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# Israel: Corporate Bond Purchase Program

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# Israel: Corporate Bond Purchase Program[1]

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**Abstract**

By March 2020, the quickly spreading novel coronavirus began disrupting business activity and industry, generating uncertainty throughout the global economy. As financial panic spread, Israeli investors fled to liquidity, impacting equities, corporate bonds, and even Israeli treasury securities. As short-term horizon mutual funds experienced high withdrawals in the first few weeks of March, they were forced to sell corporate bonds. This increase in supply pushed corporate bond prices down, and yields spiked. Between March and May, domestic rating agencies downgraded 23 companies (12% of all rated companies), and by July 2020, yields remained in the double-digits for 23% of corporate bonds. On July 6, 2020, the Bank of Israel (BoI) announced its intent to initiate secondary market purchases of NIS 15 billion in domestically issued corporate bonds rated A- and above that did not have an equity conversion option. The Corporate Bond Purchase Program (CBPP) began in late July 2020, and holdings leveled off at NIS 3.5 billion by November 2020. Following the CBPP's announcement, two major corporate bond indexes—the Tel Bond 60 index and the General Corporate Bond Index gained 2.6% and 2.5%, respectively.

**Keywords:** CBPP, corporate bonds, COVID-19, Israel, market liquidity

[1] This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering market support programs in response to COVID-19. Cases are available from the *Journal of Financial Crises* at https://elischolar.library.yale.edu/journal-of-financial-crises/.

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# Overview

By March 2020, the quickly spreading novel coronavirus began disrupting business activity and industry, generating uncertainty throughout the global economy. As financial panic spread, mutual funds fled to liquidity, selling equities and corporate bonds (BoI 2020j). The financial market reaction was "exceptionally quick and violent" and yields spiked on corporate bonds, particularly those issued by lower-rated companies (BoI 2020i). Bid-ask spreads on equities in broad indices (such as the Tel-Aviv 90 and Tel-Aviv 35 stock index) increased approximately 100%, while spreads on broad bond indices (Tel Bond 20 and Tel Bond 40) increased approximately 400% (BoI 2020i).

Between 2010 and 2020, the market value of Israeli corporate bonds had doubled to around NIS 340 billion.[3] Structural developments in the corporate bond market had exacerbated systemic risk; between 2008 and 2020, the share of marketable corporate bonds held by mutual funds increased from 12% to 33% (BoI 2020i) (See Figure 1).

Compared to the Global Financial Crisis of 2007-08, corporate bond ratings were high leading into March 2020: 67% of tradable bonds had high ratings (AAA-AA), 29% had medium ratings (A-BBB), and only 4.5% had low or no ratings (compared to 19% in 2007) (BoI 2020i). However, corporate bonds in Israel are rated by a local rating scale that differs from the international standard: a representative of the BoI indicated that an A- rating in Israel is equivalent to a BB- rating in the U.S.[4]

### Key Terms

Purpose: To "ensure the continued orderly functioning of the corporate bond market, and to strengthen the passthrough from monetary policy to the credit market, by reducing the interest rate at which companies issue credit in the capital market, and making additional sources of credit available for all industries" (BoI 2020h).

