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Protection of the Bank Customer: By Statute or by Ethical Codes — Which Is Preferable? An Israeli Perspective

Prof. Sinai Deutch*

I. The Various Methods of Controlling Banks’ Activities

Banking is a field subjected to close scrutiny. The elaborate and comprehensive statutory regulation of bank-customer relations expresses the priority that the law gives to the legal, administrative, and judicial supervision of the banking system. This article will focus upon the various dimensions of statutory regulation. However, the breadth of these arrangements notwithstanding, there is considerable discomfort regarding the scope and substance of the protection of the bank customer under the law, particularly with respect to enforcement. In the author’s opinion, the dissatisfaction with the existing arrangements is not surprising, in view of the limits on the supervisory ability of the authorities, *inter alia*, by reason of budgetary constraints. With that in mind, the author proposes to examine the question of whether it might be preferable to regulate some of the matters by ethical codes or fair trade conventions (Soft Law) instead of, or in addition to, specific statutory provisions. This article presents the principle statutory arrangements which provide for legal enforcement of customer’s rights against banks and the difficulties involved in their implementation; that presentation will be the background for the author’s proposal regarding the adoption of ethical codes.

In the realm of civil law, the bank-customer relationship under Israeli law is governed by no less than five supplementary and parallel statutory arrangements.¹ First, is the laws of obligations: the laws of

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¹ For a comprehensive discussion of these laws, see Sinai Deutch, *Bank-Customer Relations — Contractual and Consumer Aspects*, in 163-209 GAD TEDESCHI MEMORIAL (1995). The article is updated until 1993; of course since then there have been changes in statutes and case-law. Recently the comprehensive book of GILAD NARKISS & MORDECHAI MOR, 1 DUTIES APPLICABLE TO BANKS (2002), was published.

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¹. For a comprehensive discussion of these laws, see Sinai Deutch, *Bank-Customer Relations — Contractual and Consumer Aspects*, in 163-209 GAD TEDESCHI MEMORIAL (1995). The article is updated until 1993; of course since then there have been changes in statutes and case-law. Recently the comprehensive book of GILAD NARKISS & MORDECHAI MOR, 1 DUTIES APPLICABLE TO BANKS (2002), was published.
contracts, torts\textsuperscript{2} and unjust enrichment. The central focus of these laws is general contract law, consisting of the Contracts (General Part) Law, 5733-1973,\textsuperscript{3} and the Contracts (Remedies for Breach of Contract) Law, 5731-1970.\textsuperscript{4} Second, is the special contract laws, such as the Guarantee Law, 5727-1967,\textsuperscript{5} the Security Interests Law, 5727-1967\textsuperscript{6} and the Agency Law, 5725-1965.\textsuperscript{7} Third, is the Standard Contracts Law, 5743-1982.\textsuperscript{8} Fourth, is the banking laws — the most important of which are the Banking Ordinance, 1941,\textsuperscript{9} and the Banking (Customer Service) Law, 5741-1981.\textsuperscript{10} Fifth, is the special laws for the protection of the bank customer, such as: the Interest Law, 5717-1957,\textsuperscript{11} the Charge Cards Law, 5746-1986,\textsuperscript{12} and the amendments to the Guarantee Law of 5752-1992\textsuperscript{13} and 5758-1997.\textsuperscript{14}

While the five statutory frameworks are not automatically and simultaneously applicable to all transactions, there are in fact many transactions to which they all apply.

The level of intervention in the contractual relationship between bank and the customer in the first four legal frameworks differs from the level of intervention in the fifth. In the first four, the intervention in the relationship between the parties is not direct. On the other hand, the laws in the fifth group involve direct interference with the bank’s freedom of action. These laws determine, for example, the amount of interest in linked loans, the extent of customer liability where a credit card is lost and the extent of liability incurred by an “individual guarantor” and a “protected guarantor.”

In addition to these provisions, which are primarily of a civil nature,\textsuperscript{15} there is another system of direct intervention in the administrative field, by statutory mechanisms for the extensive supervision of

\begin{itemize}
\item \textsuperscript{2} In Deutch, \textit{supra} note 1, the author discussed the contractual and consumer aspects only, but the duties governing banks in the civil field are based on all the rules of civil law and also include the law of torts and unjust enrichment. The duty of care under tort law has special importance; for a discussion of this duty, see Narkiss \& Mor, \textit{supra} note 1, at 275-306.
\item \textsuperscript{3} The Contracts (General Part) Law, 1973, S.H. 118.
\item \textsuperscript{4} The Contracts Law, 1970, S.H. 16.
\item \textsuperscript{5} \textit{Id.} 1967, S.H. 46.
\item \textsuperscript{6} \textit{Id.} at 48.
\item \textsuperscript{7} \textit{Id.} 1965, S.H. 220.
\item \textsuperscript{8} \textit{Id.} 1982, S.H. 8.
\item \textsuperscript{9} Iton Rishmi Supp. 1 (Heb.) 69, (Eng.) 85.
\item \textsuperscript{10} The Banking Law, 1981, S.H. 208.
\item \textsuperscript{11} \textit{Id.} 1957, S.H. 50.
\item \textsuperscript{12} \textit{Id.} 1986, S.H. 187.
\item \textsuperscript{13} The Guarantee Law (Amendment), 5752 (1992), S.H. 144.
\item \textsuperscript{14} The Guarantee Law (Amendment no. 2), 5758 (1997), S.H. 2.
\item \textsuperscript{15} There are several penal provisions in the Banking (Customer Service) Law, in §§ 10, 11, & 12, and in the Banking Ordinance, 1941, in §§ 8E, 81(2), 11A1, 14B, 14C, & 15.
\end{itemize}
banks, under the Banking (Licensing) Law, 5741-1981,16 the Banking Ordinance, 1941, and the Bank of Israel Law, 5714-1954.17 These laws were the basis for the enactment of numerous regulations and rules, which prescribe detailed arrangements in a number of areas connected to bank management. The supervision exercised under these statutes is primarily administrative, with criminal sanctions. In this way these provisions differ from the civil and consumer statutes in the area of banking.

