



Banking Supervision Department
Policy and Regulation Division
Jerusalem, February 3, 2025

Circular No. C-06-2811

Attn: Banking corporations and holders of a payment service provider with prudential importance license

Re: Large Exposures

Proper Conduct of Banking Business Directive no. 313

Introduction

1. Credit portfolio concentration is one of the main sources of risk for a banking corporation. In April 2014, within the framework of the Basel III reform, the Basel Committee published a detailed standard for measuring and limiting large exposures with the goal of protecting the banking corporations' stability from losses originating from a sudden failure of a single counterparty or a group of connected counterparties.
2. This Directive replaces Proper Conduct of Banking Business Directive no. 313 on "Limitations on the Indebtedness of a Borrower and of a Group of Borrowers" (hereinafter, "the existing directive") within the framework of adjusting Proper Conduct of Banking Business Directives to Basel Committee recommendations, including adjusting the wording of the directive to the wording of the original published by the Committee.
3. With the publication of this circular, there will be an adjustment of Banking Supervision Department directives that reference the existing directive.
4. Regarding this Circular, "credit card company"—a Payment Service Provider with Prudential Importance License holder that is an entity listed in Paragraph (2) of the definition of "Payment Service Provider with Prudential Importance" in Section 36i of the Banking (Licensing) Law, 5741-1981 (hereinafter, "Payment Service Provider with Prudential Importance license holder").
5. The regulation was not accompanied by the publication of a report under the Principles of Regulation Law, 5762-2021 (in this section, "the Law") in view of the exemption established in Section 34(c)(4) of the Law, as it is based on rules generally accepted in countries with significant markets. In addition, the regulation will not be subject to the ex post examination based on Section 36 of the Law, but rather when there will be a change in the rules accepted in countries on which the regulation was based.
6. After consulting with the Advisory Committee on Banking Business Affairs, and with the approval of the Governor, I have issued this Directive.

Main provisions of the Directive

7. In December 2019, the Basel Committee published a document called "The Basel Framework"¹, which aggregates all the standards that serve as the basis for Directives. This directive is parallel to Chapters LEX10–LEX40 of that document.

¹ https://www.bis.org/basel_framework/index.htm

8. Application and implementation level:

The Directive applies on a consolidated basis and on corporations listed in Section 20 of Proper Conduct of Banking Business Directive no. 201 on “Introduction, Scope of Application, and Calculation of Requirements”, including a “foreign bank”. The implementation of the Directive on a consolidated basis means that the banking corporation is required to take into account all the exposures to third parties in the entire consolidated group, and to compare their amount to Tier 1 Capital in the group; for a foreign bank, Tier 1 Capital in accordance with the meaning of “Capital” in the foreign bank license.

Explanatory remarks

The application to “foreign bank” is consistent with the requirements of the existing directive. A definition of capital for estimating the limitation on a foreign bank is added.

9. Definitions

Alternative definitions for the definitions currently existing in Directive 313 were determined as follows:

“Counterparty” was defined, instead of “Borrower”. The definition does not include the number of borrowers when the expected repayment of indebtedness is primarily based on the same source, and none of them has an additional significant source to repay the indebtedness.

“Group of connected counterparties” was defined, instead of “borrower group”. The definition includes banking corporations and credit card companies.

“Counterparty that engages in speculative activity” was defined, instead of “borrower who engages in speculative activity”

“Supervised counterparty” was defined, instead of “supervised borrower”

“Banking group of counterparties” was defined, instead of “banking group of borrowers”. This group does not include a “new banking corporation” or “banking corporation in formation”, as they were defined in Proper Conduct of Banking Business Directive no. 480, and it does not include “Payment Service Provider license holder” or “Payment Service Provider with Prudential Importance license holder”

A definition for “large exposure” was added—“an exposure for which the sum exceeds 10 percent of the banking corporation’s total Tier 1 Capital”

In addition, alternative definitions were not provided for “credit card companies group” or for “controlled borrower group” in Directive 313 (Sections 8.10a–18c.10).

