Banking Supervision Department
Policy and Regulation Division

Jerusalem, April 10, 2022
Circular No. C-06-2703

Attn: The banking corporations and credit card companies

Re: Board of Directors and Remuneration Policy at a Banking Corporation
(Proper Conduct of Banking Business Directive No. 301 and 301A)

Introduction

1. Proper Conduct of Banking Business Directive no. 301 on the issue of the Board of Directors (hereinafter, "**Directive 301**") and Proper Conduct of Banking Business Directive no. 301A on the issue of remuneration (hereinafter, "**Directive 301A**") have been amended and adjusted to statutory requirements of board chairpersons in banking corporations in general, and at banking corporations without a controlling core in particular.

2. The amendments to the directives are intended to strengthen the standing and independence of the board and to enhance the effectiveness of its work. One of the basic principles of a suitable corporate governance regime is a clear and absolute separation between the function outlining policy and supervising, which is the board of directors, headed by the board's chairperson, and the executing function, headed by the CEO, so that the said supervision will be effective. As part of this, the amendment is intended to strengthen the standing of the chair of the board as part of the board of directors and to distinguish the chair from the bank management, while emphasizing the board's being a collective entity and the responsibility of each member of the board. Accordingly, the amendment to Directive 301 establishes that the board is to define and detail the functions and authorities of the chair of the board, in such manner that they will not deviate from the functions and authorities ascribed to the chair by the provisions of the Law, so that there will not be a mixture of the chair's functions and how to carry them out and the functions of the management and a manner so that they will not derogate from the responsibilities of the board or reduce the obligations and responsibilities of the rest of the directors, and in a banking corporation without a controlling core—so that a connection will not be created between them and the banking corporation. In addition, the amendment to Directive 301A sharpens the principle that is currently anchored in directive, according to which the

remuneration of the board chairperson is to be determined relative to the manner of remuneration of the other directors of the board.

3. In addition, the amendment is intended to enable a banking corporation without a controlling core to pay the chair of the board compensation that is appropriate to what is required of him in carrying out his functions, provided that it will not be enough to serve as some connection or to adversely impact the autonomy of the chairperson or his independence of the banking corporation. This, among other things, is based on the approach that is expressed in the legal memorandum of the Companies (Corporate Governance in Public Companies that do not have a Controlling Core) Law, 5781-2021, which was published by the Ministry of Justice on March 10, 2021, according to which it was proposed to enable a public company that does not have a controlling core to pay an independent director serving as chairperson an annual remuneration in addition to the remuneration established in Section 244 of the Companies Law, 5759-1999, and provided that the Compensation Committee determined that the additional annual remuneration is not enough to adversely impact the independence of the independent director.

4. Following consultation with the Advisory Committee on Banking Business Affairs and with the approval of the Governor, I have amended these Directives.

Main updates

5. Section 24(c) of Directive 301

Section 24(c) of Directive 301 details the sections in the Companies Law, the provisions of which apply to an external director according to Directive 301, including Section 244 of the Companies Law that regulates the remuneration to which an external director is eligible. The amendment establishes that Section 244(a) shall not apply to an external director according to Directive 301 who is serving as the Chairperson of the Board in a banking corporation without a controlling core and that the banking corporation shall be permitted to pay him compensation in accordance with Section 13a of Directive 301A.

Explanatory remarks

Section 24(c) of Directive 301 imposed on an external director according to Directive 301 provisions that apply to an external director according to the Companies Law, including provisions related to the compensation to which he is eligible. The provision of Section 244(a) of the Companies Law establishes that an external director is eligible for remuneration and expenses reimbursement, as shall be determined by the Minister in consultation with the Israel Securities Authority. By the power of this section, the Companies (Rules regarding compensation and expenses for an external director)

Regulations, 5760-2000, (hereinafter, the **Remuneration Regulations**), which regulate the remuneration to an external director, were amended. The Remuneration Regulations do not regulate the remuneration to the chairperson of the board who carries out additional functions vis-à-vis the other directors, as an external director, according to the Companies Law, is not permitted to serve as chairperson of a board. As in accordance with the provision of Section 28(e) of Directive 301, at a banking corporation without a controlling core an external director according to Directive 301 is permitted to serve as chairperson of the board, the amendment is intended to enable him to accept compensation that is appropriate to the carrying out what is imposed on him, in line with what is established in Directive 301A, which imposes the principles of the Remuneration Regulations on the remuneration to which the board chairperson shall be eligible, with the required adjustments, including the provisions of Section 244(b) of the Companies Law.