Foremost among the entities supervising the banks are the Examiner of the Banks and the Governor of the Bank of Israel, whose powers are elaborated in detail in dozens of laws, regulations, and orders. There are however additional authorities that regulate certain aspects of the supervised banks' activities. For example, the Securities Authority supervises matters connected to securities consultation, and the Director of the Capital Market supervises matters relating to provident funds. Moreover, under section 8A(a) of the Banking Ordinance, the Bank Examiner may demand that a bank correct defects in the proper management of its business. Over the years, the Bank Examiner has given public expression to his concern for the norms required for proper bank management, in the form of instructions published within the framework of the Examiner's circulars. Since August 1991 the instructions have been published in the collection of Directives for Proper Bank Management.18 These directives provisions do not have the normative status of statutes or regulations, but the banks regard them as binding.

What is the source for the normative validity of the norms of proper bank management? When the Examiner orders the bank to correct defects in the management of its business under section 8A of the Banking Ordinance and a bank does not obey, he can adopt serious measures under section 8C of the Ordinance.19 Failure to comply with these measures may lead to criminal sanctions under section 8E of the Ordinance. Nevertheless, provisions regarding proper management are general norms, and their breach as such does not constitute a

17. Id. 1954, S.H. 192.
19. Section 8A of the Banking Ordinance 1941 provides that the Bank Examiner should send a notice to a banking corporation regarding defects that may impair its ability to meet its obligations or the proper conduct of its business, and he may demand their rectification or the adoption of preventative measures. Section 8C provides that should the Examiner deem that the banking corporation has not rectified the defects within the prescribed period, he may order the corporation to adopt different measures and even suspend and restrict the powers of the board of directors, a business manager, or an authorized signatory.
breach of section 8A. A special notice of the Examiner to the bank is required in order to adopt the procedures prescribed in section 8A. As stated, the banks regard themselves as bound by these provisions. But, breach of the provisions as such does not constitute grounds for the right of a civil action by a customer who has been harmed.

The five frameworks of civil law, together with supervisory laws and extensive supervisory mechanisms create a situation in which the field of banking is one of the fields in which there is the tightest and closest legal supervision, similar to the supervision of the field of insurance.

Governmental intervention and supervision of business activity may occur at four levels, constituting a normative-supervisory hierarchy. The first level is judicial review on the basis of civil and consumer legislation. The second level is review of standard bank contracts under the Standard Contracts Law. The third level is administrative supervision by bodies empowered to supervise the business activity of the banking corporation. The fourth and highest level is the direct legislative intervention in the contents of the agreement. As the degree of intervention in the banking activities increases, so too does the conflict between the regulatory laws and the principles of the freedom of contract and freedom of occupation. Under Israeli law, these two freedoms now have constitutional status under the Basic Law: Freedom of Occupation and the Basic Law: Human Dignity and Liberty.20

Traditionally, there has been considerable opposition to such extensive intervention of the law, and particularly with regard to direct legislative intervention.21 The argument is that judicial and administrative review is preferable to direct legislative intervention, whereas it is ideal for the banks' themselves to exercise self-restraint. On the other hand the centrality of the banking sphere to the consumer public, necessitated legislative intervention in bank-customer relations at various levels, including the most direct methods of intervention. This is not surprising in view of the important economic interests served by the banking system and in view of the essential need to protect customers who have deposited their money and savings in the bank. The essential need for supervision is emphasized by the scandals that have plagued the public in the past, such as the collapse of the Eretz-Israel Britannia Bank and the North America Bank and


recently the scandal of the Commercial Bank, where customer monies were stolen and embezzlement was committed with regard to more than 200 million NIS (about fifty million dollars).

The question that this article seeks to address is, whether in view of the difficulties in operating the supervision systems in the field of banking, it would not be preferable to consider replacing some of these with codes of ethics or to consider adding such codes as a backup for the existing supervision. The possibility of using codes of ethics and codes of practice (soft law) instead of supervision, or in addition thereto, has not been considered in Israel in the context of bank-customer relations. But before this question is considered, the level of enforcement of the supervision under the law as a means of consumer protection must be first addressed.

II. BANK CONSUMER PROTECTION IN LEGISLATION AND CASE-LAW — ENFORCEMENT DIFFICULTIES

As noted above, the civil legislation regarding bank-customer relations comprises no less than five sets of laws. These laws are briefly considered below.

A. General Contract Laws

General contract laws\(^2\) provide real protection for bank customers. In numerous judgments regarding contract laws, courts ruled in favor of customers in their disputes with the bank.\(^3\) In addition to the banks’ duties pursuant to contracts between the bank and the customer and duties pursuant to the provisions of the contract laws, caselaw introduced the fiduciary duty owed by the bank to its customers. The duty was the basis of a significant number of court decisions concerning bank-customer relations. This duty can be classified as a contractual duty in the broad sense of the term. Its basis may be derived from sections 25 and 26 of the Contracts (General Part) Law as part of the interpretation of the contract and supplementary details, or as a part of good faith and the contractual duties of disclosure enshrined in sections 12 and 39 of the General Contracts Law,\(^4\) even though the behavioural standard mandated by the fiduciary duty is higher than that of the regular duty of good faith.

\(^2\) The same is true with regard to the laws of tort and unjust enrichment. Not wishing to expand too much on this topic, which could fill up volumes, the author has limited the presentation of this point in the present context mainly to the laws of contract.

\(^3\) For a list of nine sample judgments in the article see Deutch, supra note 1, at 183; note 107.

