

LIMITATIONS ON THE INDEBTEDNESS OF A BORROWER AND OF A GROUP OF BORROWERS

Introduction

1. (a) The concentration of the credit portfolio constitutes one of the sources of credit risk in banking corporations, and awareness of this has resulted in limitations being set on the indebtedness of a borrower and a group of borrowers.
- (b) This Directive sets limitations on the total indebtedness of a borrower and of a group of borrowers to a banking corporation and to all corporations in Israel and abroad whose financial statements are consolidated with the financial statements of the banking corporation.
- (c) The limits established in this Directive should be construed as minimum rules. In addition, a banking corporation must discuss and establish internal limits on maximum credit exposures. In setting said limits, the banking corporation must weigh, *inter alia*, factors such as its characteristics, those of its exposures, credit rating levels, and the extent of correlation between borrowers included in a borrower group and the overall level of credit concentration of the banking corporation and the banking group. The situation to strive for is one in which the lower the quality of exposure and the higher the correlation among its components, the stricter the limit pertaining to said exposure will be.
- (d) The board of directors of the banking corporation, as part of its credit policy, shall define parameters for determining whether significant relations between customers exist, taking into consideration the different elements of these relations.

The banking corporation may determine a threshold level of significance in considering certain elements.

Applicability

2. (a) This directive applies to all banking corporations except joint service companies.

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- (b) This directive also applies to the following corporations as if they were banking corporations: corporations of the type stated in sections 11(a) (3a)–(3c) and 11(b) of the Banking (Licensing) Law, 5741–1981 (henceforth, the Licensing Law), incorporated in Israel and controlled by a banking corporation, unless the controlling banking corporation meets the following requirements:
- (1) It includes it in its financial reports on a consolidated basis;
 - (2) It has indemnified it for all its liabilities;
 - (3) It maintains an effective control system for monitoring that the limitations on a consolidated basis are met.
- (c) This Directive shall apply to a credit card company as if it were a banking corporation.

Definitions

3. **“Credit”** – As defined in the Licensing Law, excluding guarantees, documentary credit, and a commitment to pay money on a customer’s account;

“Credit at the responsibility of the banking corporation” – Credit excluding from deposits whose repayment to the depositor is contingent on collecting the credit;

“Open documentary credit” – Documentary credit that a banking corporation has opened or is maintaining, or a receipt that a banking corporation has made on a bill of exchange in connection with international trade in goods until they reach the banking corporation, or until the documents needed to make the banking corporation’s indebtedness absolute are written, to the exclusion of open documentary credit that does not give the banking corporation control over the goods;

- "Bank" –** As defined in Section 60 of Proper Conduct of Banking Business Directive no. 203, "The Standardized Approach—Credit Risk" (hereinafter-**"Directive no. 203"**);
- "Credit card company"** A company that is an acquirer as defined in Section 36i of the Banking (Licensing) Law, 5741-1981, that issues payment cards, as these terms are understood in the Debit Cards Law, 5746-1986;
- "Capital" –** Tier I capital after regulatory adjustments and deductions, as defined in Proper Conduct of Banking Business Directive no. 202, "Regulatory Capital" (hereinafter-**"Directive no. 202"**) in accordance with the last report submitted to the Banking Supervision Department in accordance with Reporting to the Public Directive no. 838 concerning "Capital Measurement and Adequacy (Quarterly)";
- "Indebtedness" –** The total of the following:
- (1) Credit at the responsibility of the banking corporation;
 - (2) The banking corporation's investments in the borrower's securities, unless they were deducted from capital for purposes of Directive no. 202; for this matter, the total investment in securities will be according to the records of the banking corporation;

- (3) Commitments of the banking corporation to pay money on a customer's account (including guarantees and documentary credit). In this matter, guarantees to ensure the investments of home buyers as denoted in Section 84(v) of Directive 203, shall be weighted as per the credit conversion coefficients detailed in that section.
- (4) Transactions in OTC derivatives—the total of the following:
 - (a) net mark-to-market exchange cost, as defined in Appendix C of Directive no. 203;
 - (b) the “supplement” coefficient that reflects future potential exposure during the remainder of the contract:
 - In the case of an individual derivative—as defined in Section 92(i) of Appendix C of Directive no. 203;
 - In the case of a reciprocal offset—as defined in Section 96(iv) of Appendix C of Directive no. 203.
- (5) Commitments of the banking corporation to the MAOF (i.e., Futures and Financial Instruments) Clearing House for the amount of collateral to which the customer is committed, calculated in accordance with the amount of the exposure to central counterparties as noted in Directive 203, Appendix C.

- (6) Commitments (including contingent) of the banking corporation to extend credit or issue a guarantee, excluding the above-mentioned commitment, the realization of which is contingent upon receiving collateral of the type specified in Section 5, to the amount of the credit or guarantee.

