

Sale of housing loans and collaborations in extending housing loans

Introduction

1. In recent years, banks and institutional investors have signed several agreements regulating loan sale transactions, and agreements regulating collaborations covering the extending of housing loans.
2. In general, we view sales transactions and syndication of housing loans positively, due to the benefit in such transactions for the overall financial system. Such transactions free up capital and make it possible to continue extending credit, while providing a response to increasing demand for housing credit and to the needs of the institutional investors. Such transactions can be viewed as an efficient financial means to increase access to alternative sources of financing, to manage concentration, vary sources of credit, and broader potential diversification.
3. However, for reasons of caution, and as this refers to activity that can impact substantially on the quality of a banking corporation's assets, we intend to limit, at this stage, the scope of such transactions. In addition, and based on lessons learned from the Global Financial Crisis, in order to reduce transaction risks, to ensure cautious management of legal and operating risks from the activity, and to avoid an adverse impact on borrowers' rights, we have established several principles for executing such transactions.
4. We note that borrowers' rights from a banking corporation are determined based on general law, on the special law that applies to certain of the banking corporation's borrowers, Proper Conduct of Banking Business Directives of the Supervisor of Banks, agreements with the banking corporation's borrowers, and the existing practice at banking corporations. The principles set in this Directive are in addition to the above, and the agreements for loan sale transactions will ensure that the said borrowers' rights are not adversely impacted.
5. The principles detailed in the Directive replace the Supervisor's letter number h9905111, from August 25, 2009, on the subject of "traditional securitization of housing loans in Israel" and are consistent with the recommendations detailed in the report of the Team to Promote Securitization in Israel.¹
6. Additional directives and emphases on the issue of selling and securitizing loans are detailed in Proper Conduct of Banking Business directives and in Reporting to the Public Directives of the Supervisor of Banks.

Application

7. This Directive shall apply to the following corporations that extend housing loans, as they are defined in the Banking (Licensing) Law, 5741-1981, (hereinafter, "the Law" and "banking corporation", respectively):

¹ A joint team with the participation of representatives of the Bank of Israel, Israel Securities Authority, Ministry of Finance, Ministry of Justice, and the Israel Tax Authority, to examine the promotion of securitization in Israel. In 2015, it issued a concluding report, in the framework of which it was recommended to open a securitization market in a cautious and calculated manner by removing barriers.

- a. Banking corporation;
 - b. Corporation as per the provisions of Section 11(a) (3a) and (3b) of the Law;
 - c. Corporation as per the provisions of Section 11(b) of the Law;
 - d. Acquirer as defined in Section 36i of the Law.
8. The Supervisor may establish certain directives other than those detailed below, which will apply to a specific banking corporation, or exempt, in anomalous cases, a specific banking corporation from a certain directive, when there are special reasons for which the Supervisor saw fit to do so and for reasons that will be listed.

Definitions

9. **“Sale transaction”**—a transaction of selling housing loans, syndication of housing loans including an agreement that regulates collaborations in extending housing loans;
10. **“Housing loans”, “PTI (payment to income ratio)”, “LTV (loan to value ratio)”**, as they are defined in Directive 329 on “Limitations on issuing housing loans”.

Corporate governance

11. A banking corporation’s board of directors is responsible for formulating a sale-transaction strategy and a framework for managing the risk in such transactions. Sale transactions create many risks that require attention of the board of directors and of management. The board and management are responsible for formulating a framework for managing the risk in such transactions—among other things, formulation of policy and of enforcement procedures at all levels, as well as a clear definition of the goals for which such transactions will be executed.

Principles for carrying out a sale transaction

12. A banking corporation shall not selectively choose “good” loans (“cherry picking”) or “bad” loans (“lemon picking”) that will participate in the sale transaction. A permitted sale transaction will be of a portfolio of housing loans that were chosen randomly out of a group of housing loans that were extended during a particular period, and on the condition that the quality of the loan sold will not serve as a criterion for including it or excluding it from the portfolio to be sold.
13. It is clarified that choosing housing loans designated for a sale transaction on the basis of the following criteria is considered selective picking in terms of Section 12—the LTV and PTI.
14. A syndication transaction for extending loans in a defined project, such as a purchase group, shall not be considered a selective choosing by virtue of it applying to a specific group of loans, provided that other criteria of selective choice are not set as detailed below,
15. Notwithstanding the provisions of Sections 12 and 14, a banking corporation that executes a sale transaction may remove from the portfolio:
- a. Loans that on the sale date are nonperforming;
 - b. Loans with government participation;
 - c. Loans to employees;

