

## **SUPPLEMENTARY PROVISION FOR DOUBTFUL DEBTS**

### **Introduction**

1. In view of the structural risks inherent in the banks' indebtedness portfolios, the banking corporations shall make supplementary provision, other than the provision for debts defined as doubtful, based on the quality of the indebtedness portfolio in each banking corporation, i.e., on a differential basis.

### **Definitions**

2. **"Less Developed Countries"** - Countries classified by the World Bank as having low or medium income (see Appendix C);  
  
**"Industry Sectors"** - In accordance with the definition of industry sectors in Appendix B of this regulation, which is based on the list in Regulation no. 831 of "The Reporting Regulations to the Supervisor of Banks".

### **Characteristics of risk** (4/98) (4/99) (2/02)

3. For the purpose of this regulation, the characteristics of risk of the indebtedness portfolio are defined as follows:
  - (a) **Financial information about the borrower**  
Undue indebtedness in this context is indebtedness of a borrower whom the banking corporation does not adhere to [Regulation no. 317](#) (Financial information in borrowers' files). For this purpose, the amount of deductions may be subtracted from the indebtedness, in accordance with section 5 of [Regulation no. 313](#).
  - (b) **Indebtedness of related parties**  
Undue indebtedness in this context is any indebtedness (on a consolidated basis) that constitutes an infraction from the limitations on the indebtedness of related parties ([Regulation no. 312](#)) and that is not specifically authorized.

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(c) **Concentration of indebtedness by borrower or group of borrowers**

Any infraction from the limitations on the indebtedness to a banking corporation of a borrower, a group of borrowers, or a controlled group of borrowers ([Regulation no. 313](#)) shall be considered undue indebtedness for the purpose of this regulation, even if it has been permitted under transitional regulations or has been authorized by the Supervisor of Banks. However, if a specific borrower has exceeded the limit, both as a borrower and as a group of borrowers or controlled group of borrowers, the undue portion shall not be doubly counted.

(d) **Industry sector concentration of indebtedness**

(1) When the total indebtedness of a given industry sector to a banking corporation (on an unconsolidated basis) exceeds 20% of the public's total indebtedness to the banking corporation, the excess shall be considered undue indebtedness for the purposes of this regulation. For this purpose “**indebtedness**”, is as defined in [Regulation no. 313](#), except for investment in shares, 100% of the total commitments (including contingent) of the banking corporation to extend credit or issue guarantees and guarantees given by the borrower to a third party to ensure credit received by the third party from the banking corporation.

(2) For the purpose of characterizing this risk:

(a) The sum of the components of the indebtedness, which the State has guaranteed under their policy to encourage residential construction, shall be weighted at 65%. This weighting factor shall be permitted only after the banking corporation has verified the existence of the terms of the State's letter of guarantee. For this purpose, “**the State's guarantee**” is the State's guarantee to finance residential construction in accordance with the approval of the Knesset Finance Committee in the format of the State's guarantee as approved on 21.6.1994, 16.1.1996, and 18.12.1997.

(b) Bank guarantees to a mortgagor given in accordance with the Sale (Apartments) (Assurance of Investments of Persons Acquiring Apartments) Law, 5734–1974 (henceforth, sale guarantees), shall be

weighted at a rate of 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.

- (3) In a mortgage bank, industry sector concentration of indebtedness shall be calculated relative to the total indebtedness of the public plus 20% of the credit extended to the public that is not the bank's responsibility (i.e., as stated, 20% shall be added to the denominator).
- (4) For the purpose of calculating the industry sector concentration of indebtedness, the following deductions shall be permitted:
  - (a) A banking corporation that has "excess minimum capital ratio" will be entitled to deduct from the undue indebtedness an amount equivalent to up to twice the excess capital, provided that the banking group to which it affiliates has an excess minimum capital ratio and that the excess is subtracted in every corporation in proportion to its capital to that of the group. In order to determine the deduction permitted to the parent-company, investments in subsidiaries dealing with extending credit that have been consolidated in the parent corporation's financial statements shall also be deducted from its capital, and if the subsidiaries do not have excess minimum capital ratio as stated, the parent-company is entitled to deduct the full amount.

