

**LIMITATIONS ON THE INDEBTEDNESS OF A BORROWER AND A
GROUP OF BORROWERS** (4/97) (8/03) (11/03)

Introduction (8/03)

1. (a) The concentration of the credit portfolio constitutes one of the sources of credit risk in the banking corporations., and awareness of this has resulted in limitations being set on the indebtedness of a borrower and a group of borrowers.
- (b) This regulation sets limitations on the total indebtedness of a borrower and of a group of borrowers to a banking corporation and to all corporations in Israel and abroad whose financial statements are consolidated with the financial statements of the banking corporation.
- (c) The limitations set in this regulation represent the minimum requirements. Each banking corporation shall set its own limitations beyond those stated in this regulation, in accordance with its risk management, its customer profile, the structure and size of the banking corporation, etc.
- (d) The board of directors of the banking corporation, as part of its credit policy, shall define parameters for determining whether significant relations between customers exist, taking into consideration the different elements of these relations.

The banking corporation may determine a threshold level of significance in considering certain elements.

Applicability

2. (a) This regulation applies to all banking corporations except joint service companies.
- (b) This regulation also applies to the following corporations as if they were banking corporations - corporation of the type stated in sections 11(a) (3a) - (3c) and 11(b) of the Banking (Licensing) Law, 5741–1981 (henceforth, the Licensing Law), incorporated in Israel and controlled by a banking corporation, unless the controlling banking corporation meets the following requirements:

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- (1) It includes it in its financial reports on a consolidated basis;
- (2) It has indemnified it for all its liabilities;
- (3) It maintains an effective control system for monitoring that the limitations on a consolidated basis are met.

Definitions (11/98) (8/03)

3. **“Credit”** - As defined in the Licensing Law, excluding guarantees, documentary credit, and a commitment to pay money on a customer’s account;

“Credit at the responsibility of the banking corporation” - Credit excluding deposits whose repayment to the depositor is contingent on collecting the credit;

“Capital” - As defined in Appendix A to [Regulation no. 311](#) “Minimum capital ratio” (henceforth – [Regulation no. 311](#)) according to the most recent report to the Supervisor of Banks pursuant to Regulation No. 811;

“Indebtedness” - The total of the following:

- (1) Credit at the responsibility of the banking corporation;
- (2) The banking corporation’s investments in the borrower’s securities, unless they were deducted from capital for purposes of [Regulation no. 311](#); for this matter, the total investment in securities will be according to the records of the banking corporation; the above notwithstanding, a banking corporation may take into account the

total investment in a borrower's securities, as follows:

- (a) Shares of a company included on an equity basis - according to cost adjusted by the rate of increase of the CPI from the purchase date, provided that if they are recorded on the equity basis, the increase in their value resulting from this fact shall not be included in the capital of the banking corporation;
- (b) Debentures available for sale - according to reduced cost (as stated in section 24.g. of the Regulations regarding the Preparation of Annual Financial Statements);
- (3) Commitments of the banking corporation to pay money on a customer's account (including guarantees and documentary credit); in this matter, bank guarantees to a mortgagor given in accordance with the Sale (Apartments) (Assurance of Investments of Persons Acquiring Apartments) Law, 5734 – 1974, will be weighted at 60% if the apartment has not yet been transferred to the possession of the mortgagor, and at 20% after it has been transferred to the possession of the mortgagor;
- (4) Futures transaction -the total of the following:
 - (a) 10% of the balance of a future transaction as stated in section 2(1) of Appendix C to [Regulation no. 311](#);

- (b) Commitment of a customer in according to section 2(7)(c) of Appendix C to [Regulation no. 311](#).
 - (c) The borrower's indebtedness for a future transaction as stated in section 2(1) of Appendix C to [Regulation no. 311](#), included under the "other assets" item as stated in section 35(a)(7) of the Guidelines for Preparing reports for the Public.
- (5) Commitments of the banking corporation to the MAOF (i.e., Futures and Financial Instruments) clearing house for the amount of collateral the customer is committed in accordance with the scenarios as specified in the bylaws of the MAOF clearing house.
- (6) Commitments (including contingent) of the banking corporation to extend credit or issue a guarantee, excluding the above-mentioned commitment, the realization of which is contingent upon receiving collateral of the type specified in section 5, to the amount of the credit or guarantee.

