MARKET RISK MANAGEMENT

Introduction (2/97)

1. (a) Developments in the money and capital markets in Israel, the transition from financial intermediation to the status of market maker, globalization and financial innovation, all have an ever-increasing effect on potential exposure to financial risks inherent in the various aspects of banking corporations' activities.

(b) Void.

(c) This directive sets out the basic principles for market risk management and measurement that apply the general fundamental principles set forth in Directive 310 regarding "Risk Management". Additional guidelines on the issue of market risk are included in Supervisor of Banks directives on the issue of capital adequacy and measurement–market risk (Directive no. 208), dealing with illiquid positions (Directive 209) and Securitization (Directive no. 205). Likewise, the issue of interest rate risk management overall, and particularly in the banking portfolio, is dealt with in a detailed manner in Proper Conduct of Banking Business Directive no. 333 regarding “Interest rate risk management”.

Application

2. This directive applies to a banking corporation, as defined in the Banking (Licensing) Law, 5741–1981, excluding a joint services company, and to an auxiliary corporation which is a credit card company (the two groups will be referred to below as a “banking corporation”).

Definitions (2/97)

2a. "**Economic Capital”** The difference between the fair value of assets and liabilities, on- and off-balance-sheet, in a particular sector (indexed, unindexed, or foreign currency);

"**Fair value of a derivative financial instrument**" As defined in the Directives concerning the preparation of a banking corporation's annual financial statements (Reporting to the Public Directives);

"**Market risk**" Risk of a loss in on- and off-balance-sheet positions deriving from a change in the fair value of a financial instrument due to a change in market conditions (e.g., changes in price levels in different markets, interest rates, foreign exchange rate, inflation, share and commodities prices).

"**Market maker**" A banking corporation which deals in financial instruments and derivative financial instruments with customers and other market makers, and which holds a portfolio of these instruments, and sells and buys them by quoting selling and buying prices, obtaining income from the margin between purchases and sales.

The administrative infrastructure (2/97)

3. Void.

The exposure document (2/97)

4. Void.

The board of directors and policy (2/97)

5. Void.

The risks manager (2/97)

6. Void.

Internal audit (2/97)

7. Void.

Interest rate risks (2/97)

8. Void.

Market risk (2/97) (7/99) (6/04)

9. (a) A banking corporation which takes positions in foreign currency, invests in securities for its own account (nostro), or makes a large-scale market in derivative financial instruments (as defined in Subsection 9(b) below) shall manage the market risks deriving from its overall activities by means of a comprehensive system as detailed in Subsection 9(c) below. Notwithstanding the above, a banking corporation whose main market risks are concentrated in relatively few areas of activity shall be allowed to manage its market risks as set out in this section in those areas only.

(b) The provisions of this section shall apply only to banking corporations which satisfy at least one of the following criteria:

(1) The portfolio of investments in securities held for resale and for trading exceeds NIS 3 billion or 50% of the banking corporation's capital.

(2) The total limits and authorizations to meet positions in the foreign currency sector, including existing ceilings of exposure in the banking corporation's branches abroad, exceed NIS 500 million or 33 percent of the banking corporation's capital less nonfinancial items, net.

(3) Void.

(4) The banking corporation acts as a market maker in derivative instruments (excluding market making in the two-sided trading in the foreign currency/NIS market) and it has not received an exemption from this section from the Supervisor of Banks due to a low level of activity.

(c) The banking corporations' market-risk management system must include all the following components:

(1) An internal model for measuring market risks, based on such statistical techniques as: variance-covariance, historical simulations, and Monte Carlo simulations.

(2) Regular measurement (at least monthly, and in the trading book, daily) of the banking corporation's exposure to market risks by estimates of Value at Risk (VAR) based on the corporation's internal model. VAR estimates the corporation's maximum expected loss in the event of the realization of market risks in a given time period and with a predetermined degree of statistical confidence. The use of this method requires regular revaluation of all the corporation's positions based on the fair value of assets and liabilities.

(3) Stress-scenario analyses of market risks.

(4) A model or method of assessing the feasibility of taking positions in various areas, taking the risks into account.

(5) A market and interest rate risk control unit (as described in Section 10 below).

Market and interest rate risk control unit (2/97)

10. (a) (1) A banking corporation which is required to manage its market risks according to a model using the VAR method, shall establish an independent function to control market and interest rate risks that will be independent of the other functions responsible for managing and trading in the various instruments.

(2) The risk management unit will be directly subordinate to the banking corporation's chief risk officer as defined in Proper Conduct of Banking Business Directive number 310 regarding "Risk Management".

(b) The risk control unit shall act in accordance with the provisions of Proper Conduct of Banking Business Directive no. 310 regarding "Risk Management". Among other things, the risk control unit must assess the adequacy of the models implemented in the banking corporation for measuring risk; examine whether actual activity and exposures conform with the approved principles and exposure limits; periodically check the actual results against the models' forecasts; develop and perform stress-scenario analyses; compile regular reports quantifying the risks; and report regularly on the results of the examinations.

(c) Void.

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Circular 06 number	Version	Details	Date
1852	1	Original Directive	February 23, 1997
1980	2	Update	July 14, 1999
2134	3	Update	June 13, 2004
2358	4	Update	December 27, 2012
2378	5	Update	May 30, 2013
2669	6	Update	September 30, 2021