Explanatory remarks

The definitions replace the following definitions that currently exist in Directive 313: “borrower”, “borrower group”, “borrower who engages in speculative activity”, “supervised borrower”, “banking group of borrowers”.

The wording of the definitions is consistent with the generally accepted definitions in the Basel international standard, including guidelines for setting control and economic dependence ties for the purpose of classifying a group of counterparties, and are partly different from the definitions existing under Directive 313.

10. Requirements

A banking corporation’s exposure to a group of connected counterparties shall not exceed 25 percent of its Tier 1 Capital. A banking corporation’s exposure, excluding a Payment Service Provider with Prudential Importance license holder, to a counterparty or to a banking group of counterparties shall not exceed 15 percent of its Tier 1 Capital; exposure of a banking corporation to an “unknown” counterparty or to a counterparty that is a Payment Service Provider with Prudential Importance

license holder or a counterparty that is a bank or insurance company from a foreign country and has an external credit rating of at least A- shall not exceed 25 percent of Tier 1 Capital; exposure of a banking corporation to a counterparty that engages in speculative activity and is not supervised, and a cumulative exposure of said counterparties that belong to a connected group of counterparties, shall not exceed 10 percent of Tier 1 Capital, the amount of all large exposures shall not exceed 120 percent of Tier 1 Capital (Sections 20.1–20d.1).

Explanatory remarks

The directive partially maintains the limitation levels currently established in Directive 313: the limitations in Directive 313 on the exposure to a “credit card company borrower group” and “controlled group of borrowers” were cancelled; the limitation of 25 percent on exposure to an “unknown” customer is intended to ease the operational difficulty involved in looking through with regard to exposure deriving from investment in buildings; the limitation of 25 percent on exposure to a foreign bank or insurance company is intended to allow the continued purchase of credit protection from such entities; the limitation determined in Directive 313 on exposure to a credit card group of companies was cancelled, and this remained subject to the general limitation on connected counterparties, and a relief was added to the exposure of a credit card group of companies to a banking corporation; a new banking corporation, a banking corporation in formation, and a Payment Service Provider with Prudential Importance license holder were exempted from the limitation of a banking group of counterparties and were retained subject to limitations on a counterparty and a group of connected counterparties.

11. Measurement of the exposure

11.1. The amount of the exposure shall include balance sheet and off-balance sheet exposures in the banking book and in the trading book, as well as instruments that include credit risk of a counterparty as defined in Proper Conduct of Banking Business Directive no. 203A on “Handling Counterparty Credit Risk”. Off-balance sheet items will be converted to equal value of credit exposures by using credit conversion factors as noted in Directive 203 on “Credit Risk—The Standardized Approach”, excluding commitments to provide credit or to issue collaterals for which a conversion coefficient of 100 percent was established (Section 6.30).

Explanatory remarks

A 100% conversion factor for commitments to extend credit or issue guarantees is consistent with the principle of maximum loss and is therefore appropriate in this context.

11.2. Eligible financial collateral, balance sheet netting, guarantees, and credit derivatives that meet the threshold requirements and eligibility conditions for credit risk mitigation under Directive 203 are considered eligible for reducing the exposure amount for the purposes of large exposures (Sections 30.7 – 30.12).

Explanatory remarks: In accordance with international standards, the scope of credit risk mitigation has been expanded compared to current practice.

11.3. In parallel with reducing the exposure amount through an eligible credit risk mitigation technique, the banking corporation is required to recognize an exposure to the protection provider equal to the amount by which the exposure to the original counterparty was reduced (Sections 30.13—30.14). An

exception to this applies when the protection is provided via a CDS held in the trading book, as will be detailed later.

Explanatory remarks:

This requirement is intended to prevent concentration risk with counterparties providing protection.