The above is subject to the following:

- (a) If the commitment to extend credit or to issue a guarantee is contingent upon the repayment of another credit or guarantee, the amount of indebtedness shall not exceed that of the larger of the two, provided the banking corporation has

ascertained that the commitment cannot be realized without reducing the existing credit or guarantee by the same amount;

- (b) A commitment to extend credit shall not be weighted at a higher rate than the final indebtedness itself, should it be realized;
 - (c) A commitment to extend credit or to issue a guarantee, which as specified in an agreement with the borrower is to be realized only if doing so does not result in exceeding the borrower or group of borrowers limitations respectively, shall not be considered as “indebtedness”, provided the banking corporation has ascertained that the commitment cannot be realized if it will result in the borrower or group of borrowers limitations respectively to be exceeded, by the same amount.
- (7) 50% of all the “commitments as an underwriter”, as specified in [Regulation no. 321](#) regarding “Underwriting issues of securities”.
 - (8) 50% of the total guarantees provided by the borrower to secure the indebtedness of a third party to the banking corporation, excluding the above-mentioned guarantees provided by one member of a group of borrowers to another member of the same group; in this matter, “guarantee” includes any commitment in the form of draft, in the amount of at least NIS 1

million or 0.1% of the capital of the banking corporation, whichever is lower, if the draft is used in the banking corporation for a discount by the third party, or as security for the third party's indebtedness.

All the above exclude amounts for which specific loan-loss provision is made.

“Borrower” -

A person, including his spouse and a number of borrowers, where the expected repayment of the indebtedness is based mainly on the same source, and none of whom has another significant source from which to pay the indebtedness (see Appendix A), excluding:

- (1) The state, the Bank of Israel, a government of an OECD country, and a banking corporation;
- (2) A bank outside Israel which is incorporated in an OECD country and which maintains a minimum capital ratio in accordance with the recommendations of the Basle Committee;
- (3) Another bank outside Israel authorized in this matter by the Supervisor of Banks;
- (4) A corporation to which this regulation applies in accordance with section 2(b) and which is controlled by the banking corporation.

“OECD countries” -

As stated in Appendix B to [Regulation no. 311](#).

“A group of borrowers” -

All the following together:

- (1) The borrower, a person controlling him and anyone controlled by them; in the case of a corporation controlled by more than one person, the holders of the controlling interest for whom the controlled corporation is significant (e.g., from the aspect of capital) shall be included in one group of borrowers, including the controlled corporation and anyone controlled by them (see Appendix B);
- (2) In the case of a corporation held by more than one person, a holder who does not hold a controlling interest for whom the held corporation is significant (e.g., from the aspect of capital) shall be included in one group of borrowers together with the held corporation and anyone controlled by them (see Appendix C);

See Appendix D regarding a combined situation.

- (3) Borrowers whose relation is such that the undermining of the financial soundness of one of them will affect the financial soundness of the other(s), or such that the same factors are likely to affect the stability of both or all of them.

Such a relation occurs in the following cases, among others:

- (a) Borrowers at least one of whom granted a significant amount of credit to another

borrower or bought the other's bonds for a significant sum;

(b) Borrowers at least one of whom is a guarantor for a significant part of the indebtedness of another borrower, or has provided a guarantee of unlimited amount to secure the indebtedness of another borrower;

(c) Borrowers, the indebtedness of each one of whom to the banking corporation exceeds 5% of the banking corporation's capital, and there is material commercial interdependence between them, not limited to the short-term, including by securing claims;

(d) Joint directors, joint management, etc.

(4) Anyone determined by the Supervisor of Banks to be a part of a group of borrowers;

and excluding anyone whom the Supervisor of Banks has removed from a group of borrowers, for the purposes of this regulation.