The above is subject to the following:

- (a) If the commitment to extend credit or to issue a guarantee is contingent upon the repayment of another credit or guarantee, the amount of indebtedness shall not exceed that of the larger of the two, provided the banking corporation has ascertained that the commitment cannot be realized without reducing the existing credit or guarantee by the same amount;
- (b) A commitment to extend credit shall not be weighted at a higher rate than the final indebtedness itself, should it be realized.
- (7) 50 percent of the total “commitments as an underwriter”, as specified in Directive no. 321 regarding “Underwriting issues of securities”;
- (8) Guarantees provided by the borrower to secure a third party’s indebtedness to the banking corporation, excluding the above-mentioned guarantees provided by one member of a group of borrowers to another member of the same group, according to the following weighting:

(a) A banking corporation's guarantees to a credit card company to ensure the indebtedness of payment card holders, shall be weighted at a rate of 20 percent;

(b) A guarantee of an insurance company recognized as a deduction under Section 5(b3) shall be weighted at 100 percent;

(c) Other guarantees shall be weighted at a rate of 50 percent; In this matter, "guarantee" includes any commitment by instruction, in any form, in the amount of at least NIS 1 million or 0.1 percent of the capital of the banking corporation, whichever is lower, if the instruction is used in the banking corporation for a discount by the third party, or as security for the third party's indebtedness.

In calculating the "indebtedness" of a banking group of borrowers to a banking corporation, overnight deposits and settlement balances shall not be included;

All of which except such sums for which an accounting write-off has been performed or a credit-loss allowance on individual basis has been made;

"Settlement balances" –

Balances originating in exposure for acceptable terms in the ordinary course of business of settlement in respect to the same transaction, provided that said term does not exceed five days;

“Borrower” –

An indebted person, including the person’s spouse, as well as a number of borrowers, where the expected repayment of the indebtedness is based mainly on the same source, and none of whom has another significant source from which to pay the indebtedness (see Appendix A), excluding:

- (1) the State, the Bank of Israel, and a sovereign to which a zero risk factor may be assigned under Sections 53–55 of Directive no. 203;
- (2) a corporation that belongs to the same banking group of borrowers as the banking corporation;
- (3) entities to which a zero risk factor may be assigned under Sections 56 and 59 of Directive no. 203;

“Borrower engaging in speculative activity” –

A borrower classified under the financial services industry in accordance with Appendix 5 of Chapter 651 of the Reporting to the Public Directives, and who is a customer engaging in speculative activity as noted in Proper Conduct of Banking Business Directive no. 330, “Managing Credit Risk Derived from Trading Activity of Customers in Derivatives and Securities”;

“Supervised borrower” –

A supervised customer as defined in Proper Conduct of Banking Business Directive no. 330, “Managing Credit Risk Derived from Trading Activity of Customers in Derivatives and Securities” as well as a customer that is a stock exchange member in accordance with the

Securities Law, 5728-1968; except for a nostro account as defined in the Tel Aviv Stock Exchange's Rules.

“Overnight deposits” – Deposits with a banking corporation that are to be withdrawn on the next business day;

“A group of borrowers” – All of the following together:

(1) The borrower, a person controlling him and anyone controlled by them, except banks and credit card companies; in the case of a corporation controlled by more than one person, the holders of the controlling interest for whom the controlled corporation is significant (e.g., from the aspect of capital) shall be included in one group of borrowers, including the controlled corporation and anyone controlled by them (see Appendix B);

(2) In the case of a corporation held by more than one person, a holder who does not hold a controlling interest for whom the held corporation is significant (e.g., from the aspect of capital) shall be included in one group of borrowers together with the held corporation and anyone controlled by them (see Appendix C);

See Appendix D regarding a combined situation.

(3) Borrowers whose relation is such that harm to the financial soundness of one of them may affect

the financial soundness of the other(s), or such that the same factors are likely to affect the stability of both or all of them.

Such a relation occurs in the following cases, among others:

- (a) Borrowers, at least one of whom granted a significant amount of credit to another borrower or bought the other's bonds for a significant sum;
- (b) Borrowers, at least one of whom is a guarantor for a significant part of the indebtedness of another borrower, or has provided a guarantee of unlimited amount to secure the indebtedness of another borrower;
- (c) Borrowers, the indebtedness of each one of whom to the banking corporation exceeds 5 percent of the banking corporation's capital, and between whom there is material commercial interdependence, not limited to the short term, including by ensuring rights;
- (d) Joint directors, joint management, etc.

- (4) Anyone determined by the Supervisor of Banks to be a part of a group of borrowers;

and excluding anyone whom the Supervisor of Banks has removed from a group of borrowers, for the purposes of this Directive.