\(^4\) For an interesting survey of the development of these rules, see CA 5893/91 Tefahot Israel Mortgage Bank Ltd v. Tzabah, P.D. 48(2) 573, 590-595.
This rule was first established twenty-five years ago in the case of *Israel Mortgage Bank v. Hirschco*.²⁵ It was reaffirmed and elaborated upon in the leading case in this field, CA 5993/91 *Tefahot Israel Mortgage Bank Ltd v. Tzabah*,²⁶ in which mortgage agreements with customers were declared void due to the bank's negligence and its non-compliance with the directives of the Bank of Israel. The court held that the bank breached the duties of disclosure by which it was bound, in accordance with the laws and the laws of contract.

In all matters connected to customers' money in its possession, the bank and its officers shall act in the best interests of the customers. Bank-customer relationships are relationships premised upon the customer's dependence on the bank. Moreover, the "double loyalty" that may arise in balancing the customer's best interests on the one hand and bank profitability on the other hand, necessitates a large degree of integrity, honesty and fairness. Because of the accumulation of data in the possession of the bank's officials, and because of the dependence of the customer on the advice of the bank officials and on the services that they provide, corruption may easily occur. There is a fiduciary relationship between banks and their customers, and in the planning of their financial affairs, customers are guided in planning by the banks' employees, who must conduct themselves with a high level of integrity and avoid being subject to irrelevant influences in the discharge of their roles in respect of each individual customer and to the public generally.²⁷

The judgment further cites the following passage from an article of Prof. Ariel Porat:

Customers and non-customers tend to repose special trust in the banker with whom they come into contact, and in the abilities of the bank and its technical resources. In many cases they do not seek another opinion before they act on its recommendation, and nor do they carefully scrutinize its actions. Admittedly, this confidence has been undermined over the years, as a result of several events that had widespread public repercussions, particularly the bank shares crisis in 1983. Yet it would appear that generally speaking, the loss of confidence relates to the banking system as a whole, and not necessarily to the particular bank employee with whom the individual comes into daily contact. The public at large still regards the latter as a reliable person, an expert in his work, and whose main function is to provide it with fair and professional services. The public functions fulfilled by the bank further fortify this impression. The banks, for their part, diligently attempt to increase public confidence in them, and it is only reasonable that duties be imposed on

²⁶. See CA 5893/91 *Tefahot Israel Mortgage Bank Ltd v. Tzabah*, P.D. 48(2) 573, 591.
²⁷. This passage cited from the *Tefahot v. Tzabah* judgment is taken from CrimA 122/84 *Manzour v. State of Israel*, P.D. 38(4) 94, 101 (*per* President Shamgar).
them which reflect the reasonable expectations that they themselves play a part in forming.28

This rule has been widely affirmed in many judgments. And, in fact there are numerous court decisions in which courts ruled in favor of the customers on the basis of this rule. However, the relevant question is whether the general law of contracts provides appropriate tools for regulation of bank-customer relations?

The answer is no, and for two reasons: the first as a matter of principle and the second as a matter of practicality. On the level of principle, general contract laws impose general duties, such as a prohibition of misrepresentation and exploitation, the duty of good faith, the fiduciary duty, and the duty of care.29 These duties vary from case to case, as the Supreme Court of Israel held in Tefahot v. Tzabah:

"Nonetheless, one should not conclude from this [the duty of trust] that the duty of the bank to the customer is identical in every case. The extent of the duty and the "level of trust" required of the bank beyond the general basic level vary from case to case and are affected by the nature of the relationship between the bank and the customer, the extent of the bank's involvement in this relationship and other variables."30

In other words – and this is the inherent problem - without litigation in the courts and prior to judgment being given, we cannot know whether in the circumstances of the case the bank breached its fiduciary duty to the customer, or not. Indeed, in the dozens of judgments given on this issue, we find that in different cases the courts reached different outcomes.

The second reason is a practical one. Court decisions are made on a local and individual basis. Judicial intervention on an individual basis is the lowest level of intervention, and it does not violate contractual freedom or the Basic Laws. This is also the reason for the court's tendency to use the general laws of contract for intervention in the bank-customer relationship more than other laws. Since decisions are

28. See Ariel Porat, Law of Torts, Israel Law Annual, (1992-1993) 301, 324. This passage has been cited in several judgments that adopted its perspective of the duty of trust of banks to their customers.

29. The duty of care is, in general, a term from the field of the law of torts. However it is customary to regard the duty of care in the field of bank-customer relations also as a duty in the contractual sphere. Prof. Ben-Uliel in his book also deals with the contractual duty of care derived from sections 12 and 39 of the Contracts (General Part) Law. See Ricardo Ben-Uliel, Banking Law, General Part, the Harry and Michael Sacker Institute for Research of Legislation and Comparative Law, 1996, 86-91. See also NARKISS & MOR, supra note 1, at 278-279. As the author previously noted in note 2 supra that any reference within this framework to contractual duties also includes other obligations such as the law of torts.

30. See CA 5893/91 Tefahot Israel Mortgage Bank Ltd v. Tzabah, P.D. 48(2) 573, 592.
given on a concrete basis for each particular case, each dispute must come to court. The result is that there is a need for litigation in every case; in the author’s opinion, this is an unsatisfactory method for the enforcement of customers’ rights.

Moreover, reliance on the general laws of contract alone is not a practical solution for the customer, because of the time required for enforcing his rights in the courts. An action usually begins in the Magistrates’ Court. An appeal will be filed to the District Court and an application for leave to appeal will be filed in the Supreme Court. The proceedings are protracted, and their outcome is unclear. For example, take the case of Tefahot Israel Mortgage Bank Ltd v. Lippert. It began in 1983 and the Supreme Court gave its final judgment in 1993. It is an untenable situation that legal battles of this nature be conducted on an individual basis and continued in court for years on end.