- d. Loans in respect of which there is a technical/operational difficulty in selling them, provided that the sum of such loans does not exceed 5 percent of the relevant portfolio;
 - e. Loans that are excluded from the transaction as a result of regulatory limitations that apply to the transaction's counterparty.
16. Reducing moral hazard
- a. A banking corporation shall retain at least 10 percent of every loan in the sale transaction, such that the rights and undertakings deriving from the loan of the banking corporation and of the purchaser shall be on an equal level, in accordance with their share of the loan (*pari passu*); in a securitization transaction, the banking corporation shall be permitted to comply with this requirement by retaining at least 10 percent of every tranche (vertical risk retention).
 - b. The portfolio of loans designated for sale shall include loans that were included in the banking corporation's balance sheet for a period of at least 12 months prior to the sale.
 - c. A banking corporation shall not hedge the remaining credit risk as noted in Section (a) above.

Limitations on the scope of housing loan sale transactions

17. The amount of housing loans that the banking corporation will sell, plus the housing loans at the responsibility of the institutional investor in a syndication for which the banking corporation provides substantial service, shall not exceed 10 percent of the housing loan portfolio balance² or a higher share on which the banking corporation's board decided after examining the said consequences on the business model and quality of the housing loan portfolio, provided that approval for that is granted by the Supervisor of Banks.

Protection of the borrower's rights

18. The banking corporation must guarantee that the borrower's right or the rights of the owner of the property being used as a security, if the loan was secured, shall not be deteriorated or adversely impacted, due to the sale transaction. In addition, the banking corporation must ensure that protections that were granted to the borrower or to the owner of the property being used as a security as noted by law, shall not be deteriorated or adversely impacted. In every transaction, the appropriate arrangements for the specific transaction that will be designated for securing said rights and protections shall be determined.
19. The banking corporation must receive the borrowers' consent to the sale transaction, such consent can be received on the date the loan agreement is reached.
20. The banking corporation shall update the borrower with regard to the sale of his loan, no later than 3 months from the date the sale is finalized. Among other things, the banking corporation shall give the borrower details regarding the identity of the entity that purchased the loan from

² The balance includes as well the housing loans that have already been sold.

the banking corporation as well as information regarding the protection of the borrower's rights concerning the sale.

Repurchase of loans that have been sold

21. A banking corporation may buy back the loans that it sold, in accordance with the handling of a Clean-up Call option as determined in Proper Conduct of Banking Business Directive no. 205 on "Securitization" and in the relevant Reporting to the Public directives. The banking corporation is to verify before executing the transactions that the clean-up call option complies with the eligibility requirements as noted in Proper Conduct of Banking Business Directive no. 205, and that it does not adversely impact the requirements for recognition as a sale for accounting treatment purposes as established in the Reporting to the Public directives. In this regard, it is clarified that these provisions apply as well on purchases through other banking corporations in a banking group, and on the purchase of rights in loans sold by the banking corporation.

Documentation and opinions

22. For the banking corporation to be able to recognize a True Sale, for the purpose of measuring capital adequacy and for accounting purposes, it is to retain appropriate opinions.
23. The legal opinion required shall include, at least, reference to the following issues:
- a. Compliance of the sale transaction with the conditions that enable it to be classified as a true sale based on the relevant legislation and Supervisor of Banks' directives, including its compliance with the requirements of Section 27.21a(a) of the Reporting to the Public Directives.
 - b. The manner of recording the collaterals and the manner of receiving the borrower's payments (in a designated or other account) and the ramifications of such on the classification of the sale transaction as a true sale transaction.
 - c. Ensuring the borrowers' rights, including reference to receiving the borrowers' consent to the sale of the loans.
24. The opinion of the external auditor, according to which, in line with the audit standards set in the US and the Reporting to the Public directives, the legal opinion can be relied upon, because the rest of the conditions set in the Reporting to the Public directives are satisfied, and that the transaction can be treated, from an accounting perspective, as a true sale.
25. If a substantial profit was generated in the housing loans sale, the banking corporation is to document the circumstances in respect of which this profit was generated.

The selling banking corporation as service provider

26. The banking corporation that is the seller in the sale transaction may act only as a service provider for loans in the sale transaction. However, in a case in which the banking corporation does not act as such a service provider, another banking corporation shall be designated as a service provider; this is, among other things, in order to ensure the borrowers' rights in such transactions as noted in Sections 18, 19, and 20 above.

For this section, “service provider”—includes managing the loans, collecting the loan repayments, realizing the collateral, and sending a warning about carrying out a collection or realization activity.

Updates

Circular-06 number	Version	Details	Date
2724	1	Original circular	October 6, 2022