“A banking group of borrowers” – All the following, collectively:

- (1) a borrower that is a banking corporation

and any corporation controlled by it;

- (2) a banking corporation that controls a banking corporation noted at the beginning of Subsection (1) above, and any corporation controlled by it.

“A credit card group of borrowers” — All the following collectively:

- (1) a borrower that is a credit card company and any corporation controlled by it;
- (2) a credit card company that controls a credit card company noted at the beginning of Subsection (1) above, and any corporation controlled by it.

“A controlled group of borrowers” – Borrowers controlled by the banking corporation or more than 10 percent of whose means of control of any type is held by the banking corporation, and a borrower, more than 50 percent of whose means of control of any type are held by the borrower referred to above (excluding a consolidated company), excluding corporations that belong to the banking group of borrowers to which the banking corporation belongs;

“Indemnity” – An irrevocable and unconditional commitment to indemnify a particular indebtedness.

“Control” – As defined in the Banking (Licensing) Law. However, without derogating from said

definition of control, it is assumed that a person controls a corporation if at least one of the three following conditions is satisfied:

- (1) He holds the largest share of the means of control of any type;
- (2) There is no other holder of the means of control of any type who holds a larger share of the same means of control;
- (3) He consolidates the corporation in his financial statements.

However, the holdings determined in Paragraphs (1) or (2) above shall not apply to an “institutional investor” as defined in the Control of Financial Services (Provident Funds) (Investment rules applying to institutional investors) Regulations, 5772-2012, whose holding in the means of control in the corporation do not exceed 20 percent.

Limitations

4. (a) The indebtedness of a borrower other than a bank, to a banking corporation, after deducting the amounts detailed in Section 5, shall not exceed 15 percent of the banking corporation’s capital. The indebtedness of a borrower engaging in speculative activity and that is not a supervised borrower, to a banking corporation, after deducting the amounts detailed in Section 5, shall not exceed 10 percent of the banking corporation’s capital. These limitations shall also apply to the cumulative indebtedness of said borrowers who belong to a group of borrowers.

- (b) (1) The indebtedness of a group of borrowers to a banking corporation, after deducting the amounts specified in Section 5, shall not exceed 25 percent of the banking corporation's capital.
- (2) The indebtedness of a banking group of borrowers or credit card group of borrowers to a banking corporation, after deducting the amounts specified in Section 5, shall not exceed 15 percent of the banking corporation's capital.
- (c) Repealed.
- (d) The indebtedness of a controlled group of borrowers to a banking corporation, after deducting the amounts detailed in Section 5, shall not exceed 50 percent of the banking corporation's capital.
- (e) Total indebtedness (after deducting the amounts specified in Section 5, hereinafter—“**net indebtedness**”) of all “borrowers,” “groups of borrowers,” “banking groups of borrowers,” and “credit card groups of borrowers”, whose net indebtedness to the banking corporation exceeds 10 percent of the banking corporation's capital, shall not exceed 120 percent of the banking corporation's capital. It is stated for clarity that the following shall not be included for this purpose:
 - (1) the indebtedness of a controlled group of borrowers;
 - (2) the indebtedness of a borrower if it is included in the indebtedness of a group of borrowers.

For the purpose of measuring total indebtedness subject to this limitation, indebtedness of a borrower included in more than one group of borrowers (including a banking group of borrowers and credit card group of borrowers), shall be included only in the group of borrowers in which its indebtedness is greatest.

- (f) The Supervisor may, under special circumstances, set and apply limits at different rates than those specified above for a specific banking corporation.

Deductions

5. The amounts which may be deducted for the purpose of Section 4 are for the following:
- (a) A deposit made with the banking corporation and that is recognized as a credit risk mitigant under Directive no. 203; as collateral (Sections 119–138 and 145–187(i)), or for the purpose of balance-sheet offsetting (Sections 139 and 188). The amount to be deducted from the indebtedness shall be determined in accordance with the amount recognized as a credit risk mitigant under Directive no. 203 (particularly in reference to Sections 200 and 202–205);
 - (b) Indemnification for one of the entities included in Paragraphs (1) and (3) in the exceptions to the definition of “borrower,” and also for a bank whose risk weighting under Directive no. 203 is 50 percent at the most, from which repayment may be effected if the borrower fails to meet the terms of the debt. The amount to be deducted from the indebtedness shall be determined in accordance with the amount recognized as a credit risk mitigant under Directive no. 203 (particularly in reference to Sections 200 and 202–205);
 - (b1) A guarantee provided by Ashra–The Israel Foreign Trade Risks Insurance Corporation Ltd. The amount to be deducted from the indebtedness shall be determined in accordance with the amount recognized as a credit risk mitigant under Directive no. 203 (particularly in reference to Sections 200 and 202–205);
 - (b2) A guarantee given by a public sector entity (PSE) that may be assigned a zero risk weight under Sections 57–58 of Directive no. 203. The amount to be deducted from the indebtedness shall be determined in accordance with the amount recognized as a credit risk mitigant under Directive no. 203 (particularly in reference to Sections 200 and 202–205);
 - (b3) Indemnity of an insurance company, whose risk weight under Proper Conduct of Banking Business Directive no. 203 does not exceed 50 percent, in respect of the indebtedness of a government company with a domestic rating of A or higher, from which repayment can be made if the borrower does not meet the terms of the indebtedness. The amount of the deduction from the indebtedness shall be 70 percent

