

Banking Supervision Department

Jerusalem, January 31, 2022

Circular No. C-06-2688

Attn: The banking corporations and credit card companies

Re: Banking corporation business with related parties

(Proper Conduct of Banking Business Directive No. 312)

Introduction

1. Within the framework of the Banking Supervision Department's policy to reduce, to the extent possible, the regulatory burden on banking corporations, and to simplify some of the Directives, several changes were made in Proper Conduct of Banking Business Directive no. 312. The goal is, among other things, to make it easier for the banking corporations to implement it, without any change in the main principles on which it is based.
2. After consulting with the Advisory Committee on Banking Business Affairs, and with the approval of the Governor, I have amended this Directive as noted below.

Main points of the amendments to the Directive

3. **Section 2 (application) and Appendix A:** Section (1a) was amended regarding a banking corporation that is a foreign bank, and established that such a corporation will be exempt from the application of the Directive if it complies with the terms set in Appendix A.

Explanatory notes

In view of the difficulty for foreign bank branches to implement the provisions of this Directive literally, it was decided to exempt a branch of a foreign bank from the requirements of this Directive, subject to receiving authorization from the parent bank that in this issue the parent bank implements the regulatory requirements that apply to it by the regulator in the home country, including in regard to the foreign bank's branch in Israel, and subject to ongoing management and monitoring of the transactions carried out between the branch in Israel and its office holders and the reporting of such transactions, once a year, to the branch's internal auditor.

4. **In Section (c) of the definition of "related party" (Section 3 – Definitions),** the reference at the end of the Section was amended, so that in place of the referral to terms that were set in the letter by the Supervisor of Banks on June 16, 2016, regarding "Bank-holding permits for institutions managing customers' money—policy update", the referral will be to the updated policy document of the Banking Supervision Department that was published on the Bank of Israel website.

Explanatory notes

In view of the periodic policy update and the publication of a new policy document on the subject of “Permits for holdings in banking corporations, in acquirers, and in corporations holding them for institutions managing customers’ money—policy update”, the need arose to amend as well the referral in the Directive and to formulate it in a general manner without noting a specific date of the publication of the policy document, and thus to allow the flexibility required for periodic updates on the issue.

5. **In Section (d) of the definition of “related party” (Section 3 – Definitions)**, the inclusion of office holders in a corporation such as the one noted in Section 3(c) of the definition of “related party” was cancelled, and office holders in a corporation that controls a banking corporation were added.

Explanatory notes

Office holders in a corporation that holds more than 5 percent of the means of control in a banking corporation were excluded as part of the policy of providing relief in this area. However, office holders in a corporation that controls a banking corporation were added to the definition of “related party”.

6. **In Section (d1) of the definition of “related party” (Section 3 – Definitions)**, the chairperson of the board of directors and the CEO of a main subsidiary were added. The definition of a main subsidiary is based on its definition in the Reporting to the Public Directives, however, banking corporations are permitted to not include in the definition, corporations in which the banking corporation holds at least 95 percent of the means of control in it, subject to the conditions in Section 4(b).

Explanatory notes

It was decided to add office holders who are the Chairperson of the board of directors and the CEO in main subsidiaries, to the definition of Related Party, as they have considerable influence.

7. **In Section (f) of the definition of “Related Party” (Section 3 – Definitions)** – the inclusion of corporations held by the banking corporation with means of control exceeding 10 percent of the means of control, if the banking corporation doesn’t control them and if the value of the banking corporation’s holding in them does not exceed 0.5 percent of the banking corporation’s capital, was cancelled.

Explanatory notes

Within the framework of reexamining the definition of related parties, corporations in which the investment in them is not material and the banking corporation does not control them, will be excluded from the definition.

8. **In Section (g) of the definition of “Related Party” (Section 3 – Definitions)** – in order to include it in the definition of “Related Party”, the share of holding in means of control in the corporation that the banking corporation holds was raised from 10 percent and more to 20 percent or more of the means of control.

Explanatory notes

Within the framework of reexamining the definition of related parties, it was decided to increase the share of holding in means of control in a corporation that the banking corporation controls from 10 percent to 20 percent regarding the definition of “Related Party”.

9. In Section 3a –

9.1 Added to Subsection (a) was a sentence according to which the Committee for transactions with related parties, and if such a committee was not appointed in accordance with Directive 301 – the Audit Committee, shall propose to the board of directors to establish policy and procedures for approving transactions with related parties and among other things will refer to establishing an indebtedness threshold of a related party that requires the Audit Committee’s approval, and the establishment of criteria for applying related-party limitations even on someone who is not included in the definition, if it felt that there is a need for it.

Explanatory notes

The Committee for transactions with related parties or the Audit Committee shall propose to the board of directors to establish policy and procedures for approving transactions with related parties. This is on the basis of criteria or indicators, and among other things will refer to the correlation of the indebtedness thresholds and definitions of a related party in the Directive with the corporation’s risk profiles, including the need to classify contracts, affiliations, and collaborations of the corporation with other entities or people. In accordance with its suggestion, the board of directors will be required to establish policy regarding the approval of transactions with related parties that will include reference to, among other things, establishing a threshold of indebtedness that will require the approval of the audit committee, and the setting of criteria for also imposing related-party limitations on one who does not comply with the definitions in the Directive.

