



April 28, 2015

Circular Number C-06-2461

To:

The banking corporations and the credit card companies

Issue: Directives Regarding Credit Risk

(Proper Conduct of Banking Business Directives 311, 323, 327)

Introduction

1. In November 2014, the Committee to Examine Debt Restructuring Proceedings in Israel (hereinafter, “the Committee”) published its report summarizing its activity. The report by the Committee, which was appointed against the background of numerous debt restructuring proceedings in the Israeli economy during recent years, contains, among other things, recommendations related to banking corporations’ activity as credit providers. As part of the implementation of these recommendations, the need arose for updating the Proper Conduct of Banking Business Directives dealing with credit.
2. Following consultations with the Advisory Committee on Banking Business, and with the approval of the Governor, I have decided to amend Directive no. 311—“Credit risk management”, Directive no. 323—“Limitations on financing capital transactions” and to issue a new directive, no. 327—Leveraged lending management.

Main points of the amendments to directives

Directive no. 311—Credit Risk Management

3. As part of the credit policy, a banking corporation is to determine internal limitations on leveraged lending (Section 15e), and internal limitations on extending credit to borrowers who are more highly leveraged than accepted in the industry, subject to the materiality thresholds and the manner of calculating leverage as determined by the banking corporation (Section 15e1).

Explanation

The Committee recommends (in Sections b.1.e and b.1.a) to determine internal limitations as noted.



4. A banking corporation originating a loan syndication is required to include in the credit policy a reference to syndication transactions in which the sale/allocation process has not yet been completed (Section 15r). Likewise, the originating banking corporation is required to report to management on a regular basis about the gaps between original expectations and the actual process of the sale of such transactions (Section 67a).

An independent self evaluation of the risks incorporated in a syndication is required by a banking corporation participating in syndicated loans, as if it itself were the loan originator (Section 29).

Explanation

Syndication transactions generally involve loans—and the risk inherent in them—of considerable size.

A banking corporation organizing syndication transactions is liable to absorb material losses as a result of a delay in completing the process of selling exposures, and thus the policy and credit management framework should include a specific reference to these types of transactions. The Committee recommends (in Section b.1.a) a report to management regarding syndication transactions.

A banking corporation participating in a syndication transaction is exposed to the risk of credit default as a result of inappropriate underwriting, and is thus required to conduct an independent assessment and analysis process.

5. When a material amount (more than NIS 50 million) of credit is extended to a corporation, the banking corporation is to take into account, among other things, information on credit taken out by the controlling shareholder of the borrowing corporation to purchase the controlling shares of the corporation (or use them as a pledge), and on his past conduct (Section 27a).

Explanation

The Committee recommends (in Sections b.1.b and b.1.c) to impose disclosure requirements related to credit taken out by the controlling shareholder to finance the purchase of the controlling shares in the borrowing corporation (or use them as a pledge) and related to the past conduct of the controlling shareholder in situations in which a company he controlled faced financial difficulties.

6. The banking corporation is to conduct a review of leveraged loan ratings at a higher frequency than that of rating review of regular loans (Section 62).



Explanation

The Committee recommends (in Section b.1.a) to set standards for monitoring leveraged lending.

7. The banking corporation is to anchor processes in its procedures that will allow it to write off a loan. The procedures are to include, among other things, appropriate quantitative calculations that will serve as the basis for the bank's considerations, as well as a requirement to consider several alternatives before the debt write-off (Section 83a).

Explanation

The Committee recommends (in Section b.2.f) to update the banking corporations' procedures related to the collection, debt restructuring, and write-off policies.

Directive no. 323—Limitations on Capital Transactions

8. The Directive shall apply to all “credit for capital transactions”, as opposed to “credit for the acquisition of means of control”, and accordingly the name of the Directive will be updated. A capital transaction is a transaction whose goal is to acquire capital rights in another corporation, a buyback, or capital distribution (Section 2).

Explanation

Bringing the definition in line with the provisions of Directive 327.

9. The definition of capital was narrowed to Tier 1 capital (after regulatory adjustments and deductions), as per the provisions of Proper Conduct of Banking Business Directive no. 202 (Section 2).

Explanation

In accordance with the determination of the Basel Committee's final standard regarding large exposures (Supervisory Framework for Measuring and Controlling Large Exposures, April 2014).

10. For simplicity, the quantitative threshold for defining “credit for a capital transaction” was revised to NIS 35 million (or 0.5 percent of the banking



corporation's capital, whichever is greater), and all indexation mechanisms were cancelled (Sections 2, 4(b)2, and 5).

11. The administrative and operational requirements were integrated into Directive 327 (Introduction and Section 3).
12. The appendix with questions and answers was cancelled. Questions and answers that are no longer relevant were deleted, and the others were integrated into the body of the directive or in a central question and answer file that is concentrated on credit risk. The revised file is published together with this circular.

New directive no. 327—Leveraged lending management

13. The directive defines the framework for managing risks, including to leveraged lending, and regulates the following issues:
 - a. Definition of leveraged lending (Sections 3–5)
 - b. General policy expectations (Section 6)
 - c. Periodic review by board of directors (Sections 7–8)
 - d. Underwriting standards (Sections 9–11)
 - e. Valuation standards (Sections 12–16)
 - f. Report and quantitative analysis (Section 17).
 - g. Classification of leveraged loans (Sections 18–19)
 - h. Credit analysis (Section 20)
 - i. Deal sponsors (Section 21)
 - j. Credit review (Section 22)
 - k. Stress testing (Section 23)

Explanation

In view of the high risk profile of leveraged lending, and in accordance with the Committee's recommendations, the Banking Supervision Department's minimum expectations of banking corporations were defined with regard to adequate and cautious risk management of such loans.

Start

14. The provisions of this circular shall apply to credit extended beginning from January 1, 2016.



File update

15. The updated pages of the Proper Conduct of Banking Business file are attached.
The following are the update instructions:

Remove page:	Insert page:
311-1-32 [2] (11/14)	311-1-33 [3] (4/15)
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Sincerely,

David Zaken
Supervisor of Banks