Bank of Israel
Banking Supervision Department

Jerusalem, July 11, 2010
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To: **The banks—attn. Chief Executive Officer**

Developments in risks on account of housing loans

Introduction

1. In view of macroeconomic developments related to differences of timing in the matching of supply to demand in the housing industry and the lengthy low-interest environment, housing demand is steadily increasing. In many parts of the country, this demand is inducing increases in housing prices that are outstripping the increase in households' standard of living and income.

2. These processes, reflected both in the extent of issuance of housing loans and in average loan size, may gradually lead to long-term impairment of housing credit portfolio quality and an increase in total portfolio risk.

3. In accordance with the Reporting to the Public Directives and Generally Accepted Accounting Principles, banking corporations must make a loan loss provision that will reflect expected credit losses in the credit portfolio. In determining the loan loss provisions, banking corporations must also bear in mind the effects of recent economic developments on expected credit losses. In the Appendix to Proper Conduct of Banking Business Directive Number 314, "Dealing with Problem Debts," it is stated that in a situation where a banking corporation's management has information about developments or events related to the credit portfolio that render the provision for delinquency in accordance with the extent of the arrears insufficient, it must make a supplemental provision in accordance with the requirements of said information.

4. Consequently, the banking corporations shall take the following measures:
   4.1 a review of the risk management in housing credit (Sections 5–7 below);
   4.2 supplemental provision (Sections 8–11 below).

Management of housing credit risks

5. The banking corporations shall review its existing credit portfolio and credit policy in respect of mortgage lending and shall make sure that said policy is not inducing an increase in its exposure to risks beyond its risk appetite as defined in its business strategy.

6. Said review shall address itself, *inter alia*, to the following indicators:
   6.1 exposure of the banking corporations on account of nonindexed local-currency loans at variable interest rate[1];
   6.2 loans issued for the acquisition of dwellings for investment;
   6.3 loans issued at high payback-to-income ratios (poor payback ability) and loans issued at high LTV.
   6.4 Implications of stress scenarios of different levels of severity, including low-probability but possible scenarios. Reference shall be made, *inter alia*, to the effect of these scenarios on LTV rates and payback ability, with a distinction made among different types of credit (e.g., housing credit as against investment credit, nonindexed local-currency credit at variable interest rate, etc.).

7. The banking corporations are asked to send the Banking Supervision Department the details of the review, its findings, and the measures it took in their aftermath, as the case may be, within two months of the receipt of this letter. A banking corporation that finds this requirement difficult to perform by the specified time should apply in advance to Mr. Ido Yad-Shalom, manager of the Regulation Unit.

Supplemental provision for housing loans

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[1] In this matter, see my letter of Aug. 18, 2009, concerning variable rate housing loans. The letter also explains the Banking Supervision Department's expectations in respect of disclosure to customers. The letter may be accessed at http://www.bankisrael.gov.il/deptdata/pikuah/lett_sup/200937.pdf.

8. In view of the increase in risk occasioned by recent developments in the Israeli housing market as specified above, banking corporations shall carefully examine the need to increase their loan loss provisions on account of housing loans.

9. In any case, a banking corporations shall make a supplemental provision at the rate of at least 0.75 percent on account of outstanding housing loans that were issued on or after July 1, 2010, and in which the existing ratio in each case between the debt (prorated to the bank's share in the mortgage) and the value of the mortgaged property on the date of loan execution exceeds 60 percent. For this purpose, a housing loan is defined as in Proper Conduct of Banking Business Directive Number 451, "Procedures for Extending Housing Loan."

10. It is stated for clarity that insofar, as of the reporting date, the maintenance of said supplemental provision for housing loans is required on account of a different parameter of risk, the value of the provision to be maintained shall be the higher of the two.

11. The foregoing shall apply from the financial statements as of September 30, 2010, and thereafter.

Conclusion

12. The Banking Supervision Department intends to continue monitoring risk in this industry and to weigh the need to take appropriate measures, such as adjusting the share of risk in housing loans for capital adequacy purposes and adjusting loan loss provisions on a specific and group basis, to any extent required.

Respectfully,

Rony Hizkiyahu
Supervisor of Banks