Bank of Israel
Supervisor of Banks

DRAFT

March 14, 2012

To: Banking corporations and credit card companies

Attention: CEO

Re: Basel III—Minimum Core Capital ratios[1]

1. Among the lessons learned from the global crisis which began in 2007, leading supervisory authorities around the world have concluded that banks' core capital, comprised primarily of share capital and retained earnings, is the main component that absorbs losses even under regular business conditions, and so maintaining it at an appropriate level is critical to aiding banks in difficulty, and even preventing their collapse.
2. In December 2010, the Basel Committee on Banking Supervision published a revised framework for capital requirements of banks, known as Basel III.[2] The framework focuses on the need for capital to be increased and its quality improved, primarily through increasing the share of core capital in the capital base. In addition, the Committee referred to the need to deal especially with financial institutions with significant systemic importance.
3. Following the crisis, and the publication of Basel III, a global trend of a marked increase in banks' capital, particularly its core capital component, can be discerned.
4. Following the above, the Banking Supervision Department began preparations for the adoption of Basel III in Israel. As part of the adoption process, new core capital ratios were set for banking corporations and credit card companies, as detailed in this letter. In setting these ratios, the Banking Supervision Department took into account the need to ensure the stability of the banking system in Israel along with its continued support of growth of the economy. Among other things, the Banking Supervision Department took into account the following characteristics of the economy and banking system in Israel:
   - Israel's economy is exposed to significant risks which are unique to it. Moreover, Israel has a small open economy, with a significant export component. This fact increases the economy's exposure to shocks from

[1] Core Capital in this letter refers to Common Equity Tier 1.
[2] Basel III: A global regulatory framework for more resilient banks and banking systems, Basel Committee on Banking Supervision, December 2010 (revised June 2011).

abroad, particularly Europe and the US, and to risks from changes in the exchange rate.

- The banking system exhibits a high level of concentration. This concentration creates a strong linkage between the stability of the banking corporations and activity in the overall economy. In addition, a relatively small number of business groups representing a significant share of the demand for credit generates high credit concentration risk for the overall banking system with regard to those groups. This concentration also creates strong reciprocal ties between the banks themselves and the rest of the financial system.
- The dimensions of the banking system relative to the size of the economy and the small number of banking corporations operating in Israel lead to the fact that nearly all the banking corporations in Israel are systemically important. The last crisis showed that countries tend to provide aid to the banking system in order to maintain its stability, even at the cost of heavy public expenditure, and so it is critical to reduce as much as possible the probability of a failure of one of the banking corporation operating in the system.
- Several banking corporations are especially large relative to the economy. The extent of their operations and the inability of other financial institutions to acquire or merge their activities in the event of a failure require establishing an even larger core capital ratio for them.

5. **In light of the above items, the banking corporations and credit card companies are required to act as follows:**
    - To meet a minimum core capital ratio of 9 percent by January 1, 2015.[3]
    - In addition, a banking corporation whose total consolidated balance sheet assets represent at least 20 percent of total banking system assets, is required to meet a minimum core capital ratio of 10 percent by January 1, 2017. For those banking corporations, a core capital ratio of 9 percent by January 1, 2015, is an interim target.
    - The core capital ratio will be calculated in accordance with Basel III directives and with the adjustments which will be set out in Supervisor of Banks directives on this issue.
6. The Banking Supervision Department expects banking corporations to continue to strengthen their financial resiliency, as required in this letter, and at the same time to continue and support the growth of the economy. To that end, it is expected that banking corporations will increase their core capital balances as required above gradually.
7. Banking corporations are required to update their capital plans for the coming years in a manner appropriate to the demands in this letter. To that end, the Banking Supervision Department expects that banking corporations will avoid distributing dividends if doing so means that they will not be able to meet the above requirements.

[3] This ratio includes a capital conservation buffer of 2.5 percent, as described in Basel III, and as will be adopted in the Supervisor's directives.

8. Within the framework of the process of adopting Basel III, the Banking Supervision Department continues to examine the other issues included in the framework, including the reference to minimum overall capital adequacy ratios, and will refer to the manner of their adoption in the future.

Sincerely,

David Zaken

Supervisor of Banks