6. Section 28 of Directive 301

Chapter 4 of Directive 301 deals with the Chairperson of the Board. The amendment adds a section that establishes—

(1) that the board of directors shall define the functions and authorities of the Chairperson of the Board in such manner that they shall not deviate from the functions and authorities accorded to him under the provisions of the Law, such that there will not be an intertwining of his functions and manner of carrying them out and the functions of the management, so that his independence from the banking corporation is not adversely impacted and in a manner that shall not derogate from the functions of the board and will not decrease the obligations and responsibilities of the other directors, and in a banking corporation without a controlling core – so that a connection will not be created between him and the banking corporation.

(2) that the board shall define the scope of time that the chairperson of the board must dedicate to carrying out his functions.

Explanatory remarks

The duties and powers of the Chairperson of the Board of Directors should not exceed those conferred on him by the provisions of the Law. In addition, the Board of Directors may impose on the Chairperson any position that he may authorize one of its members to perform and that is related to the work of the Board of Directors.

One of the basic principles of proper corporate governance is to create a buffer and maintain independence between the policy-making entity and supervisor, which is the board headed by the chairperson of the board, and the executive headed by the CEO, so that said supervision is effective. This principle is reflected, inter alia, in the provision of Section 95(b) of the Companies Law, according to which the powers of the CEO will not be conferred on the Chairperson of the Board of Directors; The chairperson of the board of directors shall not be given powers that are given to a direct or indirect subordinate of the CEO, and the chairperson of the board shall not serve as another function in the banking corporation or in a corporation under its control, nor in Sections 57 (c) and (d) of Directive 301, according to which the Chairperson of the Board of Directors will not have an executive position in the banking corporation and will refrain from participating in its day-to-day management, nor will he be present at discussions of management and its committees, except for discussions of the banking corporation's overall strategy. In general, the more the activity of the Chairperson of the Board of Directors is integrated and involved in the activities of the banking corporation and the greater the scope of his relations with the management of the banking corporation, the greater the risk of an adverse impact on his independence. On this basis it is important to clearly define the roles and powers of the Chairperson of the Board. It must also be ensured that the determination of the functions of the chairperson of the board of directors does not replace or detract from the functions of the board of directors or reduce the duties and responsibilities of the other directors.

In a banking corporation without a controlling nucleus, it must also be ensured that the positions and powers of the chairperson of the board, in force or in practice, as well as the extent of his relations with the corporation's management, do not constitute affiliation and do not impair the independence of the Chairperson of the Board of Directors and his independence from the banking corporation.

In accordance with the functions of the Chairperson of the Board of Directors to be determined as aforesaid, the Board of Directors shall determine the amount of time that the Chairperson of the Board of Directors must devote to performing these functions.

7. Section 3 (application) and Section 4 (definitions) in Directive 301A.

Subsection (3) was added to Section 3(a), imposing the directive on an acquirer, and in Section 4, the definition of banking corporation without a controlling core was added.

Explanatory remarks

The imposing of the directive on an acquirer was established clearly in Directive (until now it applied by power of the appendix to Proper Conduct of Banking Business Directive no. 472). In addition, it was established that the provisions of the directive regarding a banking corporation without a controlling core shall apply solely to a banking corporation as defined in the Banking (Licensing) Law, 5741-1981.

8. Section 13a(b) of Directive 301A

Subsection (2) of Section 13a(b) of Directive 301A was cancelled, and a section was added that regulates the principles for determining the remuneration of the board chairperson in a banking corporation without a controlling core. The remuneration of such a board chairperson shall be in line with the Remuneration Regulations, with the adjustments established in the Directive.

A board chairperson is eligible solely for annual remuneration that will be determined relative to the average remuneration of an expert director in a banking corporation. Likewise, in addition to expense reimbursement as established in the Remuneration Regulations, the banking corporation shall be permitted to bear the Chairperson's travel and phone expenses involved directly in respect of the performance of the Chairperson's functions, as well as room and board expenses directly involved in carrying out thus functions outside of Israel. The Chairperson shall be permitted to use the banking corporation's office and administration services for carrying out his duties.