“A controlled group of borrowers” - Borrowers controlled by the banking corporation or more than 10% of whose means of control of any type is held by the banking corporation, and a borrower more than 50% of whose means of control of any type are held by the borrower referred to above (excluding a consolidated company);

“Indemnity” -

An irrevocable and unconditional commitment to indemnify a particular indebtedness.

“Control” –

As defined in the Banking (Licensing) Law, with the presumption that a person controls a corporation if he holds the largest share of the means of control of any type, or if there is no other holder of the means of control of any type who holds a larger share of the same means of control.

Limitations (11/98) (8/03)

4. (a) A borrower’s indebtedness to a banking corporation, after deducting the amounts detailed in section 5, shall not exceed 15% of the banking corporation’s capital.
- (b) The indebtedness of a group of borrowers to a banking corporation, after deducting the amounts detailed in section 5, shall not exceed 30% of the banking corporation’s capital.
- (c) The indebtedness of a controlled group of borrowers to a banking corporation, after deducting the amounts detailed in section 5, shall not exceed 50% of the banking corporation’s capital.
- (d) The total indebtedness to a banking corporation of the six largest borrowers and groups of borrowers, after deducting the amounts detailed in section 5, shall not exceed 135% of the banking corporation’s capital. In this matter, the following are not included:
- (1) The indebtedness of a controlled group of borrowers;
- (2) The indebtedness of a borrower if it is included in the indebtedness of a group of borrowers.

For purposes of determining the six largest borrowers and groups of borrowers of a banking corporation, the indebtedness of a borrower included in more than one group of borrowers shall be included only in the group of borrowers that has the largest indebtedness.

- (e) The Supervisor of Banks may, under special circumstances, extend the limitations applicable to a particular banking corporation.

Deductions (8/03) (12/04)

- 5. The amounts which may be deducted for the purpose of section 4, are for the following:
 - (a) A deposit in a banking corporation for which the banking corporation has a right of setoff or of a lien of the first degree to secure the indebtedness, and there is also a written commitment not to withdraw the deposit as long as the indebtedness has not been repaid;
 - (b) An indemnity of one of the entities included in subsections (1) – (3) to the definition of a “borrower”, which may be realized if the borrower does not meet the terms of the indebtedness;
 - (b1) Guarantee given by the Israeli Foreign Trade Risks Insurance Corporation Ltd. (IFTRIC), which is a fully owned government company whose obligations are fully guaranteed as to the payment of principal and interest by the Government of Israel, in accordance with the Foreign Trade Guarantees Law – 5719-1959, as long as the guarantee is in effect and provided that the transaction was approved by the inter-ministerial committee headed by the Accountant General of the Ministry of Finance;
 - (c) 85% of the market value of state loans traded in the stock exchange, mortgaged to secure the indebtedness;
 - (d) An irrevocable commitment of a bank outside Israel which is not included in subsection (b), against an open documentary credit (as defined in section 2(3) of Appendix C to [Regulation no. 311](#)), including an indemnity of the Export-Import Bank (Exim Bank) and of the Overseas Private Investment Corporation (OPIC)

which are agencies of the US government, that guarantees all payments of principal and interest on their liabilities, provided it can be realized after payment of the documentary credit.

Common control (8/03)

6. Repealed.

Partnerships (8/03)

7. The indebtedness of a partnership (whether registered or not) to a banking corporation in which a borrower is a partner, will be added to the indebtedness of the borrower.

Non-recourse credit (8/03)

7a. The content of this regulation notwithstanding:

- (1) Non-recourse credit guaranteed by a security will be added both to the indebtedness of the borrower and to the indebtedness of the corporation issuing the security.
- (2) In the case of a group of borrowers that includes both the purchased corporation and the borrowers to whom the indebtedness was granted, the indebtedness shall be included only once.

In this section **non-recourse credit** means credit which, in the event of default, the banking corporation does not have general recourse to the borrower, but rather has recourse only to the property used for collateral or other specific property, or if the property that served as collateral is the borrower's main assets.

Mergers and purchases

8. If a change has occurred to the indebtedness of a borrower or a group of borrowers due to a merger of borrowers or due to changes in the control over a borrower or a group of borrowers, which results in an infraction from the limitations under this regulation, the

amount of the infraction is to be reduced by equal quarterly amounts within two years of the date of the change.

