personal interests that conflict with the company's best interests.

However, shareholders often must incur expenses to attend general meetings, which leads to rational indifference among public-company shareholders. To address this indifference, the Israeli capital market has embraced the "online era" by enabling shareholders in Israeli public companies to cast their votes on line, which significantly reduces the costs involved.

This article examines how online voting has changed the institutional dynamics of general shareholder meetings of Israeli public companies. The analysis of the involvement of controlling shareholders, institutional investors, and public shareholders shows that the online era has established public shareholders (retail investors) as an additional influential body in general meetings, alongside the controlling and institutional investors.

This article explains the significance of this development and the need for further review the need to require institutional investors to participate in general meetings in the online era.

Esther Eliash-Gelkop, *An Empirical Analysis of Local Institutional Investors' Behavior in Light of Israel's Securities Law*

This study is the first to analyze whether Israeli institutional investors, which constitute the major investors in Israel and represent the Israeli citizens through provident, pension, and severance funds, take advantage of the 21st amendment to the Israeli Securities Law of 1968. In the study, we empirically analyzed whether there have been changes in institutional investors' exposure to dual-listed companies on the Israeli stock exchange while comparing the institutional investments in the same companies on foreign stock markets. It seems that institutional investors can invest on foreign stock exchanges according to analyze and according to optimal returns, including in companies that are not listed on the Tel Aviv Stock Exchange. In light of our results, including the finding that Israeli institutional investors tend to invest in dual-listed

companies through their Tel Aviv Stock Exchange listing, we examine the expansion and applicability of the home bias phenomenon in the context of a specific trading medium. According to the home bias theory and previous studies, there is a connection between dual listings and home bias, whereby investors may prefer to invest in companies that are located physically closer to them. In addition to providing this important insight into the behavior of institutional investors in Israel, the results of the study can be used as a basis for future development of the Israeli Securities Law and to update Israeli capital market regulations.

*Dana Nayer, Is it Possible to Compete with Banks? Attitudes of SMEs toward Non-Bank Credit*

Although SMEs (small- and medium-sized enterprises) play a major role in the growth of Israeli markets, their access to financing and loans has been and remains limited and complicated. This problem casts a shadow on SMEs' longevity and future development. While the emerging market of non-bank lending appeared to be an additional source of financing, attempts to incorporate this market into the broader SME credit market have not yet been successful.

In this quantitative study involving 525 SME owners, we explored perceptions of and attitudes toward non-bank credit as a possible alternative to bank credit. The questionnaires included questions about credit utilization and terms, as well as about their perceptions and attitudes toward non-bank lending. According to the findings, fewer than one-fourth of the participants that obtained any kind of credit for their business obtained it from a non-bank financial institution. We also found that the attitudes of different types of participants (e.g., men vs. women; low- and average-income participants vs. high-income participants) toward non-bank lending differ, mainly regarding information security and availability of information about non-bank lending. Another finding indicates that younger SMEs and older SME owners tend to approach this source of financing differently.

A major conclusion of this study is that it is likely that the non-bank lending market can compete with the bank lending market for SME customers. Some barriers to this outcome were detected, but few of them are substantial. These barriers include SMEs' lack of trust in non-bank financial institutions, the lack of available information on non-bank lending, and the high interest rates in the non-bank lending market.

We argue that the scarce research in this field makes it difficult to monitor changes in competitiveness on these markets. Future research and data collection are therefore suggested, as well as a few practical solutions.

Iris Soroker, Hilit Katz, *A Wealth Fund for Digital Platforms*

The leading digital platforms, such as Google, Facebook (renamed as Meta), Amazon, and Apple, are often labeled as "gatekeepers." This designation highlights their monopolistic stature within the global digital market, facilitating the creation of significant entry barriers. These entities play a crucial role in a wide range of economic and social activities, including commerce, cultural events, communication, and various public and personal interactions.

These prominent digital platforms adopt diverse methodologies to leverage user data and online behaviors, thereby generating considerable revenue, often without directly compensating the users. They intricately mine personal preferences, search histories, and social interactions to craft targeted advertisements and optimize their services for heightened profitability. Such exploitation of user data for financial gain prompts serious ethical questions. The users, whose data is an integral component of the digital economy, frequently remain uncompensated and are often unaware of the extent to which their information contributes to monetization. This scenario highlights a substantial imbalance within the digital ecosystem: the value generated by users is capitalized upon by these platforms, bolstering their market dominance and profit margins, while the primary data contributors, the users, are left without direct benefits. The presence of large monopolies is recognized in various sectors. However, the digital market experiences a particularly intensified form of monopoly, colloquially termed as "monopolies on steroids." Such pronounced market concentration threatens the evolutionary competitiveness of the market. While technological innovation indisputably propels human advancement and improves individual welfare, it is accompanied by adverse effects linked to over-centralization, such as the extensive and intricate commercial use of user data and a disproportionate accumulation of wealth, intensifying societal disparities.

To address these challenges, we propose establishing a Digital Wealth Fund, financed through a "digital information levy." This levy would be based on the revenue each platform earns from users in specific countries, correlating with the volume of personal data exchanged, predominantly for advertising purposes. The objective of the Wealth

Fund is to reinvest significant revenues, obtained from the commercialization of user data, back into the public domain, fostering social investments.

Although these digital platforms are not uniform and their revenue generation models vary, they are collectively addressed due to their substantial market influence and similarities in data-driven profit mechanisms.

The primary goal of this initiative is not to develop new taxation regulations but to present a conceptual justification for implementing a digital information levy on platforms that derive income from Israeli sources. This strategy is aimed at redistributing the financial gains from the commercial exploitation of personal data, thereby aligning economic progress with societal well-being.