

## **The Relative Advantages of Banks in Israeli Legislation**

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This brief article provides a short review of the relative advantages that have been conferred upon banks by Israel's legal-legislative framework. These advantages reflect the importance of enabling banks to provide the credit required to allow trading life to continue. These relative advantages take into consideration the fact that banks are quasi-public institutions owing a higher standard of fiduciary duty towards their customers, and that banks are intended to be driven not merely by economic benefit, but also by cautious and appropriate conduct and transparency towards customers.

However, despite the relative benefits enjoyed by the Israeli banking system, it ought to be recalled that Israel's legal system at all times takes into consideration the advantages held by bankers over their customers, and adopts judicial decisions with this in mind. Therefore, a delicate equilibrium exists within the Israeli legal system that balances, on the one hand, the need to protect borrowers against the possibility of exploitation by banks due to the power granted them,<sup>1</sup> against the necessity of providing efficient tools that allow banks to recover credit extended by them to non-performing borrowers.

### **The preferential status of banks with regard to rules of evidence**

A basic canon in Israeli rules of evidence is that the party seeking to recover a debt has the burden of proof with regard to demonstrating the extent of such debt. In accordance with this rule, and pursuant to the "Best Evidence Rule" which is also included in Israeli evidence law, historically a bank would be required to prove the contents of its books by way of filing the originals with the Court. Even if though a bank was able to prove the accuracy of the contents of its books without the need of producing the original, for the purpose of proving the authenticity of the entries in its books, the bank was required to provide as part of its legal claim a copy of the bank's books authenticated by a witness.

Against the background of the difficulties this evidentiary rule created, legislators found it appropriate to amend the law<sup>2</sup> so that a *copy* of the entries in a banker's books when "authenticated" (by affidavit or personal testimony) constituted "*prima facie* evidence of those entries and any matter or transaction or account therein entered". This principle not only resolved the technical difficulty of providing original books, but also provided banks with a relative advantage over defendants by shifting the burden of proof and creating a presumption that became the responsibility of the defendant to rebut.

Parenthetically, we mention that following the advent of the computerization of institutional and banking book-keeping, a law<sup>3</sup> was passed in Israel which revolutionized the admissibility of entries made by public institutions, including banks, in the ordinary course of business. *The*

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<sup>1</sup> Certain laws like *The Banking (Service to Customer) Law*, 5741-1981 impose statutory duties towards customers which cannot be disposed of by way of the contract between the bank and the customer.

<sup>2</sup> Sections 36 and 37 of *The Evidence Ordinance (New Version)*, 5731-1971 (hereinafter the "*Evidence Ordinance*").

<sup>3</sup> *The Computers Law*, 5755-1995.

*Computers Law* provides that the essential admissibility of an "institutional entry"<sup>4</sup> is *prima facie* evidence for proving the authenticity of its contents in any legal proceeding (while laying down qualifying conditions for reliability<sup>5</sup>). This statutory rule facilitates the conduct of legal proceedings by banks in collecting debts from debtors, by shifting the burden of proof onto defendants.

### **Grant of preference to banks as secured creditors pursuant to the *Pledges Law*<sup>6</sup>**

The Israeli legal system, through the *Pledges Law*, enables a creditor and a debtor to enter into an agreement together whereby the debtor secures its debt to the creditor by providing collateral which will be valid *in rem*, either by way of registering the collateral or depositing it on trust with the creditor or third parties. This rule confers upon the creditor the ability to realize the property in the event that the debtor fails to discharge its debt.

The basic rule in the *Pledges Law*<sup>7</sup> with regard to realizing pledges provides that realization should be carried out under judicial review in a manner that ensures the preservation of the rules of justice, in an impartial pledge realization proceeding.<sup>8</sup> Accordingly, unlike in the English legal system, a loan agreement in Israel that permits a creditor to independently realize a pledge is generally ineffective.<sup>9</sup> An exception to this general rule requiring judicial supervision is made with regard to banks, when a bank takes a pledge that has been duly deposited with a banker or on its behalf. In such case, the bank may, at its discretion, realize the deposited pledge without being under a duty to apply to the courts in this regard.<sup>10</sup>

This relative advantage awarded to banks according to the *Pledges Law vis-à-vis* other lenders in Israel has been explained by the need to provide banks with the ability to swiftly realize the collateral they hold in a manner that enables them to maintain statutory liquidity

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<sup>4</sup> "Institutional entry" is defined as "A document including a computer print-out made by an institution during its ordinary course of activity."

"Institution" is defined as "the State, a local authority, business or any party supplying a service to the general public."