Establishing procedures

9. The management of a banking corporation, authorized by the board of directors, shall establish in writing procedures for monitoring the concentration of risks of large borrowers. These procedures must address at least the following issues:
 - (a) The existence of a system of gathering data and of control which enables the analysis of credit concentration and continuous monitoring of adherence to the indebtedness limitations on a consolidated basis, including indebtedness of overseas offices.
 - (b) The existence of an internal audit system to identify relations between borrowers which seem to create “a group of borrowers”. These procedures will define rules for monitoring economic, legal, and other relations between large borrowers, with emphasis on identifying groups of borrowers whose relations are not necessarily formal ones, but which nevertheless, according to the banking corporation’s estimates, create a common risk; and control of the system of information flow in the banking corporation and in subsidiaries.
 - (c) Monitoring of large borrowers’ indebtedness development, including periodic reports to the board of directors, even when the indebtedness does not exceed the limitations. These procedures will establish the authority required to increase borrowers’ indebtedness, as mentioned, and the benchmark indebtedness requiring monitoring.

Reporting

10. (a) Banking corporations to whom this regulation applies shall report to the Supervisor of Banks once every three months on the indebtedness of borrowers, groups of borrowers, and controlled groups of borrowers as detailed in the Regulations for Reporting to the Banking Supervision.

- (b) The report according to this section shall be on a consolidated basis and on a non-consolidated basis (although the limitations apply only on a consolidated basis).
- (c) The report on indebtedness of a group of borrowers and a controlled group of borrowers must give details of the components of the group.
- (d) A report on the indebtedness of borrowers who exceed the limitations must be submitted to the Supervisor of Banks within seven days of the infraction.

Authorization of infractions

- 11. (a) The Supervisor of Banks may authorize infractions from the limitations for a period to be determined by him, if they arose due to a change in economic circumstances, such as a significant change in currency exchange rates, or profits on equity basis.
- (b) If the banking corporation, authorized by the board of directors, has submitted a reasoned request in writing to authorize an infraction from the limitations for other reasons, and the Supervisor of Banks is convinced that the circumstances provide justification for such, he may consider authorizing infractions for reasons other than those mentioned in this regulation. The Supervisor of Banks shall consider, among other issues,
 - (1) Whether the borrower has submitted to the banking corporation a recovery program which in the Supervisor's opinion can be implemented;
 - (2) Whether the above recovery program requires an increase in the borrower's indebtedness.

Transitional regulations (8/03) (11/03)

- 12. (a) If an infraction of the limitations in this regulation on the indebtedness of a group of borrowers results from the implementation of the changes in the regulation, the amount of the infraction will be reduced by equal quarterly amounts within two years from 31.3.2004.
- (b) If an infraction of the limitations on the six largest borrowers results from the implementation of the changes in the regulation:

- (1) Until 31.12.04, the total indebtedness of the six largest borrowers and group of borrowers to a banking corporation, as stated in section 4(d) (Limitations), shall not exceed 150% of the banking corporation's capital.
- (2) From 31.3.2005 until 30.6.2006, the limitation on the total indebtedness of the six largest borrowers and group of borrowers to the banking corporation, will be reduced by 2.5 percentage points per quarter from 150% to 135% of the banking corporation's capital.
- (c) In the financial statements at 30.9.2003, no supplementary provision as stated in [Regulation No. 315](#) of the Proper Conduct of Banking Business (Supplementary Provision for Doubtful Debts), shall be made for infractions of the limitations in this regulation resulting from the implementation of the changes in the regulation.
- (d) Any authorization issued by the Supervisor of Banks in accordance with this regulation prior to 31.3.2004 is cancelled. If this results in an infraction from the limitations, it will be reduced as per subsection (a) above.

Miscellaneous (8/03)

13. (a) The entity heading a group of borrowers shall generally be an individual at the head of that group who controls a corporation, unless there is no single controller of the corporation. Nevertheless, the limitation of 15% as stated in this regulation shall apply to every member of that group.
- (b) For purposes of this regulation, everyone indebted to the banking corporation shall be considered a borrower of the banking corporation, such as: a corporation whose indebtedness to the banking corporation consists only of the banking corporation's investment in the securities of the said corporation, or whose indebtedness derives from guarantees in favor of the banking corporation for the liabilities of a third party.