of the amount recognized as a credit risk mitigant under Directive no. 203 (particularly in reference to Sections 200 and 202–205).

- (c) Debt securities that are traded on the Stock Exchange and pledged to the assurance of the debt, where said securities were issued by the State of Israel or by a sovereign that may be assigned a zero risk weight under the provisions of Subsection (1) in the exceptions to the definition of “borrower,” and are recognized as credit risk mitigants (collateral) under Directive no. 203; and which may not be exchanged (except for debt securities which meet the same criteria). The amount to be deducted from the indebtedness shall be determined in accordance with the amount recognized as a credit risk mitigant under Directive no. 203 (particularly in reference to Sections 200 and 202–205);
- (d) An irrevocable commitment of a bank outside Israel against open documentary credit, including an indemnity of the Export-Import Bank (Exim Bank) and of the Overseas Private Investment Corporation (OPIC) which are agencies of the US government, that guarantees all payments of principal and interest on their liabilities, provided it can be realized after payment of the documentary credit.

Common control

- 6. Canceled.

Partnerships

- 7. The indebtedness of a partnership (whether registered or not) to a banking corporation in which a borrower is a partner, will be added to the indebtedness of the borrower. However, when the responsibility of a partner in the indebtedness is limited, the addition to the indebtedness of the borrower in respect of the partnership shall not exceed the amount for which the borrower is responsible.

Nonrecourse credit

- 7a. The contents of this Directive notwithstanding:

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- (1) Nonrecourse credit guaranteed by a security will be added both to the indebtedness of the borrower and to the indebtedness of the corporation issuing the security.
- (2) In the case of a group of borrowers that includes both the purchased corporation and the borrowers to whom the indebtedness was granted, the indebtedness shall be included only once.

In this section “**nonrecourse credit**” means credit regarding which, in the event of a credit default, the banking corporation does not have general recourse to the borrower’s assets, but rather has recourse only to the property used for collateral or to other specific property, or where the property that served as collateral is the borrower’s main asset.

Mergers and acquisitions

8. If a change has occurred to the indebtedness of a borrower or a group of borrowers due to a merger of borrowers or due to changes in the control over a borrower or a group of borrowers, which results in a deviation from the limitations under this Directive, the amount of the deviation is to be reduced by equal quarterly amounts within two years of the date of the change.

Establishing procedures

9. The management of a banking corporation, authorized by the board of directors, shall establish written procedures for monitoring the concentration of risk of large borrowers. These procedures must address at least the following issues:
 - (a) The existence of a system of collecting data and of control which enables the analysis of credit concentration and continuous monitoring of adherence to the indebtedness limitations on a consolidated basis, including indebtedness of overseas offices.
 - (b) The existence of an internal control system to identify relations between borrowers which seem to create “a group of borrowers”. These procedures will define rules for monitoring economic, legal, and other relations between large borrowers, including

emphasis on identifying groups of borrowers whose relations are not necessarily formal ones, but which nevertheless, according to the banking corporation's estimates, create a common risk; and control of the system of information flow in the banking corporation and in subsidiaries.

- (c) Monitoring of large borrowers' indebtedness development, including periodic reports to the board of directors, even when the indebtedness does not exceed the limitations. These procedures will establish the authority required to increase borrowers' indebtedness, as mentioned, and the benchmark indebtedness requiring monitoring.

- 9a. A banking corporation shall set internal limits on its exposure to banks and banking groups of borrowers in respect of overnight deposits and settlement balances.

Reporting

10. Corporations to whom this Directive applies shall report to the Supervisor of Banks on the indebtedness of borrowers, groups of borrowers, banking groups of borrowers, and controlled groups of borrowers as detailed in the Reporting to the Banking Supervision Department Directives.

