

PLEDGING ASSETS OF A BANKING CORPORATION

Introduction

1. Various reforms in global regulation that have been implemented due to the global financial crisis have led to a marked increase in activity secured by various types of pledges, such as the increase in central clearing house transactions, the shift to central clearing of derivatives, as well as requirements for depositing collaterals—initial and variation—in respect of non-centrally cleared derivatives.
2. Due to the growth in the scope and range of activities in respect of which banking corporations are required to pledge assets (by law, regulation, or market practice), it was decided not to establish a quantitative regulatory limitation on pledging a banking corporation's assets, apart from what is stated in Section 11a. Nonetheless, this Directive defines requirements for sound management of pledging assets.
3. Sound management of pledging assets is very important in view of the ramification of pledging a banking corporation's assets on the amount of assets available for paying to creditors in bankruptcy proceedings, and in view of the potential ramifications of pledged assets on the ongoing management of the banking corporation—for example, on the availability of liquid assets or the availability of collaterals to deposit and on the pricing of unsecured debts.
 - (a) A banking corporation may issue covered bonds in accordance with the conditions set out in the Directive and subject to a quantitative limit on the assets pledged for the benefit of the covered bondholders, in a manner that balances the advantages inherent in issuing covered bonds against the effect of the pledge on the banking corporation's unencumbered assets.

Application

4. This Directive applies to a banking corporation, except for a foreign bank and a joint services company.

Definitions

5. **"Covered bonds"**— Bonds issued by a banking corporation whose resulting obligations are secured by specified assets designated by the issuing banking corporation.

"Pledged assets"—As defined in the beginning of Section 61a(d)(1) in the chapter on "Pillar 3 Disclosure Requirements and Additional Information on Risks" of the Reporting to the Public Directives, and including assets securing central bank facilities.

"Assets securing central bank facilities"—As defined in Section 61a(d)(3) in the chapter on "Pillar 3 Disclosure Requirements and Additional Information on Risks" of the Reporting to the Public Directives.

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

6. A banking corporation is required to maintain an appropriate balance between the need to manage its business and the need to protect depositors' rights in a bankruptcy. Therefore, a banking corporation shall not pledge its assets unless it is required by law, regulation or the requirements of the relevant market in such a manner that without pledging the assets, it will not be able to carry out the activity or will not be able to carry it out under reasonable market conditions. In addition, the banking corporation must verify that the level of pledged assets does not significantly reduce its ability to raise additional funding sources, including in various stress scenarios.
7. Subject to the provisions of Section 6 above, the banking corporation shall act as follows:
 - (a) The banking corporation's board of directors will outline the strategy regarding pledged assets and shall approve the policy established by management on the issue (hereinafter, "the policy").
 - (b) The banking corporation's management shall formulate the policy in accordance with the strategy established by the board of directors and shall be responsible for its implementation.
 - (c) The Risk Management function shall verify that the risks incorporated in pledged assets are taken into account, including the impact on liquidity and funding risk and on the legal and operational risks. As part of this, the requirements in Proper Conduct of Banking Business Directives, such as Proper Conduct of Banking Business Directive no. 342 ("Liquidity Risk Management") and Proper Conduct of Banking Business Directive no. 350 ("Operational Risk Management"), shall be taken into account.
 - (d) The Internal Audit shall examine the implementation of the policy in accordance with Proper Conduct of Banking Business Directive no. 307 ("Internal Audit Function").
8. The policy shall refer to at least the following aspects:
 - (a) The activity and transactions for which it is permitted to pledge the banking corporation's assets and the reasons for pledging the assets, such as activity in a clearing house, non-centrally cleared derivatives, etc.
 - (b) The assets eligible for pledging, by relevant segments, such as activities, products, counterparties, etc.
 - (c) The mechanisms of calculating the requirements for pledged assets and who determines them, based on categories of products, activities, and counterparties.
 - (d) Internal limitations on pledged assets. The internal limitations shall be established at an overall level as well as in relevant segments,
 - (e) Authorities for creating a pledge of the banking corporation's assets.
9. The banking corporation shall establish and operate controls over pledged assets. Those shall include, among other things, managerial information systems on pledged assets. The information systems have to provide segmented and timely administrative information in line with the level of pledged assets at the banking corporation and with the characteristic of the activity that underlies the pledged assets; such as assets securing transactions with central bank as opposed to assets pledged for another reason, methods for calculating the pledged

assets, and etc. In addition, the information systems shall enable the banking corporation to control compliance with its policy in the issue.

10. The banking corporation shall examine various scenarios in order to estimate the requirements for additional pledged assets (for example, due to changes in market conditions or due to a rating downgrade).

11. A banking corporation that heads a banking group shall formulate group policy on the issue and shall set monitoring and reporting requirements on pledged assets at a consolidated level.

Covered Bonds

11a. A banking corporation can issue covered bonds subject to the fulfilment of the following conditions.

- (a) The amount of assets pledged to secure the covered bonds issued by the banking corporation shall not exceed 2 percent of the bank's total assets. Compliance shall be measured on a cumulative basis at the time of each issuance.
- (b) The covered bonds shall be denominated in a foreign currency and issued by means of an offering outside Israel to investors incorporated outside Israel.
- (c) The covered bonds shall be secured by housing loans collateralized by residential properties.
- (d) The banking corporation will state in the issuance prospectus that Israel has no dedicated legislation or regulation governing the characteristics of covered bonds.
- (e) The features and terms of the covered bonds issued by the banking corporation will be determined in accordance with regulatory frameworks commonly applied in major markets outside Israel.
- (f) The banking corporation will establish a special purpose vehicle (SPV) to hold the assets pledged for the benefit of the covered bondholders. The transfer of the pledged assets to the SPV shall not exempt either the banking corporation or the SPV from any obligations to borrowers under applicable law, including the Proper Conduct of Banking Business Directives.
- (g) Corporate governance, risk management, and auditing
 - 1. The board of directors of the banking corporation will determine the strategy and establish the risk appetite for its covered bond issuance activities.
 - 2. The management of the banking corporation will formulate a comprehensive policy governing covered bond issuance activities, including risk management, control, and auditing. The policy will address the activities of both the banking corporation and the SPV on a consolidated basis. The policy will also be based on a "new product" process to be completed before the first issuance.
- (h) Reporting
 - 1. Upon issuing covered bonds, the banking corporation will report the issuance to the Supervisor of Banks shortly after completion, together with information on the size of the issuance and compliance with the limitation set out in subsection (a) above (following the issuance).

2. In reports submitted to the Banking Supervision Department on the bank's data (unconsolidated), the banking corporation will also include data relating to the activities of the SPV with respect to specific directives for reporting to the Supervisor of Banks as he will determine from time to time.

Miscellaneous

12. Cancelled.

* * *

Updates

Circular 06 no.	Version	Details	Date
1579	1	Original circular	June 14, 1992
1679	2	Update	January 1, 1994
----	3	New version of Proper Conduct of Banking Business file	December 1995
2270	4	Update	June 27, 2010
2277	5	Update	October 19, 2010
2661	6	Update—includes changing the name of the Directive	June 15, 2021
2854	7	Update	June 17, 2026