

**AUDIT SPECIFICATIONS FOR CREDIT MANAGEMENT**

Because of the importance of the subject of credit, the banking corporations are hereby provided with summaries of the audit specifications used by the auditors of the Banking Supervision Department as regards to managing the credit risk of borrowers (Appendix A) and extending housing loans (Appendix B).

The management of a banking corporation shall ensure that the procedures on these subjects are adhered to, and are based on these specifications.

It is noted that compliance with the procedures in this area is part of the process of building and reviewing a credit portfolio of satisfactory quality.

## APPENDIX A

### **BASIC AUDIT SPECIFICATIONS FOR MANAGING A BORROWER'S CREDIT RISKS**

#### **General**

Like all other procedures, a banking corporation's credit procedures should be clear, binding, and approved by the appropriate authority within the banking corporation.

#### **Procedures for extending and operating credit** (7/98)

1. (a) Do the banking corporation's procedures for extending credit specifically address the full order of actions required from each of the ranks involved in the process of extending and managing credit, with reference to the following areas:
  - (1) Credit requests - details of the material required when submitting a credit request;
  - (2) The way the business situation assessments of a person requesting credit and of a borrower should be handled;
  - (3) Credit authorizations and the work of the credit committees - details of the material that should be submitted at each stage of the approval process, while examining the customer's financing basket vis-à-vis his needs, and incorporating the transaction under consideration;
  - (4) Ongoing operation of credit in the areas of accounting, business, and costing;
  - (5) Ongoing management of credit risk - monitoring and control of the implementation of decisions.
- (b) (1) Do the procedures specify the type of information (financial/business) required for decision making purposes? This applies to material received from the person requesting credit as well as to other information;
- (2) It shall be treated in the following way:

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- (a) Maintenance of the above information (monitoring its receipt and the measures to be taken if it is not received);
- (b) The way the above information should be analyzed and conclusions drawn.
- (c) Repealed.
- (d) Has a procedure been established for dealing with collateral at every stage, for example:
  - (1) Receipt and documentation of the collateral;
  - (2) Evaluation, examination, and reassessments of the collateral;
  - (3) Routine information about current liens, etc.
- (e) Does the procedure specify how the banking corporation should deal with problem debts (classification, definition, management, and collection)?

**Borrower's "portfolio"** (11/99)

- 2. Does the procedure state what documentation is required for the borrower's portfolio (and hence the steps that should be taken in order to obtain this information). Does the procedure include at least the following points:
  - (a) **Borrower information** (7/98) (11/99)
    - (1) Borrower's identifying particulars, including the complete chain of ownership and full flow-chart of the group to which the borrower belongs, including details of affiliated parties;
    - (2) Other general documentation: memorandum and articles of incorporation, general business terms, decision by the authorized body to open an account, persons empowered to sign, etc.
    - (3) Description of borrower's business: industry sector, length of time in the sector, other banks which extend credit to the borrower and the extent of their credit, additional business activities of owners, etc.
    - (4) Updated assessment of the industry sector to which the borrower belongs;
    - (5) Updated analysis and assessment of borrower's business situation based on

recent financial statements and other reports, e.g., V.A.T. returns, tax withholdings reports;

- (6) Evaluation of persons who stand behind the borrower: honesty, credibility, professional expertise, management quality and ability;
- (7) Business history: information about the borrower's business history in activity in the banking corporation, and review of civil and other lawsuits against the borrower in recent years;
- (8) Analysis of borrower's contribution to the business of the banking corporation;
- (9) Borrower's exposure to foreign-currency credit and the possible influence on the quality of credit as a result of a sharp change in the exchange rate;
- (10) Concluding assessment of quality of credit and borrower's credit rating.

**(b) Details of credit and collateral**

- (1) Last credit framework approved, and collateral required at the time of approval;
- (2) Documentation of requests for credit, authorization, interest terms, commissions, maturities, etc.;
- (3) Agreements signed with borrower;
- (4) List of collateral for credit.

**(c) Foreign-currency credit**

Further to the foregoing, in the case of a borrower with foreign-currency indebtedness to the banking corporation exceeding the amount specified in section 3b, the borrower's portfolio shall include information about the sources which will or might reduce the credit risks deriving from the borrower's exposure to exchange-rate fluctuations, at least as follows:

- (1) Borrowers who are exporters - the amount and the rate of exports from the borrower's overall sales volume;
- (2) Collateral denominated in or indexed to foreign currency (in accordance with a definition determined in the bank's procedures);

- (3) Transactions in derivative financial instruments by the customer in the banking corporation in order to hedge his foreign-currency exposure.

