Banking Supervision Department

Jerusalem, October 6, 2022
Circular No. C-06-2724

Attn: The Banking Corporations and Credit Card Companies

Re: Sale of housing loans and collaborations in extending housing loans
(Proper Conduct of Banking Business Directive No. 329B)

Introduction

1. In recent years, banks and institutional investors have executed transactions, sold housing loan portfolios to nonbank corporations, extended housing loans in collaboration with institutional investors, and signed agreements regulating collaborations covering the extending of housing loans.
2. In general, sale transactions and syndication of housing loans contribute to the overall financial system—such transactions free up capital and make it possible to continue extending bank credit, while providing a response to increasing demand for housing credit, they bring new participants in to the credit providers market, and offer the institutional investors diversification for the investment portfolio and a duration for the transaction that is in line with their needs.
3. However, based on lessons learned from the Global Financial Crisis, the Directive regulates principles for carrying out such transactions. They are intended, among other things, to protect the borrowers' rights in the loan portfolios that were sold, to avoid a situation of negative selection that would adversely impact the quality of the bank's credit portfolio, and to prevent the development of moral hazard from the purchasing entity perspective.
4. After consultation with the Advisory Committee on Banking Business Affairs, and with the approval of the Governor, I have established the following Proper Conduct of Banking Business Directive as follows.

Main points of Proper Conduct of Banking Business Directive no. 329B on "Sale of housing loans and collaborations in extending housing loans"

Application (Sections 7–8)

5. The Directive applies to banking corporations and subsidiaries as well as to acquirers, to the extent that they extend housing loans.

Definitions (Sections 9–10)

6. "Sale transaction"—a transaction of selling housing loans, syndication of housing loans including an agreement that regulates collaborations in extending housing loans.

Explanatory remarks

The principles detailed in the Directive shall apply whether it is a transaction of a sale of housing loans, meaning that the bank assigns its rights to the loan to the purchasing corporation in respect of immediate payment, or whether it is a syndication of housing loans, meaning the bank extends the loan in collaboration with the purchasing corporation.

Principles for carrying out a sale transaction (Sections 12–16)

7. Section 12 of the Directive establishes that a banking corporation may not selectively choose “good” loans (cherry picking) or “bad” loans (lemon picking) that will participate in the sale transaction.

Explanatory remarks

A sale transaction will be permitted for a portfolio of housing loans that are chosen randomly, with the condition that the quality of the loan being sold shall not be a criterion for its inclusion or exclusion from the portfolio to be sold. Selection will not be permitted except for the loans detailed in the Directive, among others, loans taken out as a result of a regulatory limitation. The concern is in regard to negative selection, the sale of low-quality loans, as occurred in the Global Financial Crisis, as well as positive selection, which is liable to adversely impact the bank’s portfolio quality.

8. Section 16 of the Directive establishes that a banking corporation shall retain at least 10 percent of every loan in a sale transaction; the loan portfolio shall include loans that have been in the banking corporation’s portfolio for at least 12 months prior to the sale.

Explanatory remarks

In order to reduce the moral hazard and as part of the lessons learned from the Global Financial Crisis, principles were established that will leave an economic interest for the banking corporation in the loans that have been sold, and that will not enable the banks to separate themselves from the credit risk in those loans.

Limitations on the scope of sale transactions

9. Section 17 of the Directive establishes that the amount of housing loans that a banking corporation will sell, plus the housing loans at the responsibility of the institutional investor in a syndication, shall not exceed 10 percent of the housing loan portfolio balance; however, there is a possibility to deviate from the above subject to the approval of the Supervisor of Banks.

Explanatory remarks

With the goal of hedging the risks to both sides—the banking corporation and the purchasing corporation—as this is new activity that could substantially impact the banking corporation’s asset composition, and in order to verify that the legal mechanism and regulatory mechanism achieved their goals.

Protection of borrower's rights (Sections 18–20)

10. The banking corporation must guarantee that the borrowers' rights shall not be adversely impacted due to the sale, and that the protections granted to the borrower or the owner of the property being used as a collateral, under law, shall not be adversely impacted. The banking corporation must receive the borrower's consent to the sale, and must update the borrower about the sale of the loan within 3 months from the date the sale transaction is completed.

Explanatory remarks

In order to minimize the impact of the sale transaction on the borrowers, to guarantee that the situation of the borrower shall not be deteriorated due to the sale transaction, and to avoid adversely impacting the borrower, the Directive establishes that in the sale transaction, arrangements must be established that will ensure that the purchasing corporation shall be subject to all the directives that will be established under law and that obligate the bank regarding the loan being sold. The banking corporation is also required to receive the consent of the borrower to the sale; this agreement can be received when signing the loan agreement.

Documentation and opinions (Sections 22–25)

11. The banking corporation must guarantee that the loan portfolio sale and the final right assignment make up a True Sale, and are nonrecourse.

Explanatory remarks

One of the main risks in an asset sale transaction is the concern that the sale will not be final. In order for the transaction to be considered a True Sale transaction, and that the bank will remove the loans from its books, the selling bank is required to obtain a legal opinion and an accounting opinion that are in line with the above.

The selling banking corporation as a service provider (Section 26)

12. The selling banking corporation in a sale transaction may act as a service provider only to the 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 determined as the service provider. This is, among other things, in order to ensure the protection of the borrowers' rights in transactions such as those in Sections 18, 19, and 20 herein.

Explanatory remarks

To ensure the protection of the borrowers' rights after the sale transaction as well, the operation of the loans in the sale transaction shall continue to be by a banking corporation, whether or not it is the seller.

Commencement

13. This Directive shall go into effect on the day it is published on the Bank of Israel website.

File update

Remove pages	**Insert pages**
---	329B-1-4 (10/22) [1]

Respectfully,

Yair Avidan
Supervisor of Banks