The case of Tefahot v. Lippert raises difficult questions about the ethical behaviour of banks in certain cases. In that case, Mr Lippert guaranteed a loan to buy an apartment that was supposed to be secured by a mortgage. Because of the bank’s negligence, the bank gave the mortgage without ensuring that the apartment was purchased and the mortgage registered in favour of the bank. Mr Lippert was a new immigrant from France whose fluency in Hebrew was limited. It was questionable whether he had even understood what he had signed. His income was minimal, and ethically speaking the logic of action against him was highly questionable, given that it was the bank that had been negligent and the new immigrant was unable to pay. Nonetheless, the bank sued Mr. Lippert, the guarantor, and the ensuing legal proceedings stretched out over ten years, going from the Magistrates’ Court through to the Supreme Court. In the Supreme Court the bank finally won the case with its argument that the duties of bank disclosure only apply to relations between banks and customers and not to the relations between banks and guarantors. In fact, even after the Supreme Court ruled in the bank’s favour, no attempt was made to collect the money. The Supreme Court’s judgment led to the amendment of Banking (Customer Service) Law in 1994. An ex-

32. Apparently, even when there is direct legislation on banking matters, failing effective implementation and compliance, the customer has no alternative but to litigate in the court. However, experience teaches that we should distinguish between applying general norms from the fields of contract law, tort law and bank consumer protection law with regard to which there might be a real dispute. This distinction will compel the parties to litigate in the court, and direct, clear, specific and binding statutory provisions. Experience shows that the banks respect such provisions, and litigation reaches the courts on relatively few occasions.
licit provision was introduced in section 17A of the law, prescribing that the provisions of the law would apply also to someone who was a guarantor for a customer in favour of a banking corporation. The bank could have been expected to act more responsibly than to drag an impecunious guarantor through litigation in three courts, when the bank itself was the negligent party. In any event, the bank did not succeed in collecting the money and the law was changed to the bank's detriment. *Tefahot v. Lippert* is an example of the cases where the banks fail to show sensitivity to the public, something which does not contribute to the reputation of the banking system. Had the decision-makers in the banks devoted more attention to ethics and human values, that case would not have reached litigation in the court.

An additional difficulty in relying on the general laws of contract lies in the fact that its solutions are premised upon a defect in the actual establishment of the contractual engagement between the bank and customer for purposes of the transaction, and do not usually contain protection against abuse of the terms of the contract. The problems in bank-customer relations classically derive from the fundamental and inherent inequality between the bank and the customer as contractual partners. These are problems of market failure or market structure, and in any event, solutions provided for individuals cannot provide a general solution for this problem.

### B. Special Contract Laws

Special contract laws such as the Pledge Law, the Agency Law, the Guarantee Law in its original version and the Bailees Law, 5727-1967, provide little protection to the bank customer. These statutes are based on contractual freedom, individual autonomy, and equal, balanced bargaining positions of the parties. The provisions of these statutes are too general, and the few provisions that may be used to protect the bank customer are not binding; it is possible to contract out of them and in fact this has, and continues to be standard bank practice. An example is the Guarantee Law, which was enacted in 1967. Until the statute was amended in 1990s, it did not help guarantors at all, and almost every provision in it for the protection of the guarantor was cancelled in the bank guarantee documents, since conditions can be made upon the provisions of the statute.

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33. 1967, S.H. 52. These laws do not relate necessarily to banks' duties to their customers. Obviously the Pledge Law, the Agency Law, and the Bailees Law do not refer specifically to bank-customer relations. Even the Guarantee Law is not specifically intended for this relationship, even though the issue of the guarantee, unlike the other subjects, is a very central issue in bank-customer relations.
C. Standard Contracts

Bank contracts are standard contracts. In the Israeli legal system, standard contracts are subject to two levels of control: judicial review control exercised in regular courts and administrative control exercised by the Standard Contracts Tribunal (S.C.T.). It was expected that given their cardinal importance for the market, bank contracts too would be subjected to close supervision, both within the courts and within the framework of the S.C.T. Unfortunately, this was never the case. Supervision under the Standard Contracts Law has been a complete failure. Courts do not, as a rule, intervene on the basis of the Standard Contracts Law in the content of the contracts between a bank and its customers and the occasions when they do intervene are few and far between. In this matter the courts continue, as a rule, the conservative tradition of not cancelling oppressive provisions in standard contracts.

In recent years however, the Supreme Court has actually had more frequent resort to the Standard Contracts Law, but this trend has yet to make its mark in the field of bank-customer relations. The Standard Contracts Tribunal has also failed in its attempts to regulate the contents of the bank contract, in accordance with the provisions of the Standard Contracts Law. No standard contract between a bank and a customer has ever been thoroughly examined in the Standard Contracts Tribunal. Nor has the tribunal ever approved or invalidated any other bank contract. In the standard book on the subject, mention was made of standard contracts in many business fields, but not in the field of banking, except for the credit card contract, in respect of which section 20 of the Charge Cards Law, 5746-1986, stipulates a duty to obtain approval in the Standard Contracts Tribunal.


35. See Deutch, supra note 1, at 174-183. Since the article was written, dozens of additional judgments have been given, but as of December 2003 the results have remained the same.


37. For years litigation was conducted regarding the basic current account contract of one of the large banks. The application was struck out after they failed to reach agreement. In 1985, the Ministry of Justice undertook to deal with the bank contracts. See Deutch, supra note 1, at 182. Seventeen years have passed, and nothing has happened.

D. Banking Laws

The banking laws, and in particular the Banking Ordinance, 1941, and the Banking (Customer Service) Law, 5741-1981, only provide protection to bank customers in a relatively narrow range of issues. The Banking Ordinance deals mainly with the regulation of banking business and only a small part of its provisions apply to bank-customer relations. The Banking (Customer Service) Law in its entirety deals with bank-customer relations, but most of its provisions deal with the engagement stage of the contract, and not with the contents of its conditions or their performance. The law deals mainly with the following issues: a duty to provide certain services (which, incidentally, are very limited) that do not include giving credit, a prohibition of misleading, a duty of fair disclosure and giving information and a prohibition against making one service conditional on another. Thus, despite the law's broad title, the scope of its substantive provisions is limited, and except for the issue of making one service conditional on another, there are almost no major court decisions with regard to the law. Moreover, the provisions of the law are general and difficult to implement. Its civil remedies are limited exclusively to compensation. Even the addition of the remedy of a class action under the Banking (Customer Service) Law has not made a significant change, because of the limited application of the law and the conservative, reserved approach of the Israeli courts to class actions. There are however, prospects for a change in the courts' attitude to banking class actions, which will ultimately lead to more class actions in this field being approved.