Authorization of deviations

11. (a) The Supervisor of Banks may authorize deviations from the limitations for a period to be determined by the Supervisor, if they arose due to a change in economic circumstances, such as a significant change in currency exchange rates, or profits on an equity basis.
- (b) If the banking corporation, authorized by the board of directors, has submitted a detailed request in writing to authorize a deviation from the limitations for other reasons, and the Supervisor of Banks is convinced that the circumstances justify it, the Supervisor may consider authorizing deviations for reasons other than those

mentioned in this Directive. The Supervisor of Banks shall consider, among other issues:

- (1) Whether the borrower has submitted to the banking corporation a recovery plan which in the Supervisor's opinion can be implemented;
- (2) Whether the above recovery plan requires an extraordinary increase in the borrower's indebtedness.

Transitional directives

12. (a) During the five years following the publication of this Directive, the indebtedness of a banking group of borrowers to a credit card company shall not be subject to the limitation imposed in Section 4(b)(2) and shall not be included with regard to the limitation imposed in Section 4(e) above.

(b) A banking corporation that on the publication date of this Directive deviates from the indebtedness limitation of a credit card company group of borrowers established in Section 4(b)(2) above, is required to reduce the indebtedness of the credit card company group of borrowers within three years of the date of the separation of the credit card companies from the banking corporation, provided that the decrease will be gradual over the course of the period. The date of separation in this Section is as defined in the Enhancing Competition and Reducing Concentration in the Banking Sector in Israel (Legislative Amendments) Law, 5777-2017.

Miscellaneous

13. (a) The entity heading a group of borrowers shall generally be an individual who controls the corporation at the head of that group, unless there is no single controller of the corporation. Nevertheless, the limitation of 15 percent as stated in this directive shall apply to every member of that group.

(b) For purposes of this directive, all those indebted to the banking corporation shall be considered a borrower of the banking corporation, such as: a corporation whose

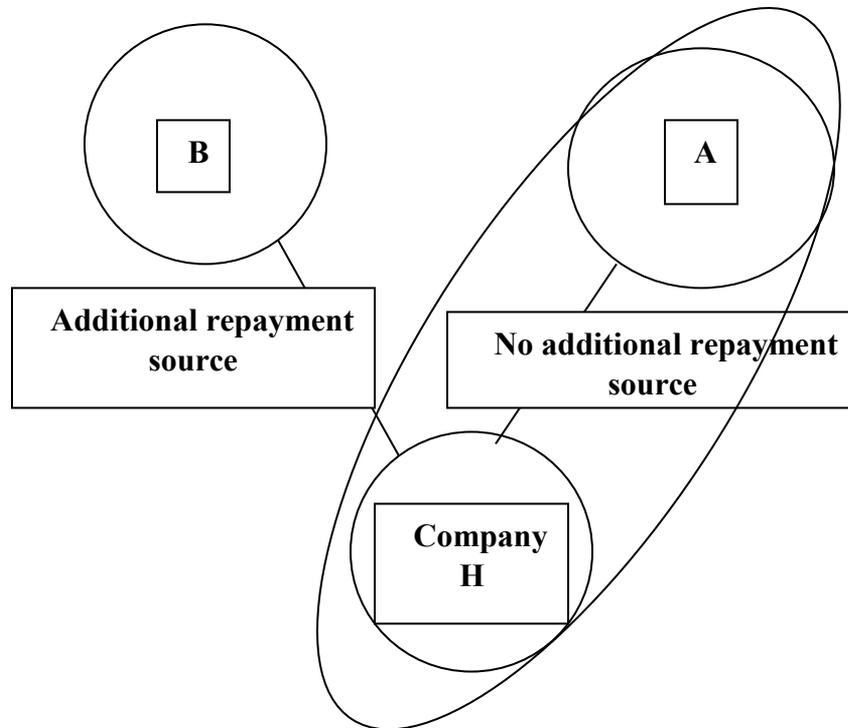
indebtedness to the banking corporation consists only of the banking corporation's investment in the securities of said corporation, or whose indebtedness derives from guarantees in favor of the banking corporation for the liabilities of a third party.