9.2 Subsection (b) was added, according to which the Audit Committee or the Committee for transactions with related parties, as relevant, will establish procedures for monitoring, control and reporting of transactions with related parties that do not require a documented approval by the Audit Committee or the Committee for transactions with related parties in accordance with the provisions of Section 7(a) including reporting of transactions with related parties that are exempt from the provisions of Section 4(a) according to the provisions of Section 4(b).

Explanatory notes

The Audit Committee or the Committee for transactions with related parties, as relevant, is required to define a policy of monitoring, control, and reporting for transactions that do not reach a level of requiring approval by the Committee in order to maintain the consecutiveness of control.

9.3 Subsection (b) – cancelled.

Explanatory notes

This subsection was moved to Directive 301 – the board of directors.

10. **In Section 4 (b) (transactions with related parties)**, the definition was expanded, allowing an exemption from the requirement in Subsection (a) also for transactions of corporations in a banking group with a corporation in which the banking corporation holds at least 95 percent of the means of control, in which one of the following two conditions applies:

- It does not grant credit or other service to a person outside the banking group
- Its entire occupation is issuing bonds for corporations in the banking group.

In this regard, “banking group” – the banking corporation, the banking corporation that controls it, and banking corporations controlled by either of them;

In addition, an exemption was provided from the requirement in Section 7(a)(1) for transactions with corporations as noted in Section 4(b).

Explanatory notes

In view of the experience accrued and the formulation of the understanding that there is reduced risk in such transactions, it was decided to expand the Directive that allows an exemption from the requirement in Subsection (a) to transactions executed by corporations in the banking group with a corporation in which the banking corporation holds at least 95 percent of the means of control, which does not extend credit or provide another service to a person outside the banking group or whose entire occupation is issuing bonds for the corporations in the banking group.

In addition, it was decided to exempt the Committee for transactions with related parties, or the Audit Committee, from a discussion on transactions that comply with these terms.

11. **In Section 5(b) – (Limitation on indebtedness of related parties)** in paragraph (3), the exclusion of subsidiary corporations, and in paragraph (4) the indebtedness limit of a banking corporation office holder, were raised to NIS 3 million, instead of NIS 1 million.

Explanatory notes

The exclusion of corporations controlled by the holder in Section 5(b)(3) was cancelled, after Section 3(g) provided an easing and increased the share of joint holding in the corporation that the banking corporation controls in terms of a holder that will be considered a related party. In Section 5(b)(4) it was decided to increase the amount of the limitation after examination and in view of the limitation including the indebtedness of related parties remaining in place.

12. **In Section 7(a)(1)(a) (approval of transactions with related parties in the board of directors)**, the indebtedness threshold for approval of a transaction was increased to NIS 1 million, instead of NIS 100,000.

Explanatory notes

The thresholds were changed with the goal of easing the burden created for the Committee for transactions with related parties or the Audit Committee from a large number of transactions it is required to approve, in order to give it more time to focus on more material issues.

13. **Section 7(a)(1)(c) was added**, with an exemption from approving a transaction when the renewal of an agreement with a controlled corporation at a scope and under conditions that are not substantially different from those approved in the past comes up for discussion.

Explanatory notes

The section was added as part of providing relief for the work of the board of directors, particularly in reference to renewing an agreement that has already been essentially approved in the past.

14. **In Section 7(a)(2)** the distinction between an individual related party and an office holder in the banking corporation was cancelled, and the same threshold will apply on both of them (NIS 500,000).

Explanatory notes

The change in the threshold is intended to ease the burden in the board committees—this will allow deeper and more comprehensive discussions in other material discussions.

15. **In Section 7(a)(3)**, a threshold was set for the approval of any other transaction (not just sale or lease) with an individual related party of NIS 500,000.

Explanatory notes

The requirement in the past was in the Directive and it was deleted in one of the versions. The threshold that was established for an individual related party in this section was adjusted to the threshold set for approval of an indebtedness transaction in Section 7(a)(1).

16. **Section 7(a)(5)** added “restructuring debt” of a related party for approval by the Audit Committee or the Committee for transactions with related parties.

Explanatory notes

The risk in restructuring debt of a related party requires approval, similar to an allowance or writing off debt of a related party.

17. **Section 7a** is cancelled.

Explanatory notes

The section was transferred to Directive 301.

18. **Section 8 (related party that is an employee)** – the wording was changed and clarified. In addition, the reference to conditions of the terms of service or employment that were established as noted in Proper Conduct of Banking Business Directive no. 301A was expanded.

Explanatory notes

The change in the wording of the section was intended for clarification and refinement, according to which the terms of service and employment that were determined in accordance with Proper Conduct of Banking Business Directive no. 301A will be exempt from the requirements of the Directive, except for Section 5(b)(4), similar to labor agreements and a collective agreement.

Commencement and transition provisions

19. The amendments to the Directive in accordance with this circular shall start on July 1, 2022 (hereinafter, the start date), though a banking corporation that completes its preparation before the start date may implement the directive with the amendments pursuant to this circular before the start date.
20. Regarding corporations defined as “related party” according to Section 3(f) just before the start date, the value and share of the holding in them are to be assessed, based on the value the investment in them is presented in the bank’s books, the most recent financial statements published by the banking corporation when the directive went into effect and in an ongoing manner.

21. File update

Following are the updates to the Proper Conduct of Banking Business file:

Remove pages	Insert pages
(9/16) [11] 312-1-6	(1/22) [12] 312-1-6

Respectfully,

Yair Avidan

Supervisor of Banks