* * *

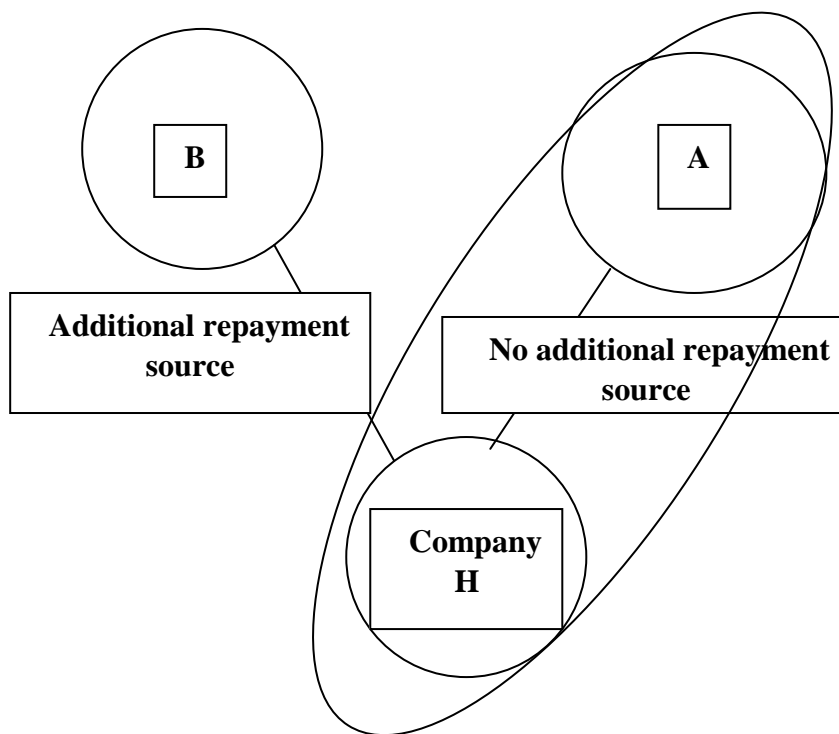
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Appendix A – Borrower

A and B sell its products to Company H -

A and Company H are based mainly on the same source for the expected repayment of the indebtedness, and none of them has another significant source from which to pay the indebtedness.

B and Company H are not based mainly on the same source for the expected repayment of the indebtedness, and B has another significant source from which to pay the indebtedness.