For the purposes of this section:

**"Minimum capital ratio"**- As defined in [Regulation no. 311](#),  
"Minimum capital ratio";

**"Excess minimum capital ratio"** - The actual capital ratio that exists in the banking corporation, *less* 10 basis points, and in a banking corporation for which the Supervisor of Banks has determined a minimum capital ratio of more than 9%, instead of the 10 basis points as stated, the

minimum capital ratio shall be as set by the Supervisor of Banks *plus* 2 basis points.

- (b) A banking corporation is entitled to offset from the industry sector indebtedness amounts which may be deducted as stated in section 5 of [Regulation no. 313](#) (Limitations on the indebtedness of a borrower and a group of borrowers), provided that the aforesaid deduction against sale guarantees is made in accordance with the weighting of the sale guarantees as stated in section 3(d)2(b). (The deduction shall be made from the numerator only.)
- (c) The banking corporation is entitled to deduct from the indebtedness of the construction sector the present value of the rent generated from income property leased to the bank or the government of Israel, provided:
  - (1) The amount of the aforesaid rent is a lien to the banking corporation, and can be utilized if the customer does not meet the terms of the indebtedness;
  - (2) There is an irrevocable commitment by the lessee to pay the rent directly to the banking corporation;
  - (3) The rental cannot be terminated before the end of the rental period.
- (d) A banking corporation is entitled to subtract from the indebtedness of the construction industry indebtedness to the banking corporation of a company that does not deal with construction in Israel, and is intended for the purchase of real estate outside Israel (for this purpose “**Israel**” - including Judea, Samaria, and the Gaza Strip).
- (e) **Problem debts**  
Any indebtedness classified as a problem debt, in accordance with [Regulation no. 314](#) (Dealing with problem debts), shall be considered an undue indebtedness for the purposes of this regulation, except:

- (1) A debt that is classified as a debt under special supervision, due to the fact that another portion of the indebtedness is defined as a problem debt in another category;
- (2) A restructured debt, if the borrower has kept to the terms of the arrangement for five years or half the period determined in the arrangement, whichever is lower. In the calculation of the period in which the terms of the arrangement have been met, the period in which the borrower is exempt from any repayment on account of his indebtedness should not be included;
- (3) The portion of indebtedness regarding which a provision for doubtful debt has been made;
- (4) Interest on a doubtful debt and interest on a debt not accruing income;
- (5) Indebtedness that is covered by collateral of the types specified in section 5 of [Regulation no. 313](#) (Limitations on the indebtedness of a borrower and a group of borrowers);
- (6) Housing loans in mortgage banks, regarding which provision for doubtful debts has been made on the basis of the extent of arrears in borrowers' payments.

(f) **Indebtedness of less developed countries**

The difference between the value of the indebtedness of borrowers from less developed countries (in accordance with Appendix C), as recorded in the books of the banking corporation, and their value in the international financial market shall be considered undue indebtedness for the purposes of this regulation.

Despite the aforementioned, the difference shall not be considered undue indebtedness if the loan is extended as participation in the credit program organized by the International Finance Corporation (Washington) or the Inter-American Investment Corporation (Washington).

For the purpose of this section, “**indebtedness**” is as defined in [Regulation no. 313](#), including the indebtedness of a country and a bank.

(g) **Concentration by extent of arrears**

Undue indebtedness in this context is when outstanding housing loans against which the provision that has been made in accordance with the extent of arrears

(deducting the provision amount) exceeds 1.5% of total outstanding housing loans. The terms in this subsection are defined in the Appendix to [Regulation no. 314](#) (Problem debts in housing loans of mortgage banks).

(h) **High leverage buyout financing**

Undue indebtedness in this context is any indebtedness (on an unconsolidated basis) that constitutes an infraction from the limitations specified in section 4 of the regulation regarding high leverage buyout financing ([Regulation no. 323](#)).

**Calculating the supplementary provision** (4/99) (2/02)

4. (a) The supplementary provision under this regulation shall be calculated as a ratio of the undue indebtedness according to the various risk characteristics specified above. Appendix A to this regulation lists the rates of the supplementary provision.
- (b) Against undue indebtedness the banking corporation must create the full rate of supplementary provision in the quarter in which the undue indebtedness emerged.
- (c) The supplementary provision against the various risk characteristics, excluding industry sector credit concentration, concentration by extent of arrears and financing high leverage buyouts, shall be calculated for each borrower separately. If the undue portion for that borrower or industry sector is reduced, the provision against them shall be reduced.
- (d) If for a specific borrower there are infractions in various risk characteristics, the supplemental provision required according to each risk element will be added up, but the target amount of the total supplementary provision against that borrower shall not exceed 10% of the highest undue indebtedness.

