Bank of Israel
Banking Supervision Department

Jerusalem, June 30, 2010
10LM0740
REG10.060.007

To:
Banks and credit-card companies—attn. Chief Executive Officer

Re: Capital policy during the interim period

1. The global financial crisis has created global awareness of the need to raise the level and quality of capital in the world's banking systems. Accordingly, the Basel Committee on Banking Supervision (hereinafter—the Basel Committee) and leading regulators abroad have been formulating changes in the existing system of capital requirements.
   As part of the foregoing, in December 2009 the Basel Committee issued draft recommendations on "strengthening the resilience of the banking sector"[1] (hereinafter—the Draft). The intention is to publish many of the proposed changes as final recommendations by early 2011 and to put them into effect on December 31, 2012.
2. The Banking Supervision Department is keeping abreast of developments in this matter and intends to examine the new recommendations, once formulated, for the purpose of aligning our directives with them where relevant.
3. Consequently, the Banking Supervision Department finds it necessary to explain what it expects banks to do during the period until the alignment of directives as noted in Section 2 above (hereinafter—the Interim Period). Said explanation follows.
4. The Banking Supervision Department is continuing to act for the improvement of the domestic banking system's strength and resilience. Within this framework, banks are required during the Interim Period:
   * to adopt a target core capital ratio for December 31, 2010. Said ratio shall pertain to core capital less all mandatory subtractions from Tier 1 capital according to Proper Banking Management Directive 202, "Capital Measurement and Adequacy—Capital Components." The target shall be set at a rate no lower than 7.5 percent;
   * to present the Banking Supervision Department with a workplan for the attainment of this target. Said workplan shall be presented within two months of the date on which this letter is received;
   * Absent the prior approval of the Supervisor of Banks, a bank shall not distribute dividends unless it meets the aforementioned target or if said distribution of dividends will cause it not to meet the target.

[1] Basel Committee on Banking Supervision, *Strengthening the Resilience of the Banking Sector*, December 2009.

A bank that has difficulty with the foregoing shall apply to the Banking Supervision Department in order to work out an agreed course of action that will lead to the attainment of the target.

5. The foregoing does not change the contents of my letter, SRP178, of August 20, 2009, in regard to my demand that banks attain the internal capital targets that they set in terms of Basel I (Proper Banking Management Directive 311) by the time they complete a comprehensive SREP.
6. We believe it proper to call your attention to the reference in the Draft to hybrid capital instruments that do not satisfy the new conditions for recognition as capital that appear in the Draft. The Basel Committee urges supervisors to consider the possibility of issuing transitional directives in regard to continued recognition as capital of such instruments that were issued *before* the publication of the Draft (December 2009). We were also informed that the duration of the transitional period shall be determined at a later time. Since we intend to adopt the final directives that will be published in this context, banks should take into account the strong probability that future issues of such instruments will not be recognized for capital adequacy purposes.

Respectfully,

Rony Hizkiyahu
Supervisor of Banks