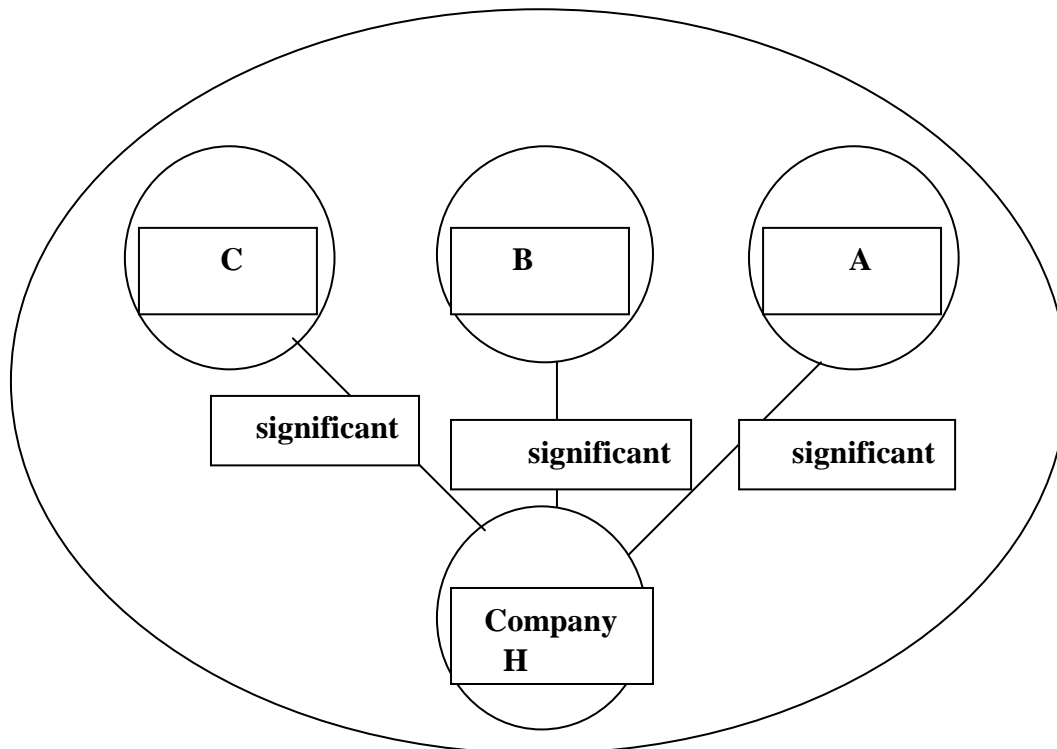


Result – A and Company H constitute one borrower (to distinguish from a group of borrowers).
B and Company H do not constitute one borrower.

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Appendix B - Control

Case 1 – A, B and C control Company H. Company H is significant to A, B and C.

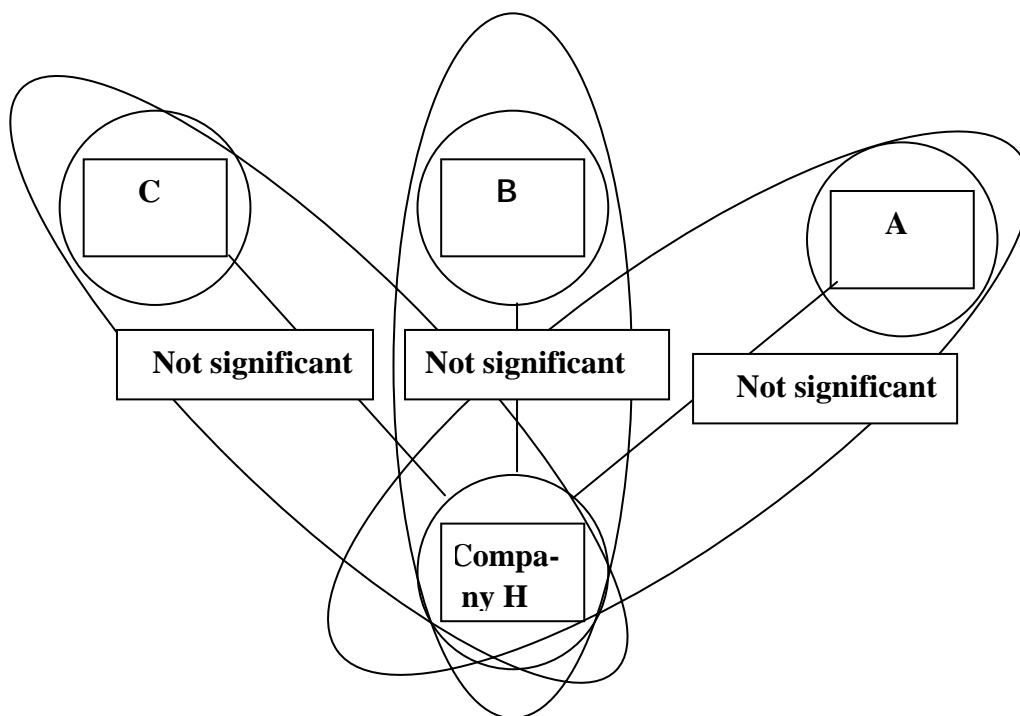


Result – The group of borrowers will include A, B, C, Company H, corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

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Appendix B – Control (continued)

Case 2 – A, B and C control Company H. Company H is not significant to A, B and C.