### **Collateral “portfolio”**

3. Has it been determined in the procedures what is to be included in a customer’s collateral portfolio, how the portfolio is to be maintained, and what are the monitoring and control procedures ensuring the existence of the collateral and assessing its value?

The collateral portfolio should include at a minimum the following material:

- A detailed list of the collateral;
- Legal and other documents attesting to the collateral;
- Insurance policies of the lien assets, endorsed in favor of the banking corporation;
- Updated assessment of the value of the collateral.

### **Managing credit frameworks in current accounts (7/98)**

- 3a. (a) Does the bank have a written “overall credit framework” agreement with every customer for whom current-account credit has been approved?
- (b) Is the bank mindful not to permit withdrawals from the account in an amount in excess of the overall credit framework?
- (c) If there are ongoing or repeated infractions from the overall credit framework, adherence to the following process should be examined:

Does the bank offer the customer the following alternatives:

- (1) If the bank is prepared to increase the customer’s framework it should propose this to the customer, specifying the costs and interest rates;
  - (2) If the bank is not prepared to increase the customer’s framework, or if the customer has not approved the proposal to do so, the bank should inform the customer of the infraction, demand its immediate annulment (if it still exists at the time of the announcement), and require that there be no future infractions of this nature. If the infraction is not annulled, as demanded by the bank, has the bank acted in order to collect the amount under infraction?
- (d) For the purposes of this section, “overall credit framework” is the maximum

amount of credit to a customer in a current account (this framework may include various brackets and different interest rates and commissions, as agreed with the customer).

**Borrower's credit rating** <sup>(7/98)</sup>

- 3b. Have rules been determined by the banking corporation for rating credits by quality, on the basis of the information required in this section, and have the authorities to determine the rating been specified?
- (a) The banking corporation must rate every borrower whose indebtedness to it is in excess of NIS 400,000. This amount will be updated in accordance with the last-known CPI at the beginning of every year (base index - November 1998).
  - (b) The credit rating shall be performed at the responsibility of the authorized person who approved the credit, and when this responsibility is in the hands of a committee, it shall be done by the person responsible for the specific borrower.
  - (c) The borrower shall be rated at least once every 12 months.
  - (d) The rating of borrowers shall be performed in a uniform way (which may be altered in accordance with the size of the borrower and type of activity), so that the borrower's portfolio will contain a standard assessment sheet ending with the borrower's credit rating.
  - (e) The borrower shall be rated on the basis of a scale with at least nine values, the six lowest being reserved for problematic borrowers who are classified as such in accordance with the categories in section 3 of [Regulation no. 314](#) (Dealing with problem debts).
  - (f) It is the responsibility of the internal audit or the credit control unit (as determined by the banking corporation) to examine the reliability of the credit rating among the population of borrowers not subject to examination by the credit control unit, as specified in [Regulation no. 319](#) (Loan review).

**Credit risks in derivative financial instruments** (2/97)

4. A banking corporation that engages in derivative financial instruments transactions on behalf of its customers, shall undertake the following examinations to ascertain whether the corporation manages the credit risks associated with those activities:
- (a) Have rules been determined for estimating the customer's credit exposure in each of the derivative financial instruments in which he operates?
  - (b) Has the banking corporation created automated tools that enable credit of this kind to be integrated in the customer's overall obligo, and enable his transactions to be monitored on an ongoing basis?
  - (c) Do the procedures for extending credit for derivative financial instruments activities refer specifically to the following subjects:
    - (1) The rates of collateral required from the customer against each kind of derivative financial instrument, and the conditions under which additional collateral will be required;
    - (2) Rules for dealing with deviant customers, including rules and conditions for closing a customer's position if necessary if he does not meet the requirement regarding collateral;
  - (d) Have areas of responsibility and credit authority been determined for this kind of activity, including the division of responsibility between the credit unit and the other departments? (The credit unit shall approve the customer's overall credit frameworks, which will also include the above credit,).

For the purposes of this section, "credit exposure" is the exposure of current and potential credit.