In accordance with the Remuneration Regulations, the amount of the annual remuneration shall be disclosed to the candidate for the position of Chairperson of the Board of Directors prior to obtaining their consent to serve in the role, and it shall remain unchanged throughout the three-year term of office. Notwithstanding the foregoing, in a banking corporation without a controlling core, the determination of the remuneration for the Chairperson of the Board serving at the time these provisions come into effect shall be completed within six months. For such a Chairperson, it is clarified that the requirement to present to the general meeting the method by which the ratio between their remuneration and the average remuneration of an expert director was determined, as well as the rationale for setting that ratio, shall apply only if the approval of the general meeting is required for the remuneration or any changes thereto.

Explanatory Remarks

Section 11(e)(b) of the Banking Ordinance, 1951 (hereinafter – "**the Ordinance**") sets out the eligibility requirements for a director in a banking corporation without a controlling core, including the requirement of the absence of any affiliation between the director and the banking corporation. These eligibility requirements also apply to the Chairperson of the Board of Directors. Accordingly, it must be ensured that the remuneration granted to the Chairperson does not create any affiliation or compromise their independence and objectivity vis-à-vis the banking corporation.

It should be emphasized that the need to anchor the position of the Chairperson as part of the Board of Directors, while distinguishing it from the management of the banking corporation – including through the determination of remuneration relative to that of other directors, as set out in Section 13a(b)(1) of the Directive – is of particular importance in a banking corporation without a controlling core.

To this end, it is established that the remuneration of the Chairperson of the Board in a banking corporation without a controlling core shall be determined in accordance with the Remuneration regulations applicable to all other directors, with adjustments reflecting remuneration appropriate to the scope, responsibilities, and unique characteristics of the Chairperson's role compared to those of the other directors.

Accordingly, the remuneration shall be determined in relation to the average remuneration paid to an expert director in the banking corporation during the three years preceding the calculation date, based on the differences between the characteristics of the Chairperson's role and those of the other directors, which affect:

1. The amount of time the Chairperson is required to devote to fulfilling their duties, as determined by the Board pursuant to Section 28(j) of Proper Conduct of Banking Business Directive No. 301, compared to other directors; and
2. The level of responsibility inherent in the Chairperson's role beyond that of the other directors. The time commitment is not measured in terms of employment percentage and may be lower or higher than a full-time position, as customary.

When determining the said ratio, the Compensation Committee and the Board of Directors shall also consider the commonalities between the Chairperson and the other directors, including the qualitative aspects of their performance, duties, and responsibilities, as well as the restrictions arising from the prohibition against conflicts of interest. They shall also take into account that the total annual remuneration of a director in the banking corporation covers the time required to perform their duties, their skills and experience, and the level of responsibility involved. Accordingly, it must be ensured that the determination of the ratio and its rationale do not diminish or detract from the roles and responsibilities of the other directors.

In accordance with Section 244(b) of the Companies Law, which applies to external directors, the Chairperson of the Board shall not receive, in addition to their remuneration and reimbursement of expenses, any other payment, whether direct or indirect, in connection with their service or its termination. This includes payments for non-compete undertakings or advance notice. Beyond the question of whether such additional payments could create an affiliation between the Chairperson and the banking corporation or impair the Chairperson's independence, the justification for granting such payments to the Chairperson but not to other directors is inconsistent with the principle that the Chairperson's role and remuneration should not detract from the collective nature of the Board or from the duties and responsibilities of the other directors. Accordingly, the Chairperson should not possess materially greater information that would justify a different protection arrangement or create dependency, particularly in light of the legal provisions governing the composition and rotation of the Board, which are intended to ensure continuity in its work.

When determining the remuneration of the Chairperson of the Board in a banking corporation **with** a controlling core, it is not mandatory to adhere to the Remuneration regulations. The banking corporation may, subject to Section 13a(b)(1) of the Directive, determine the remuneration and related terms to which the Chairperson shall be entitled, as it deems appropriate.

Commencement

The starting date of the amendments to Directive 301 and 301A are the day they are published, although regarding a Board Chairperson serving at the time these provisions go into effect—the earlier of the date a condition of his service is updated or at the conclusion of 6 months from its publication date.

File update

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

Remove pages	**Insert pages**
301-1-53 [28] (1/22)	301-1-53-[29] (4/22)
301A-1-11 [6] (12/21)	301A-1-13 [7] (4/22)

Respectfully,

Yair Avidan

Supervisor of Banks