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Appendix A – Borrower

A and B sell its products to Company H -

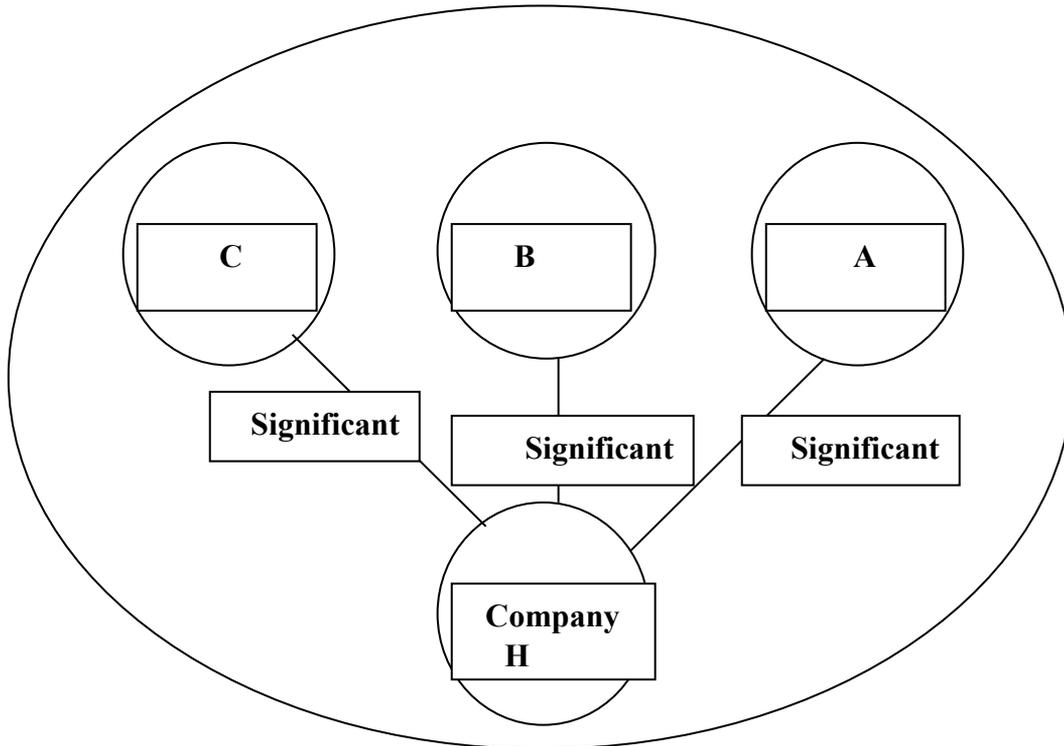
A and Company H are based mainly on the same source for the expected repayment of the indebtedness, and none of them has another significant source from which to pay the indebtedness.



B and Company H are not based mainly on the same source for the expected repayment of the indebtedness, and B has another significant source from which to pay the indebtedness.

Appendix B - Control

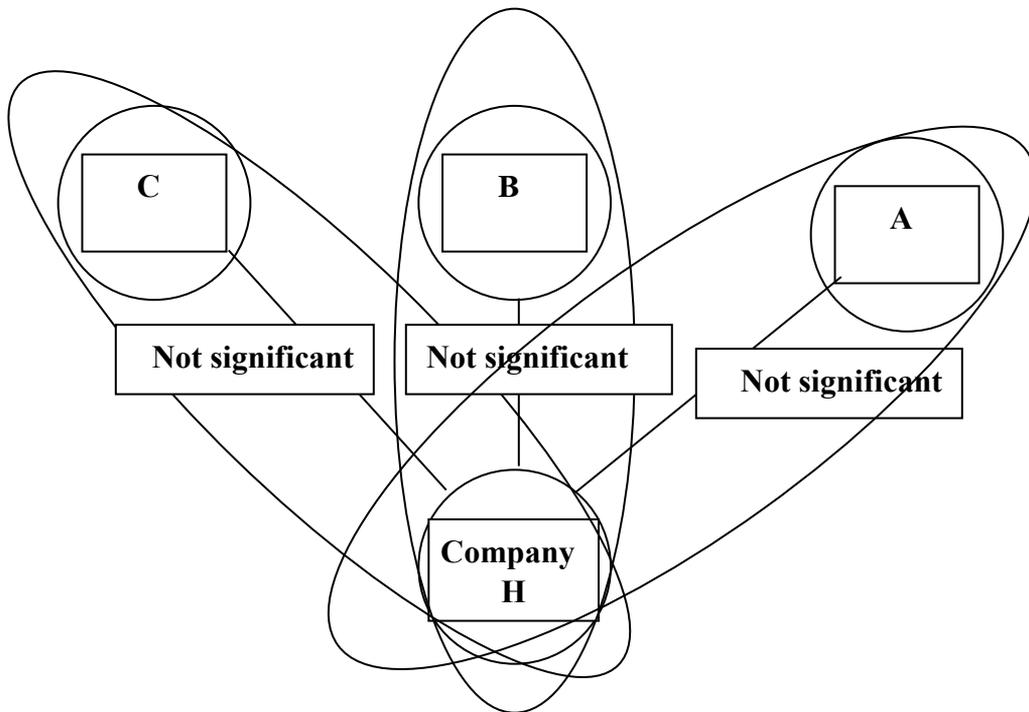
Case 1 – A, B and C control Company H. Company H is significant to A, B and C.



Result – The group of borrowers will include A, B, C, Company H, corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

Appendix B – Control (continued)

Case 2 – A, B and C control Company H. Company H is not significant to A, B and C.