5. Repealed. (7/98)

## **APPENDIX B**

### **BASIC AUDIT SPECIFICATIONS FOR EXTENDING HOUSING LOANS**

#### **General**

Like all the other procedures, a banking corporation's credit procedures should be clear, binding, and approved by the appropriate authority within the banking corporation.

#### **Procedures for extending housing loans**

1. Do the banking corporation's procedures for extending housing loans specifically address the following subjects:
  - (a) The full order of actions required from each of the authorities involved in the process of extending the loan, with reference *inter alia* to the following topics:
    - (1) Credit requests - details of the material required of the recipient of a housing loan when submitting a request for credit;
    - (2) The way the completeness and reliability of the material submitted together with the credit request (reliability of documentation, reasonableness of the contract to purchase the apartment, etc.) should be examined;
    - (3) The restrictions for initial screening of persons requesting credit, such as age of borrower, history of returned checks, personal reliability, etc.;
    - (4) A detailed list of the assets that are worthy of financing (type of asset, location of asset, its physical condition, etc.) and the rate of financing extended for their purchase;
    - (5) A key for examining the repayment ability of borrowers and guarantors, including examination of matching the amount and loan duration to the borrower's and guarantors' needs and abilities.

- (6) The authority and methods for examining the borrower's portfolio after approval, and adherence to the requirements in the portfolio, including the legal aspects, before the loan is extended.
- (b) The treatment of the collateral shall include reference to the following subjects:
- (1) The way the rights of the banking corporation on all the assets whose purchase it finances are assured by law, taking the legal standing of these assets into account (e.g., whenever land rights are not recorded in the Land Registry Office a lien on the contractual rights in land should be registered with the Encumbrance Registrar);
  - (2) The way the value of the assets financed should be assessed;
  - (3) The tools and methods ensuring an adequate monitoring of loan portfolios in which the recording of the financing corporation's rights has not yet been completed in accordance with the law, with respect to the asset against which the loan has been extended;
  - (4) The borrower's life insurance policies;
  - (5) The insurance policy of the encumbered asset;
  - (6) The way other collateral, if received, is dealt with and monitored.

### **Borrower's portfolio**

2. Are there procedures specifying what documentation is required for a borrower's portfolio, at a minimum for the following subjects:
  - (a) A loan request containing all the borrower's basic identifying details;
  - (b) The loan agreements stamped and signed as required by law;
  - (c) Full details about the borrower's earnings capacity, and any other documentation from which it is possible to learn about his economic behavior;
  - (d) A detailed calculation of the borrower's repayment ability;
  - (e) Details according to a declaration by the borrower regarding his ownership of financial and physical assets;
  - (f) When a loan is extended to a self-employed individual, the type of information and

relevant documents should be specified;

- (g) When the borrower is defined as an employee of a business entity under his control, the information required about the employing entity should be specified;
- (h) Basic details about the guarantors.

### **Dealing with problem debts**

- 3. Do the procedures contain rules for dealing with problem debts, at a minimum regarding the following subjects:
  - (a) Identifying debts in arrears;
  - (b) Sending notices to the borrower and the guarantors;
  - (c) Taking legal steps to realize the collateral.

### **Database** (7/98)

- 4. Do the procedures contain directives for managing a computerized database of “housing loans”, including at a minimum the following items:
  - (a) Size of loan;
  - (b) Value of asset as of the day the loan was extended;
  - (c) Monthly repayments;
  - (d) Disposable monthly income as of the day the loan was extended;
  - (e) Geographical location of asset (city, street, house number, postal code);
  - (f) The way the loan is to be repaid (Spitzer repayment table, balloon, etc.);
  - (g) Type of loan (various categories of eligibility - young couples according to points accrued, new immigrants, supplementary, non-directed);
  - (h) Interest rate;
  - (i) Interest characteristics (fixed/variable rate);
  - (j) Original period to maturity;
  - (k) Period remaining to maturity;
  - (l) Average duration;
  - (m) Purpose of loan (residence, investment, other);
  - (n) Manner of registering the lien (land registry, warning note, rights, other);

- (o) Characteristics of asset (apartment, house, area in square meters)
- (p) Characteristics of borrower (employee/self-employed, profession, age);
- (q) Number of guarantors;
- (r) Extent of insurance policies (property, life);
- (s) Early repayment fee (liable/exempt);
- (t) Loan repayment (data on repayment of loan and arrears);
- (u) Weighting for purposes of minimum capital ratios (100%, 50%).

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[BACK](#)