11.4. For the purpose of calculating the banking corporation's total exposure to a counterparty, the banking corporation must add to the exposure amounts to that counterparty all exposures arising from the trading book (Sections 30.15—30.31). The measurement of option exposure values differs from the measurement used for capital requirement calculations and is based on changes in option prices resulting from a failure in the underlying instrument (Section 30.20).

Credit derivative positions are included in the calculation based on the bank's role as either the seller or buyer of protection:

For positions representing sold protection, the exposure to the reference entity must be included. In the case of a credit-linked note (CLN), the exposure to the issuer must also be included (Section 30.19).

For positions representing purchased protection, the principles of credit risk mitigation in the banking book must be applied. That is, any reduction in exposure to the original counterparty must be matched by a new exposure to the credit protection provider.

In cases of credit default swaps (CDS), where the protection provider or the reference entity are not financial institutions, a lower amount will be allocated to the protection provider based on the treatment for capital adequacy purposes (30.28–30.29).

The banking corporation may, under certain conditions, offset long and short positions in the trading book that relate to the same counterparty, and include the net long exposure in the calculation of exposure for large exposure purposes (Sections 30.23–30.31). Offsetting between the banking book and the trading book is prohibited (Section 30.30).

Explanatory remarks:

In calculating concentration risk, all exposures associated with a counterparty's default and arising from the trading book must be considered. According to the principle of maximum loss, the exposure value of an option is calculated under a model that assumes high volatility linked to a jump-to-default of the underlying asset. In a CDS transaction, when both the protection provider and the reference entity are financial institutions, the exposure amount is higher due to the correlation between them.

11.5. Joint Investment Instruments, Securitization Instruments, and Other Structures

A banking corporation is required to take into account exposures even when a structure exists between the banking corporation and the exposures, and to allocate the amount invested in a specific structure to specific counterparties, based on its ability to identify the exposure to each underlying asset in the structure (through “look-through” analysis), and whether the exposure exceeds 0.25% of the banking

corporation's Tier 1 capital. After performing the look-through, the exposure value allocated to the counterparty depends on the composition of the structure's underlying assets and whether the structure includes multiple tranches with different seniority levels. In cases where the banking corporation is not required to perform a look-through or identify the counterparty, the exposure value will be allocated to the structure itself or to an "unknown client" (Sections 30.42–30.54).

Explanatory remarks:

The requirement to perform a look-through when a structure exists is intended to prevent circumvention of large exposure limits through indirect exposure via structured investments.

12. The following exposures are exempt from this Directive:

Exposures to the State of Israel and the Bank of Israel, as well as exposures to sovereigns, their central banks, and to public sector enterprises dealt with as sovereigns in accordance with Directive no. 203, provided that they are assigned a risk weight of zero (Sections 30.32–30.35), intraday interbank exposures or exposures created from a regular securities settlement process, as well as exposures of a group of counterparties created as a result of operating payment cards that were issued by a banking group of counterparties (Section 30.36).

Explanatory remarks:

The above reflects the function of these exposures in assisting a banking corporation to comply with the liquidity requirements and the payment and settlement processes.

13. Commencement and transition provisions:

- 13.1. This Directive shall commence on January 1, 2026; although a banking corporation may implement this Directive before the commencement date, provided that it has implemented all the requirements of the directive in full.
- 13.2. If a breach from the large exposure limit is created in respect of an existing exposure, as a result of this Directive going into effect, the amount of the breach shall be reduced in equal quarterly amounts within two years from the commencement date of this Directive.
- 13.3. Notwithstanding the provisions of Section 13.1 above, a banking corporation may implement the provisions of Section 30.44 of the directive, with a threshold that exceeds 0.5 percent of Tier 1 Capital of the banking corporation instead of 0.25 percent, until January 1, 2027.

File update

Update pages for the Proper Conduct of Banking Business Directives file are attached. The following are the update instructions:

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