Conceivably, in practice the Banking (Customer Service) Law has had a larger influence than is reflected in case-law. Section 16 of the law provides for the Bank Examiner to investigate public complaints, and a consumer complaints unit has in fact been established in the

39. See, e.g. C.App (TA) 136834/00 Meir v. Discount Bank, Takdin (Mag.) 2001 (3) 348 (stating "While the provisions of the Banking Law are general and broad, the relevant provisions of the Guarantee Law are detailed and specific."). This judgment was given by the Magistrates' Court, but it correctly articulates one of the problems of the Banking (Customer Service) Law, 5741-1981.


41. An example of this trend is the ruling in C.C. 2033/00 Sagiv v. Bank Leumi Leyisrael Ltd. 16.12.03 (not yet published). In this judgment an important class action was approved against the two largest banks in Israel, on the grounds of misrepresentations to customers.
Supervision of Banks Department. As a result of the enactment of the law, persons responsible for public complaints have been appointed in all banks and in the Bank of Israel too. In addition, many issues are controlled by regulations made under the law, e.g. the Proper Bank Management Rules, published under the instructions of the Bank Examiner. These provisions are not anchored in the Banking (Customer Service) Law, but rather, in the Banking Ordinance. Summing up, the banking laws are not as useful as could be expected, but nevertheless, they do influence bank-customer relations.

E. Laws that Specifically Protect the Bank Customer

On the other hand, the laws that specifically protect the bank customer, such as the Interest Law, the Charge Cards Law, and the amendments to the Guarantee Law over the last decade have had the most success in effectively protecting customer rights in the fields to which they relate. There are almost no court decisions regarding the statutory provisions protecting consumers in these laws. The reason is clear: the provisions of these statutes are specific and precise. Their implementation does not generally require judicial intervention or protracted court proceedings, because banks, as a rule, uphold the provisions of the law when they are clear and detailed.

These provisions are binding and the banks may not place conditions upon their applicability unless they are for the customers' benefit. Naturally, banking circles have strongly criticized these laws, but in retrospect it is clear that they have caused no damage to the banking system.

The result is that despite the existence of extensive supervisory legislation in the field of banking, which has increased during the last twenty years, in most areas enforcement is partial at most, and its effectiveness in many cases is questionable. The overall picture is therefore one of relatively minor success in enforcement by law. This raises the question of whether better substitutes for the existing supervision might not be found. The main argument is that customer protection is best ensured by the self-restraint of the banks and not by additional

42. Case law too gives expression to the activities of the public complaints unit. See, for example, CC (TA) 58199/93 Goldenberg v. United Mizrahi Bank Ltd, Dinim (Mag.) 17, 623, ¶ 8; CC (TA) 18051/99 Pinkovsky v. Leumi Mortgage Bank Ltd, Dinim (Mag.) 16, 727, ¶ 4.
43. This is evidenced in the response of Mr. Zeev Abeles, the chairman of the board of directors of Bank Iggud, formerly Bank Examiner, to my lecture at the 'Mishkenot Sha'ananim' Conference, on June 12, 2002.
44. See, e.g. the Banking (Customer Service) (Proper Disclosure and Delivery of Documents) Regulations, 5752-1992, Kovetz Takkanot 1512.
45. See supra notes 18-19 and the text to which they refer.
legislation. The main question is: should the supervisory systems be replaced by ethical codes?

A comparison with the banking laws in the United States may be of assistance in solving that question. U.S. law in this field, like in other fields,\textsuperscript{46} serves as a source of inspiration and comparison. In U.S. law, in the area of banking, the \textit{laissez-faire} approach prevailed, almost without any Government intervention, until the end of the nineteen-sixties.\textsuperscript{47}

Yet it emerged that the hegemony of the \textit{laissez-faire} approach led to its abuse by the banks in various fields of bank-consumer relations.\textsuperscript{48} This gave rise to intensive federal legislation at the end of the sixties and the beginning of the seventies comprising several important statutes with binding provisions intended to protect bank customers.\textsuperscript{49} The banks in the United States also argued that customer protection would result in the collapse of the banks and would lead to the destruction of the credit market, but their arguments were rejected; the protective laws and regulations were approved and nothing happened to the credit market, which continued to prosper rapidly. It is interesting to point out that in the United States too, opposition to the legislation did not issue exclusively from the banks, but also came from the bank supervisory system, led by the Federal Reserve Bank.\textsuperscript{51} The legislature in the United States ignored the opposition and enacted the legislation required to protect bank customers, and as stated — nothing happened. Notably, even during the twelve years of rule by right wing presidents, and despite an aggressive campaign during the eighties in the United States for deregulation in the field of banking, the customer protective banking legislation remained intact, since there was inter-factional agreement that customer protection is a