Result – There are three groups:

Group 1 includes A, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

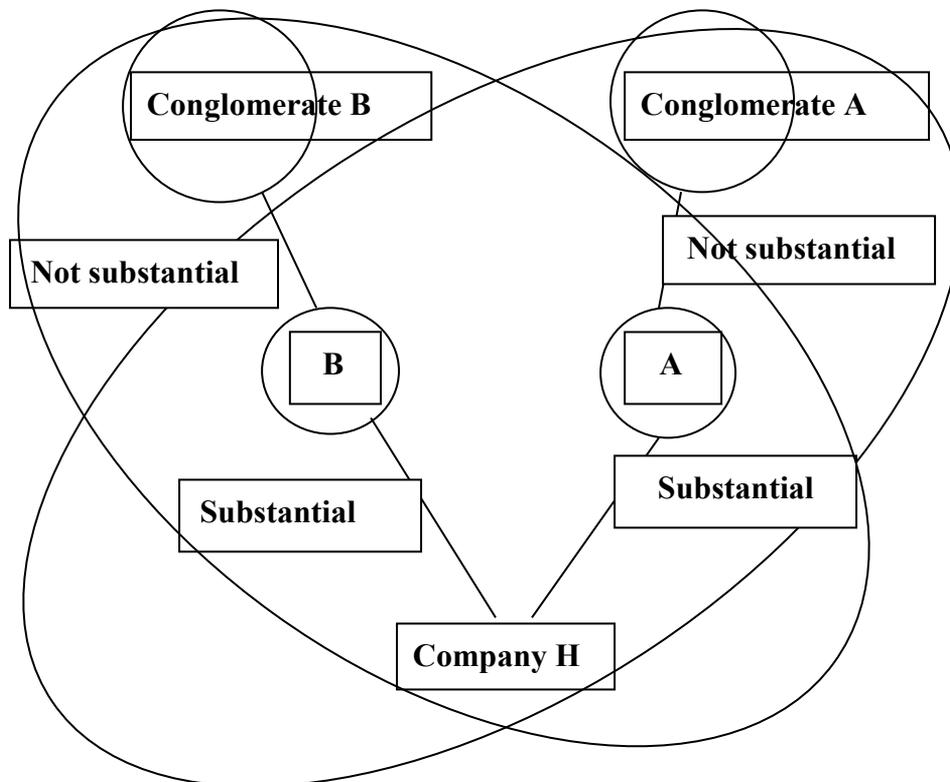
Group 2 includes B, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

Group 3 includes C, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

Appendix B – Control (continued)

Case 3 – Conglomerates A and B control A and B respectively. A and B control Company H.

Company H is significant to A and B. A and B respectively are not significant to conglomerates A and B.



Result – There are two groups of borrowers:

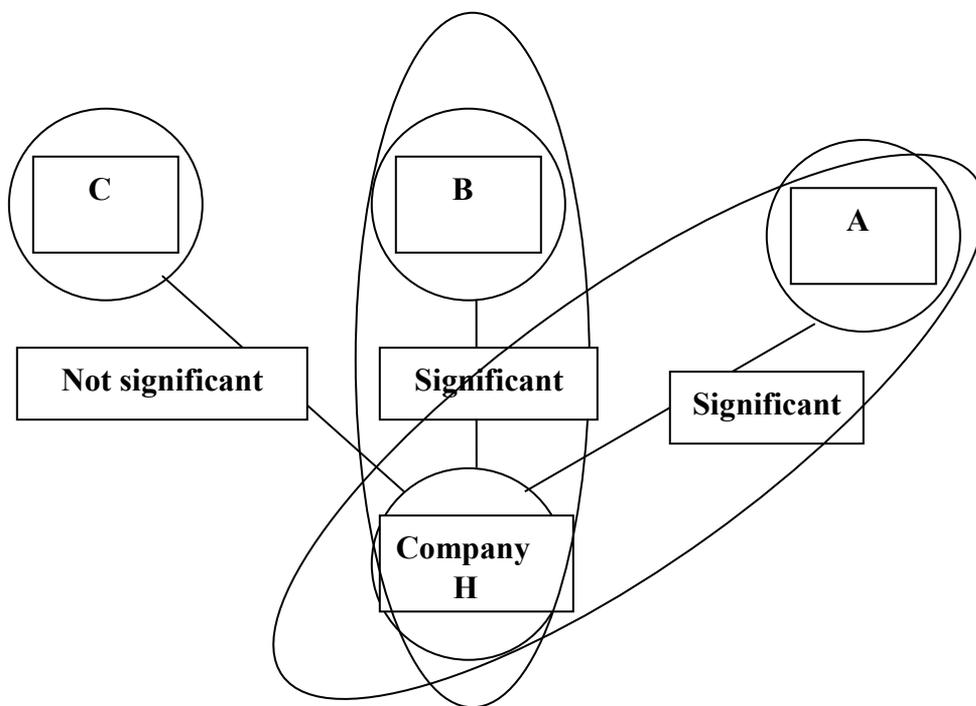
Group 1 includes Conglomerate A, A, B, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

Group 2 includes Conglomerate B, A, B, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

Note: This example is a particular case of paragraph (1) to the definition of a group of borrowers.