- (e) For indebtedness against a specific risk characteristic for which supplementary provision has been made, there is no need to make further provision for the same risk characteristic. Similarly, there is no need to create supplementary provision against a portion of indebtedness for which a specific loan-loss provision has been made.
- (f) Revoked.

### **Application**

- 5. This regulation applies to indebtedness in the offices of a banking corporation in Israel only.

### **General provision** (12/04)

- 6. The banking corporations shall continue to maintain the general provision balance that has accumulated under previous regulations, to an amount that does not exceed 1% of the total indebtedness of their customers to 31.12.1991, adjusted for inflation. Starting 1.1.2005, the balance of the general provision should not be adjusted for inflation.

### **Reporting** (2/02)

- 7. A banking corporation that has made supplementary provision under the terms of this regulation shall report it quarterly to the Supervisor of Banks, specifying the components of the supplementary provision, in accordance with the format of Regulation no. 809 in the Reporting Regulations to the Supervisor of Banks.

### **Transitional regulations** (4/99)

- 8. Despite the aforesaid in this regulation, a banking corporation is not obliged to create supplementary provision against infractions from the limitations in section 4(a)2 of Regulation no. 323 (High leverage buyout financing), and against undue amounts as stated in section 6 of that regulation until 1.1.2005, provided additional credit has not been extended to finance high leverage buyouts in the banking corporation that has been acquired.

**Appendix A** (4/99) (2/02)

**Rates for Calculating the Provision by Risk Characteristics**

(Section 4(a))

<u>Risk characteristic</u>	<u>Definition of undue indebtedness</u>	<u>Rates for calculating supplementary provision out of the undue indebtedness</u>
<b>1. Financial information on the borrower</b>	Lack of financial statement (as required by <a href="#">Reg. no. 317</a> )	
a. Floor indebtedness under <a href="#">Reg. no. 317</a> Up to 5 times of this floor		2%
b. Addition of between 5–10 times this floor		3%
c. Addition of over 10 times this floor		4%
The total provision is the sum of all the provisions in each bracket		
<b>2. Indebtedness of related parties</b>	Indebtedness of related parties (per <a href="#">Reg. no. 312</a> )	
a. Infraction from limitations of a component in a group <sup>1</sup>		6%
b. Infraction from limitations of all related parties		6%

<sup>1</sup> No provision shall be made twice for the same related party, once as a component in a group and again as a part of the total related parties.

<u>Risk characteristic</u>	<u>Definition of undue indebtedness</u>	<u>Rates for calculating supplementary provision out of the undue indebtedness</u>
<b>3. Concentration of indebtedness by borrower/ group of borrowers</b>	Indebtedness of borrower/ group of borrowers (per <a href="#">Reg. no. 313</a> )	
a. A borrower over 15% of capital <sup>2</sup>		<u>Undue Indebtedness</u>
b. Group of borrowers over 30% of capital <sup>2</sup>		10 X indebtedness ceiling
c. Controlled group of borrowers over 50% of capital <sup>2</sup>		
d. 6 largest borrowers: over 135% of capital		
<b>4. Industry sector concentration of indebtedness</b>	Indebtedness of a specific industry sector (under appendix B) <u>Percentage of total public indebtedness</u>	
	a. Over 20 to25%	3%
	b. Over 25 to30%	4%
	c. Over 30%	8%

The total provision is the sum of the provisions in each bracket.

<sup>2</sup> No provision shall be made twice for the same borrower, once as a borrower and again as a part of a group of borrowers or as a controlled group of borrowers.