\begin{itemize}
  \item \textsuperscript{46} See Deutch, \textit{supra} note 40, at 135-144, regarding the importance of U.S. Law as a source of inspiration.
  \item \textsuperscript{47} See John Spanogle, \textit{Regulation of the Bank-Consumer Relationship in the United States}, \textit{4 J. BANKING \\& FIN.} 18, 21 (1993).
  \item \textsuperscript{48} \textit{Id.} at 19-21. The issues examined were (1) duties relating to disclosure of the real interest; (2) discrimination in giving credit; (3) examinations of credit reporting; (4) dismissal from work as a result of non-payment of debts; (5) harm to consumers resulting from the rules of 'holder in due course'; (6) liability for loss of credit cards; and (7) mistakes in credit card accounts.
  \item \textsuperscript{49} The main statutes in these areas were the Consumer Credit Protection Act, 82 Stat. 146 (1968); Truth in Lending, 15 U.S.C.A. \S\S\ 1601-1667C (2004); Equal Credit Opportunity Act, 15 U.S.C.A. \S\ 1691-1691g (2004); Fair Credit Reporting Act, 15 U.S.C.A. \S\ 1681g (2004); Consumer Protection Act, 15 U.S.C.A. \S\S\ 1672-1674 (2004); Holder in Due Course Regulations, 16 C.F.R. \S\ 433 (1975); Electronic Fund Transfer Act, 15 U.S.C.A. \S\ 1693-1693R (2004); Fair Credit Billing Act, 15 U.S.C.A. \S\ 1666-1666j (2004).
  \item \textsuperscript{50} Spanogle, \textit{supra} note 46, at 23.
  \item \textsuperscript{51} \textit{Id.} at 22.
\end{itemize}
worthy interest, irrespective of the particular stance adopted toward
the issue of limitation of government supervision of banking.52

The U.S. experience shows that in the absence of legislative inter-
vention, one cannot rely upon the banks to strike a more reasonable
balance in the legal relationship between them and the customers.
Experience shows that interests can be balanced exclusively by legisla-
tion. The standard arguments that such legislation will destroy bank-
ing and the credit market have been proven unfounded.

III. SUPERVISION OF THE BANKS IN ISRAEL

The banks in Israel are subject to close scrutiny by several bodies,
chief of which is the Bank Examiner. The Securities Authority and
the Supervisor of the Capital Market oversee certain other areas of
bank activity. Prior to the 1980's the image of the banks in Israel was
almost untainted. It was then that the bank share scandal occurred;
and subsequently the Bejski Commission53 was established and the
bank directors were compelled to resign. Since there have been a
number of scandals,54 the most recent of them being the collapse of
the Commercial Bank following the embezzlement of a quarter of a
billion sheqels, five times the capital of the bank. Apparently, there is
a significant discrepancy between the image of closely scrutinized
banks and the facts on the ground.

The question arises: who is responsible in the event of failure?
There is no doubt that, first and foremost, despite all the public super-
visory mechanisms, the primary responsibility is that of bank manag-
ements. Secondarily, the liability is that of the various supervisory
bodies in the banking system, such as the control board, the banks' ac-
countants, its boards of directors, and additional bodies. Finally, the
State bears responsibility. The public relies on the State authorities to
properly discharge their role of supervising the bank system. The

52. Id. at 18. It is interesting to note that legislation in the United States did indeed lead to
the desired results. Id. at 24. Spanogle emphasizes in his article that the legislation led to the
redressing of most of the injustices that occurred prior to the legislation. The statutes deter-
mined provisions that were not optional, but binding. Apparently, it was only the Government
regulations based on the legislation which led to an improvement of the situation. Id. at 25.
Spanogle, in his article published in Australia, used the U.S law as basis of comparison for Aus-
tralian law. He concluded given that the inability of the Australian banking system to correct
itself, it is questionable as to whether distortions in the relations between banks and customers in
Australia can be corrected by way of voluntary codes. Id. at 26-28.

53. The criticism of the abuse of the economic power of the banks led to the appointment of
the Commission of Enquiry for the Bank Shares Manipulation (1986). The Bejski Commission
confirmed the allegations leveled against the banks.

54. For example, the collapse of the North American Bank, the collapse of the Eretz-Israel
Britannia Bank, the scandal involving the former director of Bank Leumi, Mr Ernest Yafet, etc.
public assumes that the authorities closely scrutinize the banks. Indeed, it is for this reason that many supervisory measures are set out in the Banking Ordinance, the Bank of Israel Law, and the Banking (Customer Service) Law. The question is whether these powers are exercised on a level that provides sufficient protection for the public?

In one of the few cases that reached a judicial decision, it emerged that the government authorities care less for the “the little man” and the customer than the courts. This was evidenced in an attempt made during the nineties to close the banks to the general public on Fridays. In a judgment on this issue,\textsuperscript{55} the Antitrust Tribunal accepted the position of the consumer organizations rather than that of the banks, the Bank Examiner, and the General Director of the Antitrust Authority. Whereas the supervisory bodies and the banks, under the pressure of the employees’ committees, were prepared to close the bank branches on Fridays, which would have caused the consumer public great harm. However, the Tribunal ruled against the supervisory bodies and held that the bank branches should remain open.

As a result of the Commercial Bank crisis in 2002, it was again proposed to undertake a comprehensive reform with regard to the bank supervision. The proposal is to establish an authority to supervise financial services, which will include the bodies that supervise the banks, the capital market, and the insurance companies. The significance of this step lies in the removal of bank supervision from the responsibility of the Bank of Israel, in view of the fact that in recent years the Governors of the Bank of Israel were not prepared to become actively involved in dealing with the directors of the banks. The proposal is not a new one, and was inspired by a similar English initiative, which led to the establishment of an authority for financial services, responsible for the supervision of the capital market, the banks, and the insurance companies.\textsuperscript{56} These types of proposals have been raised in the past, unrelated to the recent crisis, in order to standardize the levels of supervision and review for non-bank financial institutions too, which are currently permitted to do acts that in the past

\textsuperscript{55} See RP (Jer.) 1393/96 with regard to an application to approve a restrictive arrangement, General Director of the Antitrust Authority v. Israel Consumer Council, Dinim (Distr.) 32(1) 129 (Jan. 27, 1997).

