Banking Supervision Department
Policy and Regulation Division

February 2, 2021

Circular No. 06-2652

To:

The banking corporations and the credit card companies

Re: Consumer Credit Management

(Proper Conduct of Banking Business Directive No. 311A)

Introduction

1. Credit to households has expanded significantly in the past decade, against the backdrop of several factors including rising private consumption and growing availability of consumer credit including credit from nonbank sources. Consumer credit increased concurrently with the rise in GDP, and as a result household leverage increased only slightly and remained low in international comparison. In addition to the benefits to consumers of increased competition among credit providers, there is a risk of excessive household indebtedness, especially in the lower income deciles[1], to the point of a causing, in extreme circumstances, a decline in their economic welfare.
2. The Banking Supervision Department places great weight on proper, fair, and transparent treatment of customers by banking corporations and acquirers (for the sake of convenience, hereinafter "the Banking Corporations"). Such conduct is anchored in, among other things, their duty of trust and caution to which they are subject by law.
3. The conduct risk that stems from improper conduct toward customers (even if such conduct does not constitute a violation of the law) is a topical issue at the heart of regulatory discourse in Israel and worldwide. Beyond adverse effects on the Banking Corporation's customers, the conduct risk may also increase the realization of the Banking Corporations' legal and regulatory risks, and cause it reputational damage and significant losses. Therefore, a Banking Corporation's proper conduct toward its customers is also an important element in protecting its stability.
4. Consequently, and following numerous measures carried out by the Banking Supervision Department in recent years to ensure fair marketing of consumer credit,

[1] On this matter see Central of Bureau of Statistics Survey on "Households in Israel – Long-Term."

this Directive concentrates the requirements that the Banking Supervision Department imposes on the banking system in its interactions with individual customers concerning, among other things, the following matters: the existence of a proper organizational culture and procedures to ensure proper and fair credit marketing procedures and specifically initiated credit marketing procedures; the existence of credit approval procedures that include, but are not limited to, the obligation to grant credit that matches the borrower's ability to repay the loan (alongside the borrower's own duty of responsible financial management).

5. This Directive complements the directives and guidelines issued by the Banking Supervision Department in recent years on various aspects of the Banking Corporations' consumer credit activities, including Directive 449 "Simplification of Customer Agreements," Directive 450 "Debt Collection Proceedings," and guidelines on "Initiated Marketing of Retail Loans."

6. This Directive was drafted in conjunction with the Capital Market Authority, which issues guidelines for nonbank financial entities, with the aim of establishing consistent principles and standards for all credit granters.

7. Following consultations with the Advisory Committee on Matters Related to Banking Business, and with the approval of the Governor, I have issued the following Directive.

<u>Highlights of the Directive</u>

Application (Sections 5-6 of the Directive)

8. This Directive applies to the relevant entities that are supervised by the Banking Supervision Department and provide consumer credit.

Definition (Section 7)

9. Consumer credit is defined as credit to individuals, excluding loans granted to a dealer for business purposes, excluding loans secured by an asset used as a residence, and provided that the credit amount does not exceed the maximum amount stated in Section 15(b)(1) of the Fair Credit Law, and that the borrower's total credit amount in the banking corporation is less than NIS 5 million. This definition does not include credit granted as part of debt collection and restructuring proceedings of problematic debts.

   Explanatory note:

   The Directive applies to credit that has consumer features only and is granted to individual customers, and to personal credit to dealers, where the total amount does not exceed the amount stated in the Fair Credit Law, which is currently NIS 1,197,707.36. The Directive clarifies that where the purpose of the loan granted to a dealer's account is not clear, the loan is considered a loan that is for other than personal, household, or family use. The exclusion of credit granted as a part of debt collection and restructuring of problematic debts is designed to give Banking Corporations the flexibility required to optimally handle such customers. On this issue, Directive 450 "Debt Collection Proceedings" applies.

10. Initiated credit marketing is defined as a personal approach by a Banking Corporation to offer credit to a customer, whether the approach is made by the Banking Corporation itself or by a service provider, as defined in Directive 359A, including when the approach is made concurrently with another matter or at a site of sale or rent. Nonetheless, generic information on a website, application, or in a chat, on the availability of credit is not considered initiated credit marketing.

Explanatory remarks:

Any publication or approach to a customer, including a potential customer, regarding the option of obtaining credit, where no personal conversation takes place between the customer and the bank, will not be considered initiated credit marketing. A personal conversation may be conducted on a variety of media such as telephone conversation, online chat, messaging application, and others.

Functions of the board of directors and management (Sections 8-13 of the Directive)

11. The Banking Corporation's board of directors will outline the consumer credit strategy and oversee its implementation, with emphasis on the conduct risk and on responsible, fair credit marketing. Senior management will anchor the strategy in a credit policy document and appropriate procedures.

Explanatory remarks:

Consumer credit management will be performed top-down. The board of directors is in charge of outlining a consumer credit management strategy that emphasizes consumer-related issues, and management will oversee the implementation of the credit strategy and compliance with the credit policy.