Appendix C – without control

A, B and C hold (without control) Company H. Company H is significant only to A and B. D (who controls the Company) is not included in the sketch.



Result – there are two groups of borrowers:

Group 1 includes A, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

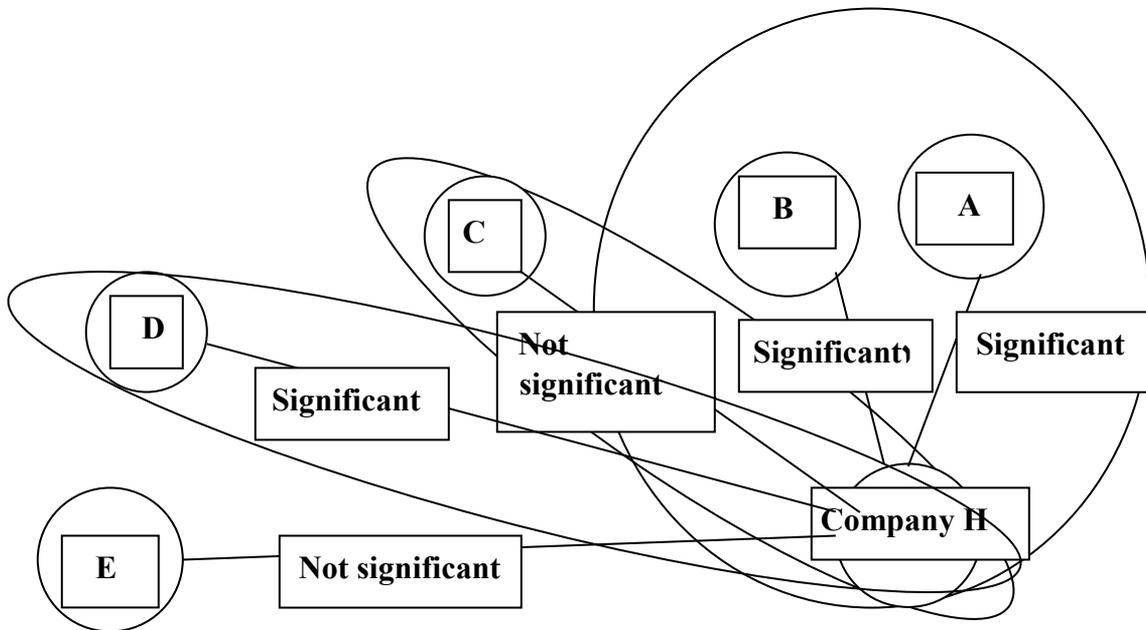
Group 2 includes B, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

(C will not include Company H)

Appendix D – Combined situation: control and without control

A, B and C control Company H. Company H is significant only to A and B.

D and E hold (without control) Company H. Company H is significant only to D.



Result – there are three groups of borrowers:

Group 1 includes A, B, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

Group 2 includes C, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

Group 3 includes D, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

(E will not include Company H)

Revisions

Circular 06 number	Version	Details	Date
1220		Original directive	10/11/85
1265		Revision	21/8/86
1309		Revision	30/4/87
1325		Revision	9/8/87
1359		Revision	31/3/88
1366		Revision	25/5/88
1411		Revision	11/6/89
1441		Revision	12/1/90
1459		Revision	15/3/90
-----	1	Integration into Proper Conduct of Banking Business Directives	8/91
1583	2	Revision	21/7/92
1628	3	Revision	28/2/93
-----	4	New version of Proper Conduct of Banking Business file	12/95
1867	5	Revision	30/4/97
1876		Temporary Order	25/6/97
1953	6	Revision	26/11/98
2113	7	Revision	20/8/03
2120	8	Revision of Transition provisions	23/11/03
2147	9	Revision	2/12/04
2304	10	Revision	8/5/11
2327	11	Revision	14/2/12
2335	12	Revision	2/5/12
2384	13	Revision	13/5/13
2466	14	Revision	09/6/15
2543	15	Revision	22/10/17
2567	16	Revision	01/08/18
2577	17	Revision	13/11/18
2595	18	Revision	27/10/19
2628	19	Revision	29/09/20
2684	20	Revision	26/12/21