<u>Risk characteristic</u>	<u>Definition of undue indebtedness</u>	<u>Rates for calculating supplementary provision out of the undue indebtedness</u>
<b>5. Problem debts</b>	Problem debts per <a href="#">Reg. no. 314</a>	
a. Debts under special supervision		1%
b. Debts in temporary arrears		2%
c. Restructured debts		3%
d. Debts not accruing income		4%
<b>6. LDC Indebtedness</b>	The difference between value of indebtedness in bank's books and its value in international financial market	100%
<b>7. Concentration by extent of arrears</b>	The balance of housing loans against which minimal specific provision has been made according to the extent of arrears, exceeding 1.5% of total housing loans	4%
<b>8. Financing high leverage buyouts (per <a href="#">Reg. no. 323</a>)</b>		
a. Infraction from limitation on purchase of means of control of all corporations		4%
b. Infraction from limitation on purchase of means of control of banking corporations		4%

## **Appendix B**

### **List of Industry Sectors**

(Section 3(d))

1. Agriculture
2. Machinery, electrical and electronic equipment
3. Metal and metal products
4. Rubber and plastics
5. Quarrying, chemicals, and petroleum products
6. Paper, publishing, and printing
7. Wood and wood products
8. Textiles, clothing, and leather
9. Food, drink, and tobacco
10. Diamonds production and trade
11. Construction, real estate, and industry and trade of construction products
12. Electricity and water
13. Commerce (excluding trade in diamonds and construction products)
14. Hotels, accommodations and catering services.
15. Transport and storage
16. Communications and computer services
17. Financial services
18. Other business services
19. Public and communal services

#### **Cross-credit concentration**

20. Total settlement movement

Appendix C (12/02)

**Less Developed Countries (LDC)**

**Table 1. Classification of economies by income and region, 2003**

Income Group	Subgroup	<u>Sub-Saharan Africa</u>		<u>Asia</u>		<u>Europe and Central Asia</u>		<u>Middle East and North Africa</u>		<u>Americas</u>
		<u>East and Southern Africa</u>	<u>West Africa</u>	<u>East Asia and Pacific</u>	<u>South Asia</u>	<u>Eastern Europe and Central Asia</u>	<u>Rest of Europe</u>	<u>Middle East</u>	<u>North Africa</u>	
Low-Income		Angola Burundi Comoros Congo, Dem. Rep. Eritrea Ethiopia Kenya Lesotho Madagascar Malawi Mozambique Rwanda Somalia Sudan Tanzania Uganda Zambia Zimbabwe	Benin Burkina Faso Cameroon Central African Rep. Chad Congo, Rep. Cote d'Ivoire Equatorial Guinea Gambia, The Ghana Guinea Guinea-Bissau Liberia Mali Mauritania Niger Nigeria S'ao Tom'e And Principe Senegal Sierra Leone Togo	Cambodia Indonesia Korea Dem. Rep. Lao PDR Mongolia Myanmar Papua New Guinea Solomon Islands Vietnam	Afghanistan Bangladesh Bhutan India Nepal Pakistan	Armenia Azerbaijan Georgia Kyrgyz Republic Moldova Tajikistan Ukraine Uzbekistan		Yemen, Rep.		Haiti Nicaragua
Middle income	Lower	Namibia South Africa Swaziland	Cape Verde	China Fiji Kiribati Marshall Islands Micronesia Fed. Sts.  Philippines Samoa Thailand Tonga Vanuatu	Maldives Sri Lanka	Albania Belarus Bosnia and Herzegovina Bulgaria Kazakhstan Macedonia, FYR. Romania Russian Federation Turkmenistan Yugoslavia, Fed. Rep.	Turkey	Iran, Islamic Rep. Iraq Jordan Syrian Arab Rep. West Bank and Gaza	Algeria Djibouti Egypt, Arab Rep. Morocco Tunisia	Belize Bolivia Colombia Cuba Dominican Republic Ecuador El Salvador Guatemala Guyana Honduras Jamaica Paraguay Peru St. Vincent and the Grenadines Suriname
	Upper	Botswana Mauritius Mayotte Seychelles	Gabon	American Samoa Malaysia Palau		Croatia Czech Rep. Estonia Hungary Latvia Lithuania Poland Slovak Rep.	Isle of Man	Lebanon Oman Saudi Arabia	Libya Malta	Antigua and Barbuda Argentina Barbados Brazil Chile Costa Rica Dominica Grenada Mexico Panama Puerto Rico St. Kitts and Nevis St. Lucia Trinidad and Tobago Uruguay Venezuela
<b>Subtotal:</b>	155	25	23	22	8	26	2	9	7	33

Source: World Development Report 2003 - The World Bank

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