Consumer credit policy (Sections 14-16 of the Directive):

12. These sections list the topics that the bank's management must include in the consumer credit policy document. These are, but are not limited to the following:

12.1. The Banking Corporation may use its discretion regarding the scope of information that is required in the underwriting procedure, which takes into account the amount and quality of the borrower's credit, and the borrower's history (Section 15).

Explanatory remarks:

To prevent an adverse impact on customers stemming from an elaborate, expensive assessment process, in certain cases, such as when the borrower has a high credit score and their history in the banking corporation provides sufficient information, the Banking Corporation may grant credit even without calculating all the defined measures, or without full authentication or verification of the information, provided that the amount of the credit does not exceed the maximum that is defined. For example, when the borrower has a high rating and the credit history at the Banking Corporation provides sufficient response.

12.2. A requirement to define mandatory criteria for consumer credit that include, but are not limited to an assessment of the borrower's creditworthiness, borrower's rating, and history (Section 16.4).

Explanatory remarks

An assessment of the borrower's creditworthiness, rating score, and history (if any) are defined as mandatory criteria for assessing the borrower's ability to repay the loan.

12.3. There is a requirement to collect financial information on the borrower from internal and external sources, for example from the credit database pursuant to the Credit Data Law, based on the amount of the loan, the borrower's rating score, and history with the Banking Corporation (Section 16.5).

Explanatory remarks

To prevent an unwieldly, costly assessment procedure, the extent of the required information should be proportionate to the amount of the credit and the Banking Corporation's familiarity with the borrower. For example, when the borrower's quality score and history are adequate, the Banking Corporation may grant credit even without obtaining information from the credit database, provided that the amount of the credit does not exceed the maximum amount that is defined.

12.4. Requirement to define quantitative measures and minimum requirements for assessing the borrower's ability to repay, such as minimum disposable monthly income, maximum ratio of monthly repayment to disposable income, and maximum ratio of total debt to annual income (Section 16.6).

Explanatory remarks

Assessing a borrower's ability to repay the loan is a key element in the consumer credit approval procedure and is designed to prevent an excessive debt burden on the borrower. The Banking Corporation must assess the borrower's ability to repay by defining quantitative tests and measures, such as the measures listed in this section, based on information from various sources. At this stage, no mandatory indicators to assess a borrower's ability to repay have been defined, and each Banking Corporation is responsible for defining them. The Banking Supervision Department expects the Banking Corporations to determine the quantitative indicators and thresholds in a prudent, conservative manner.

12.5. Requirement to clearly define the target population of initiated marketing efforts and to clearly define the profile of customer groups that will not be targets of initiated marketing efforts (Section 16.7).

Explanatory remarks

Approaching customers to offer credit is conventional practice in the banking credit business. Still, due to the inherent risk of this activity, the Banking

Corporation must clearly define the group of customers that its marketing efforts will target and the criteria that define the groups of customers who will not be approached by the Banking Corporation in its initiated marketing efforts. These criteria will include, for example, a customer's degree of credit risk or age. It should be clarified that this requirement is not designed to exclude these customers as recipients of the Banking Corporation's credit, and they may apply to the Banking Corporation for credit at their own initiative.

12.6. Mechanisms for determining targets, assessments, remuneration for, and means of control over employees engaged in initiated credit marketing should ensure fair conduct toward customers and should not encourage aggressive credit marketing (Section 16.8).

Explanatory remarks

Employee remuneration mechanisms based on individual performance targets, such as the total amount of credit granted, or team performance targets based exclusively on total credit granted might lead to credit marketing activities that fail to meet appropriate standards of fairness to customers. Banking Corporations must develop marketing and sales procedures that ensure fair and proper conduct toward customers and must engage in control and monitoring actions that enforce employees' compliance with these procedures.

Credit marketing (Sections 17-22 of the Directive)

13. Banking Corporations shall adopt proper credit marketing practices and avoid aggressive marketing that pressures customers to make decisions concerning credit, including:

13.1. Marketing conversations will be conducted according to predetermined marketing scripts and will include due disclosure of the complete and relevant facts. Among other things, at the beginning of the conversation Banking Corporations are required to disclose to the customer the purpose of the conversation, the marketer's identity, and other material information, and provide any additional disclosure that is warranted by the progression of the conversation (Section 18).

Explanatory remarks

When giving a customer a credit offer, the Banking Corporation must provide all the information that the customer requires to make an informed decision. This includes—at the beginning of the marketing conversation, the Banking Corporation must disclose to the customer the purpose of the conversation (marketing of a credit product), the identity of the marketer, and the price of the product. The Banking Corporation must disclose additional material details about the product, its conditions, and the customer's rights, according to the conversation's progress.