Result – There are three groups:

Group 1 includes A, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

Group 2 includes B, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

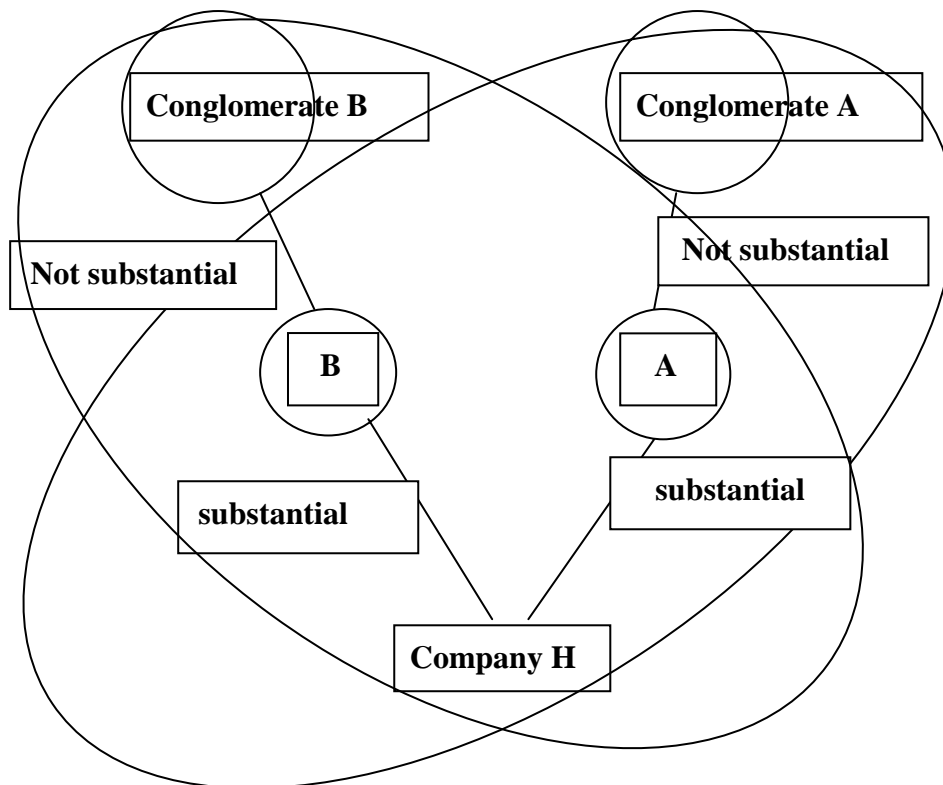
Group 3 includes C, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

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Appendix B – Control (continued)

Case 3 – Concerns A and B control A and B respectively. A and B control Company H.

Company H is significant to A and B. A and B respectively are not significant to concerns A and B.



Result – There are two groups of borrowers:

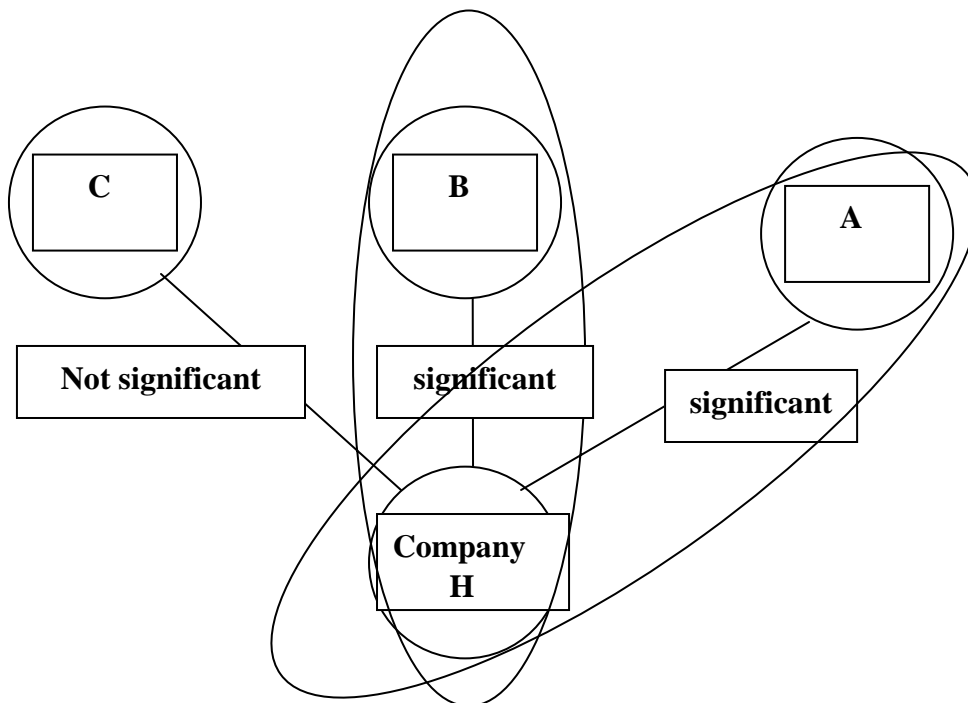
Group 1 includes Concern A, A, B, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

