

Banking Supervision Department

June 15, 2021

Circular no. C-06-2661

To:

The banking corporations

**Re: Pledging assets of a banking corporation
(Proper Conduct of Banking Business Directive no. 336)**

Introduction

1. Pledging assets of a banking corporation is a highly sensitive issue with important ramifications. Pledging a banking corporation's assets has ramifications in an insolvency on the amount of assets available for paying creditors and can also have an impact on a banking corporation's ongoing activities.
2. In recent years there has been a rising trend in pledges required from banking corporations due to various reforms in international regulation.
3. In view of the increase in the scope and range of activities in respect of which banking corporations have to pledge assets, a revision in the Directive was needed. The quantitative limitation on pledged assets was removed and replaced by requirements for sound management of pledging assets.
4. After consultation with the Advisory Committee for Banking Business and with the approval of the Governor, I have amended this Directive.

Main points of the Directive

5. Definitions (Section 5)

The terms "Pledged assets" and "Assets securing central bank facilities" were defined.

Explanatory remarks

The definitions were taken from the chapter "Pillar 3 Disclosure Requirements and Additional Information on Risks" in the Reporting to the Public Directives. The meaning of adhering to the Reporting to the Public Directives is that an asset that is no longer recorded on the banking corporation's books shall not be counted in the group of pledged assets. In addition, it means that the actual existence of the limitation on the asset (as explained in the definition) is what determines it being pledged and not only the manner of the limitation or its legal format.

6. Policy, Corporate Governance, and Control with regard to Pledged Assets

(a) The Directive establishes a guiding principle, according to which in order to balance the need to manage its business and the need to protect depositors' rights in an insolvency, a banking corporation shall only pledge its assets if it is required by law, regulation or the requirements of the relevant market. It shall also take note of the effect of pledging the assets

on the banking corporation's ability to raise funding in an ongoing manner and/or in stress conditions.

(b) Subject to the guiding principle, the Directive includes requirements for managing pledged assets and the risks inherent in it. The requirements include the involvement of the board of directors, the establishment of a policy, the involvement of risk management while understanding the connection between pledging assets and other risks in the corporation, coverage of the issue by the Internal Audit function, the establishment of lines of responsibility and authorities, limitations and definitions of permitted activity, controlling and monitoring of pledged assets including via appropriate information systems, examination of scenarios of possible changes in the pledged assets (for example, as a result of a downgrade of the banking corporation's credit rating, a change in market conditions, etc.), and managing asset pledging also at the group level when the banking corporation heads a banking group.

Explanatory remarks

A banking corporation is required to manage its activity under rules of corporate governance, risk management, control and monitor while taking into account the significance of the issue and its materiality to the activity of the banking corporation.

7. Applicability

The amendment based on this Circular shall go into effect on January 1, 2022.

8. Updating of the file

Attached are the update pages to the Proper Conduct of Banking Business file. Following are the updates:

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Sincerely,

Yair Avidan
Supervisor of Banks