\textsuperscript{56} Many articles have been published in the media on this issue. See, e.g., David Lipkin, \textit{Interpretation — A Critical Step}, \textit{Maariv Bus.}, May 27, 2002, at 3. Two other comprehensive articles were published in that newspaper, one of Yosi Greenstein, \textit{Shalom Puts Together a Supreme Supervisory Authority}, \textit{Maariv Bus.}, at 2, and a background article, \textit{The Bank of Israel Is Concerned}, \textit{Maariv Bus.}, at 3.
were clearly reserved for banks. Nonetheless, the recent crisis increased the possibility of implementing these proposals.\(^ {57}\)

A study of the difficulties in enforcing the rights of the bank consumer in legislation and case-law raises the question as to whether it would not be proper to replace some of the civil, administrative, and criminal supervisory systems with codes of ethics based on codes of practice. As stated, it may be presumed that budgetary constraints limit the supervisory ability of the authorities.\(^ {58}\) On the other hand, it is possible that norms and restrictions stand greater chances of realization where the banking sector voluntarily adopted them and is actively involved in their drafting, adopting, and enforcing. Ethical codes and conventions for fair trade (Soft Law) have been accepted in several countries around the world, but they have not yet been substantially adopted in Israel. Conceivably, in the field of banking there is a basis for considering the formulation and adoption of ethical codes, either to replace some of the supervisory systems or in addition to them.\(^ {59}\)

**IV. Ethical Codes as a Substitute or in Addition to Legislative Enforcement for the Protection of the Banking Consumer**\(^ {60}\)

An examination of the legal literature on the subject of codes of ethics in the field of consumer protection shows that ethical codes do not contribute significantly to customer protection and that protection of the consumer by way of ethical codes is fraught with difficulties.

The concept of ethical codes, which can also be defined as soft law,\(^ {61}\) derives from international law, where alongside binding conventions there are also consensual documents that do not have the status of a binding convention. For example, together with binding


\(^{58}\) This is based, inter alia on the introductory remarks of Prof. Itzhak Zamir at the conference, "The Bank and the Customer – Ethical Problems," at Mishkenot Sha'ananim on June 12, 2002. Justice Zamir served as Attorney-General and as a justice of the Supreme Court.

\(^{59}\) In the first chapters of the article, the need for increasing government supervision was stressed on several occasions. It would seem however, that the imperative of increased government supervision raises questions as to the desirability of adopting ethical codes as a substitute for supervision. Nonetheless, in view of the difficulties in effectively implementing and exercising the supervision, there is a basis for examining this path as a substitute or as an addition to the enforcement under the law.

\(^{60}\) For a preliminary discussion of the possibility of introducing codes of practice in Israel, see Deutch, supra note 20, 157-159.

conventions the United Nations documents also include documents known as guidelines or recommendations. Consumer protection was also unanimously endorsed by the United Nations in 1985 within the framework of a document known as the U.N. Guidelines for Consumer Protection. A closer example is the Code for Conduct of Multinational Enterprise of the OECD.

Why is there a need for ethical codes in the field of consumer protection? At the end of the sixties and at the beginning of the seventies major reforms were made in the field of consumer protection all over the world. Similar reforms were made in Israeli law at the beginning of the eighties.62 However, these reforms were only partially successful. As we noted above, commercial organizations are, for the most part, opposed to such legislation, *inter alia*, because of its costs. The movement that supports codes of ethics is a part of the trend of deregulation. We have also seen that in the banking field the prevailing approach is to leave the legislative, judicial, and administrative supervision intact. The question is: why is there a basic mistrust of ethical codes in the field of banking?

The explanation lies in the numerous shortcomings in the very attempt to replace binding legal norms with ethical codes whose entire validity is premised on the willingness of the relevant commercial bodies to cooperate and exercise self-restraint. These shortcomings exist despite the fact that the term “ethical” codes does not refer to moral and ethical behaviour on the part of business people, but to documents whose structure is similar to binding legislation. In a series of articles appearing in the seventh volume of the Journal of Consumer Policy, three criteria were formulated for ethical codes: 1) they are designed to function similarly to legal norms; 2) they are prepared on the basis of provisions of statute or in cooperation with supervisory bodies on behalf of the authorities; 3) the affected bodies in the market, which in our case are the banks and the customers, participated in drafting and supervising the implementation of the ethical codes.63 Yet despite the similarity between the ethical codes and binding legislation, there are many distinctions between them.

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Codes of ethics have advantages and disadvantages, when compared with binding legislation. The advantages are:

1. Flexibility — an ethical code is more adaptable - having consideration for market changes - than a statute.

2. Enforcement — there is a greater chance that the ethical code will be enforced than provisions of statute if, of course, the commercial parties examine themselves and are willing to cooperate.

3. Variety — solutions may be proposed beyond what is acceptable in the statute.

4. Willingness — presumably, commercial bodies are prepared to exercise greater care in complying with the rules of the ethical code than they are in complying with legislative provisions.

Despite these advantages, the accepted approach in the field of banking is that ethical codes cannot replace binding legislation, because of the disadvantages endemic to these codes. The disadvantages are:

1. Doubts as to the willingness of the commercial organizations — particularly where there are significant interests involved, such as bank commissions and service fees. It is easier to reach agreement about disclosure duties, etc.

2. Doubts regarding market willingness — the fact is that until now there are almost no fair trade conventions (i.e., ethical codes) in Israel, due to the lack of willingness on the part of the commercial organizations to becoming parties to such conventions.

3. Implementation — even when a code is agreed upon, there is a doubt as to who will supervise its implementation and who will ensure its actual realization.

4. Legitimacy — Statutes and regulations have legitimacy. It is questionable whether there is the same legitimacy for codes of ethics, and this reduces the chances of enforcing them.

5. Participation of all the commercial organizations — it is not clear how one can compel all the members of the relevant commercial organizations to participate in a convention and undertake to comply with the provisions of the ethical code. If one important commercial bank announces that it is not prepared to take part in the ethics code, how does one force it? The truth is that it is not possible. Leaving significant commercial bodies outside the code frustrates its chances of enforcement and would raise significant questions regarding its validity.