Group 2 includes Concern B, A, B, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

Note: This example is a particular case of paragraph (1) to the definition of a group of borrowers.

Appendix C – without control

A, B and C hold (without control) Company H. Company H is significant only to A and B. D (who controls the Company) is not included in the drawing.



Result – there are two groups of borrowers:

Group 1 includes A, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

Group 2 includes B, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

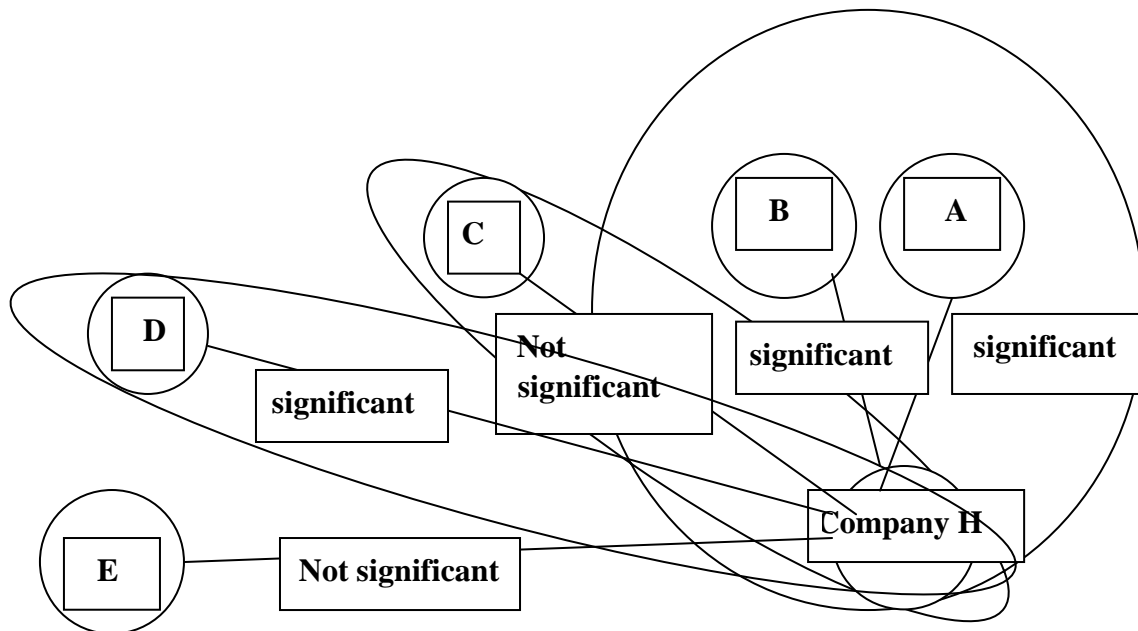
(C will not include Company H)

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Appendix D – Combined situation: control and without control

A, B and C control Company H. Company H is significant only to A and B.

D and E hold (without control) Company H. Company H is significant only to D.



Result – there are three groups of borrowers:

Group 1 includes A, B, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

Group 2 includes C, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

Group 3 includes D, Company H, Corporations controlled by them and additional borrowers in accordance with the definition of a group of borrowers.

(E will not include Company H)