<sup>5</sup> See Section 36(a)(1) - 36(a)(3) of the *Evidence Ordinance* that provides that, "an institutional entry will be admissible as evidence to prove the authenticity of the contents thereof in any legal proceeding if all of the following apply -

- (1) The institution, in its ordinary course of management, generally enters the event to which the entry relates concurrently with the occurrence thereof.
- (2) The method of gathering data to which the entry relates and the form in which the entry is made testify to the authenticity of the entry;
- (3) If the entry is a computer printout - it has been additionally proven that -
  - (a) the manner in which the entry has been issued is sufficient to testify to the authenticity thereof;
  - (b) the institution regularly employs reasonable protective measures against penetration of the computer material and against disruption of the computer's operation.

<sup>6</sup> *Pledges Law*, 5727-1967 (hereinafter the "*Pledges Law*").

<sup>7</sup> See section 17(1) and 17(2) of the *Pledges Law*.

<sup>8</sup> According to section 16(b) of the *Pledges Law*, "The parties may not stipulate the modes of realization under this Law so long as the date for the fulfillment of the obligation has not yet arrived." The legislator assumed that the borrower would be the weaker party and therefore intervened in the freedom to contract by permitting a borrower to retract its consent to independent realization granted prior to the maturity date.

<sup>9</sup> Unlike pursuant to English law where the realization of a pledge may be carried out independently by appointing a private receiver, see: R.R. Pennington, "Receiverships and Extrajudicial Remedies" in *Banks and Remedies* (Ross Cranston, Ed., 1992) at 101.

<sup>10</sup> See section 12(3) of the *Pledges Law* which provides that, "Realization of the pledge will be made by court order, save that...in a deposited pledge as described in section 4(2) serving as collateral for an obligation that is due to a banking institution, within the meaning of the *Bank of Israel Law*, 5714-1954, the realization may be effected independently by the institution, without such an order."

requirements.<sup>11</sup> Relying on the rules of public conduct pertaining to banks according to the approach adopted by Israeli courts, this independent realization of pledges was extended by case law<sup>12</sup> to include securities traded on the stock exchange and registered in the name of a nominee company (as distinct from bearer securities), provided that such shares are deposited with the bank. At the basis of this case law is the desire that banks be able to rapidly realize securities that are deposited with them by reason of the fact that they are tradable and transferable, instead of needing to turn to the courts for such purpose.

### **Banker's right of setoff**

After notice is provided, Israeli law enables the discharge of mutual financial obligations that have matured by way of setoff, without the involvement of the courts.<sup>13</sup> This right is by way of concrete security, enabling the bank to independently invoke a speedy and efficient remedy.

Therefore, Israeli bank account opening agreements<sup>14</sup> generally contain provisions that provide for the right of the bank to set off credit against debit balances, and conferring upon the bank a lien with respect to assets held in its possession,<sup>15</sup> where the assets are not monies (which monies must be set off at the time they are in the account).<sup>16</sup>

In practice, the basic rules governing bankers' liens in Israel deviate from the general principles applying to the right of lien,<sup>17</sup> *inter alia* encompassing the right of independent realization. Therefore, with the exercise of the right of lien and given the provisions contained in account opening agreements, a bank acquires not merely the right to possess the property,<sup>18</sup> but also the right to sell the asset detained and recouping any losses out of the proceeds of sale.

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<sup>11</sup> See the words of the Chairman of the Law and Constitution Committee on the first and second readings of the *Pledges Law: Knesset Debates*, Vol. 49, at 2151.

<sup>12</sup> CA 4294/74 *Obziller v. Israel Discount Bank Ltd.*, P.D.56(2) 389.

<sup>13</sup> *Contracts (General Part) Law, 5733-1973*, s. 53 and *Contracts Law (Remedies by reason of Breach of Contract)*, 5731-1971, s. 20.

<sup>14</sup> It must be recalled that agreements for opening accounts are standard contracts, the provisions of which will ultimately be scrutinized to ensure that there has not been oppression of the customer's rights.

<sup>15</sup> As appears in the *Moveable Property Law, 5731-1971* (hereinafter "*Moveable Property Law*"), in section 11(a) "A lien is a right under law to detain moveable property as security for an obligation until the obligation is discharged."

<sup>16</sup> Banks in Israel tend to regard a cash deposit as an asset to which the provisions of the *Moveable Property Law* apply, and not as monies that are deposited in an account.

<sup>17</sup> In practice the banker's right of lien in Israel more closely resembles an equitable lien.

<sup>18</sup> This approach allows the bank to exercise a lien over a cheque that has been delivered to it for collateral, discount and to use the proceeds thereof.