13.2. When a Banking Corporation engages in initiated credit marketing, the Banking Corporation must avoid credit marketing to disadvantaged populations, aggressive marketing tactics, and putting pressure on customers to enter into a credit transaction. The Banking Corporation must also avoid re-approaching a customer that rejected a similar offer for a period of three months, and must allow customers to remove their names from the marketing list. Nonetheless, the Banking Corporation may approach a customer within the three-month period if an approach is made at a point of sale or rent, or if the approach is designed to settle an overdraft or anticipated overdraft in the customer's account. The Banking Corporation is also required to allow consumers to cancel the transaction and repay the loan within three business days with no banking fees other than the expenses defined in Regulation 3(1) of the Regulations of Nonbank Loan (Types of Credit Transactions Excluded from the Application of the Law, and Fees Excluded from "Surcharges") Regulation, 5779-2019. On the agreement date, the Banking Corporation must notify consumers of this right (Section 21).

Explanatory remarks

Improper credit marketing practices constitute a significant conduct risk for Banking Corporations. Banking Corporations must avoid initiated credit marketing to customers where there is a risk that the loan will threaten their welfare, such as disadvantaged populations. Banking Corporations must avoid soliciting credit, putting pressure to bear, and harassing customers when marketing credit. Furthermore, the Directive determines that customers may cancel a credit transaction within three business days, and then will owe no fees other than certain expenses that the Banking Corporation incurs in respect of the credit. It is clarified that when the date of the approach and the date of the agreement are not identical, the Banking Corporation must inform the customer of their rights on both occasions.

13.3. The Directive defines mandatory rules that apply to credit marketing at points of sale or rent that is not related to the purchase of a product: The marketing process takes place in a designated area (not the cash register area) and is conducted exclusively by an employee or representative of the Banking Corporation. Employees at the cash registers at the point of sale or rent may inform customers of the option of obtaining credit in the designated area. The designated area will be clearly marked, credit will be made conditional upon the customer providing their consent on a separate occasion, and the Banking Corporation must supervise and control the credit (Section 22).

Explanatory remarks

A designated, pre-defined, identifiable area that is not located at the cash registers of a point of sale or rent will help customers focus their attention on the credit offer and its terms, and help them to distinguish between the Banking Corporation that is marketing the credit and the employees of the point of sale or rent. Although the credit marketing process must be conducted in entirety in the designated area by an employee or representative of the Banking Corporation, cash register employees of the point of sale or rent may direct consumers' attention to the designated area. The requirement to obtain the customer's consent at a date subsequent to the marketing activity at the point of sale, before the credit is effectively granted, is designed to give customers an opportunity to reconsider the offer, independently of the marketer and the point of sale, before actually assuming the credit. This requirement does not apply to credit card marketing, which is subject to laws that address the specific features of this product, including the Payment Services Law, 5779-2019.

Credit approval procedures (Section 23-31)

14. Underwriting procedures will include a model for rating borrowers' risk, and adequate procedures and operating systems that support information analysis and prudent credit decision making (Sections 23-25).

    Explanatory remarks

    The features of consumer credit—a large number of customers, products, and distribution channels—call for objective, automated built-in procedures, operating systems, and models for assessing customer risk. The operating systems must include all the information that is required and support an appropriate degree of documentation and updating.

15. The Banking Corporation must assess the borrower's ability to repay, and the burden of the borrower's total debt. This assessment is based on the borrower's history with the Banking Corporation, the borrower's own declarations, information that is authenticated, and information that is verified. The Banking Corporation must define the required degree of how up to date the information is and the methods and steps required to verify and authenticate the information (Sections 25-30).

    Explanatory remarks

    An assessment of the borrower's ability to repay the loan is the cornerstone of the underwriting process. Granting credit in an amount that exceeds the borrower's ability to repay may lead to over-indebtedness and consequently will weaken customers. The Banking Corporation is required to take various steps to assess the borrower's ability to repay and to match the amount of credit to the level of quality of the information and how up to date it is.

16. Collateral and guarantees supplement and do not replace an assessment of the borrower, and their assessment is subject to rules such as valuation methodologies and safety margins, legal conditions, and procedures to ensure foreclosure when necessary (Section 31).

    Explanatory remarks

    The underwriting process must be based on the borrower's ability to repay, and a pledge on collateral must not replace an assessment of the borrower's financial strength. The requirements that apply to the Banking Corporation with respect to reliance on collateral are in addition to this fundamental requirement.

<u>Cancellation</u>

17. This Directive anchors the supervisory messages and expectations in this field that were conveyed to the banking system from time to time, including in the letter issued by the Supervisor on “Initiated Marketing of Retail Loans” dated November 17, 2015 (BL-512-15).

Commencement

18. This Directive comes into effect 9 months after its publication date on the website. However, the sections related to consumer credit marketing (Section 17-22 of the Directive) come into effect 3 months after the publication date.

File updates

19. Attached are the update sheets for the Proper Conducting of Banking file. Following are the update instructions:

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Respectfully,

Yair Avidan
Supervisor of Banks