6. Proper participation of the consumer organizations — in Israel there are two small consumer organizations. The number of employees of both of these together is smaller than the number of
employees in one branch of a bank. They deal with dozens of issues. Bank related issues occupy about five to ten percent of their attention. Time wise, their best attempt at dealing with the issues would not amount to more than half of the working time of a single employee. It is difficult to see how a lone employee could conduct negotiations with the representatives of the commercial banks in Israel, which employ tens of thousands of employees. The consumers are not sufficiently organized and they have no-one to represent them on complex issues.

The conclusion is clear. Ethical codes cannot replace legislation. But the question however is whether it is viable to institute ethical codes to supplement the existing legislation. An example of this is the agreement reached with the Electric Company in which the Electric Company undertook to compensate consumers for any non-compliance with timetables. Experience shows that the Electric Company complied with its undertaking. The convention signed with the Electric Company is proof of the difficulties that plague any attempt to accept ethical codes in the banking field. In the field of electricity, since there is only one electricity company, there was no need to obtain the agreement of other companies too, in contrast to the situation in the banking field. The convention itself was signed while its main points were being prepared for enactment as regulations. Hence it was clear to the Electric Company that if it failed to accept the convention, its salient features would find expression in binding regulations. Consumer organizations had only a secondary role in relation to that of government supervisory bodies. Moreover, the Electric Company enjoys a monopoly status, which increases the need for mandatory legislative intervention, as opposed to consensually based conventions. None of these elements exist in the banking sector, the result being that the chance of creating an ethics code in the banking field is very slim.

It is not at all clear whether the commercial organizations will be willing to cooperate. The main reasons for agreeing to an ethical code are: (1) a desire to improve the image of the sector; (2) a fear that if the sector does not accept restrictions in an ethical code, the authorities will impose these duties by statute; (3) media support of the

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64. The convention was signed on December 5, 1994. The convention established rules for the supply of electricity, the quality of the supply, and customer service. In particular, it determined timetables for carrying out electric works and repairs to the network, and an undertaking to pay automatic compensation to the customer’s account for not complying with the timetable, a commitment to an arbitration body, etc.
changes; and (4) research that proves that there are indeed real problems that justify the adoption of an ethical code.

It is doubtful whether there is a chance of any ethics code being accepted in the banking sector in Israel. Even a government body such as the Ministry of Justice has not succeeded in improving the conditions of the current account contract in one of the large commercial banks, and that was after years of pressure, despite the fact that the attempt was made within an official and binding framework of the Standard Contracts Tribunal and under the Standard Contracts Law, 5743-1982.

Nonetheless, despite the doubts about the possibility of reaching an ethics code in the field of banking, it is appropriate to examine what the main features of such a code would be. In this context, the author suggests adopting the decision of the European Council of 1981, under which the voluntary codes that are made as a result of dialogue between suppliers and consumers will under no circumstances replace statutes, regulations, and consumer protection supervisory measures on a national or European level. The codes can supplement legislation, not replace it. If the heads of the banking sector in Israel were to introduce ethical codes in areas of importance to the customer public, supplementing the existing statutory requirements regulations, case-law, and the rules of proper administration, it would be to their credit.

Constructing and drafting codes of ethics requires the appointment of committees of experts, comprising representatives of the banks, the supervisory bodies, and the consumer organizations. It would be necessary to explain in advance that such codes are in addition to the statute and not instead of it. It is possible to learn from the extensive European experience in the field and in particular from the rich experience that has been gained in England with regard to fair trade conventions. For ethical codes to have real clout, a government

67. The conventions in England were introduced without participation of representatives of customers. The English codes are based on a variety of sources. See e.g., Christopher John Miller, et al., Consumer and Trading Law; Text, Cases and Materials 499-535 (1998). A voluntary code was formulated up in England in the field of banking, titled "The Banking Code" — its revised version came into effect on March 25, 1999. Another example is the voluntary code of the banks in Switzerland, dated January 28, 1998, titled "Agreement on the Swiss bank's code of conduct with regard to the exercise of due diligence" (CDB 98). We should also mention the voluntary code of eleven large banks around the world with regard to money laundering, which is called "Global Anti-Money-Laundering Guidelines for Private Banking," dated October 30, 2000, in Wolfsberg AML Principles. This last code is an example of a code that was adopted by
supervisory body would have to be established. In view of the ongoing reductions in Government budgets, the prospects of approval for such a project are highly moot. In the absence of a significant budgetary allocation that would enable the establishment of an entity resembling the Office of Fair Trading in England, which supports the preparation, drafting, and supervision of codes, any code that is composed will be in ineffective.

V. Conclusion

The author of this article has dealt with the field of consumer protection for over twenty years, during which he was involved in teaching and research in universities and colleges, including work as the legal counsel for the Consumer Protection Authority for seventeen years. From the perspective of this experience, it would seem that there is no substitute for legislation, case-law, and administrative supervision of commercial entities in general, and the banking sector in particular. Despite all the difficulties and deficiencies in enforcing the banking laws, these methods are preferable to ethical codes. Such codes may have a place, but only as a supplement to the existing arrangements, and not in their stead. There are grounds for encouraging the heads of the banking sector to adopt codes of practice in addition to the existing legislation, as a part of improving the image of the banking sector.

the large banks around the world on the subject of money laundering. Apparently, until recently, the existing legislation on this issue in many countries was insufficient. Large banks were caught committing banking offences and acts that were carried out for the purpose of money laundering. The banks, heedful of their reputation for integrity, were prepared to take several restrictions upon themselves in this matter.

68. For example, codes of practice could be used to broaden the duties of disclosure in the banking realm beyond what is currently required by statute. In my view this is an area in which ethical codes stand a chance of being adopted in the banking realm. Examples of provisions that might be included in such codes: agreement for proper disclosure of the statutory provisions and bank procedures in documents presented to customers and also disclosure of instructions regarding proper bank procedure; declarations of banks regarding their intention to indemnify the customer public in cases of misconduct. Even if these declarations add nothing from the viewpoint of the substantive law, they benefit the customer public in directing their intention to their rights as consumers.