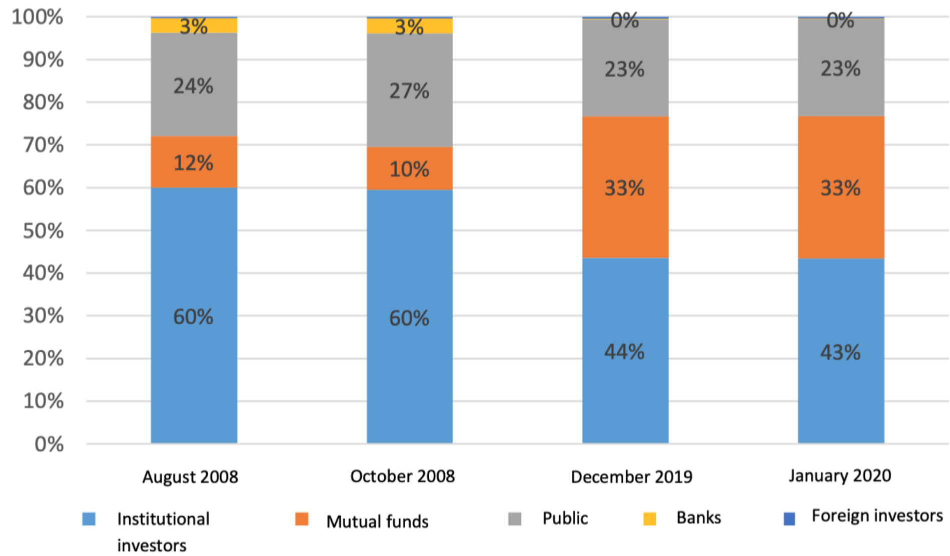
| | |
|---|---|
| Launch Dates: | Authorized: July 6, 2020<br>Announced: July 6, 2020 |
| Operational Date: | July 31, 2020 |
| End Date: | December 2021 |
| Legal Authority: | Bank of Israel Law of 2010, Section 36 |
| Source of Funding: | Bank of Israel balance sheet |
| Administrators: | Bank of Israel Markets Department/Trading Desk |
| Overall Size: | NIS 15 billion |
| Purchased Assets: | NIL-issued nonconvertible Israeli corporate bonds rated A- or above |
| Peak Utilization: | NIS 3.5 billion (USD 1.1 billion) |

[3] Exchange rate: 0.29 NIS/USD (BoI 2020b).

4 One of Israel's rating agencies describes an A rating as indicating that an obligation "somewhat more susceptible to the adverse effects of changes in circumstances...However, the obligor's capacity to meet its financial commitment on the obligation is still strong," which is consistent with A ratings in the U.S. (S&P Global

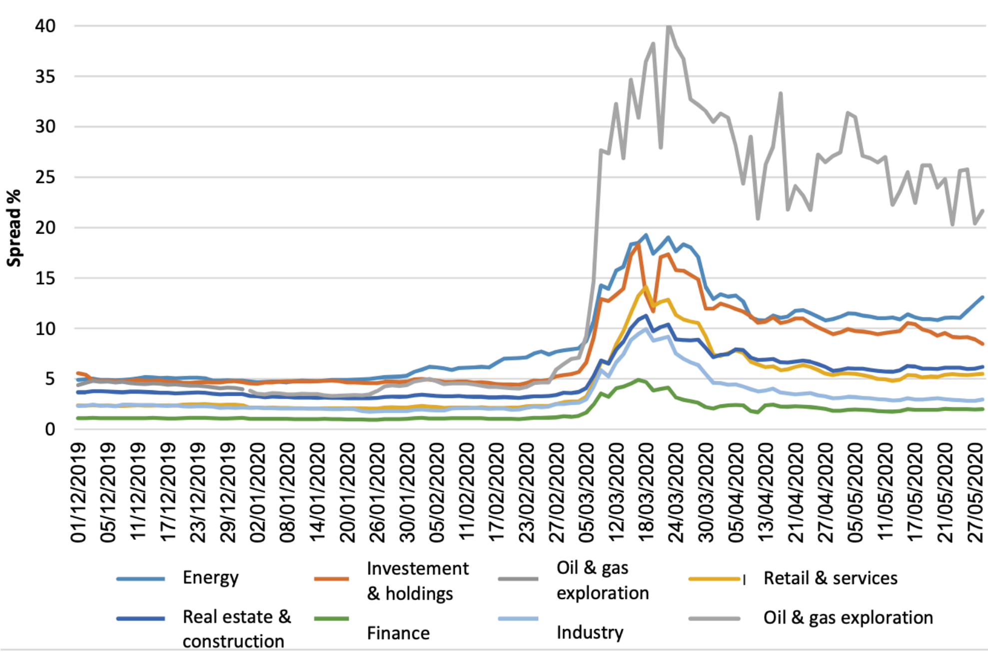
As the pandemic worsened between March and May, domestic rating agencies (Maalot, affiliated with S&P, and Midroog, affiliated with Moody's) downgraded 23 companies (12% of all rated companies), and by July 2020, the yield on bonds of 23% of companies were at double-digit levels (BoI 2020j; OECD 2011) (See Figure 2). Mutual funds sharply decreased their holdings of corporate bonds (See Figure 3).

**Figure 1: Breakdown of Corporate Bond Holders, 2008-2020**




*Source: BoI 2020i, 17.*

**Figure 2: Corporate Bond Spreads Over Comparable Maturity Government Bonds**

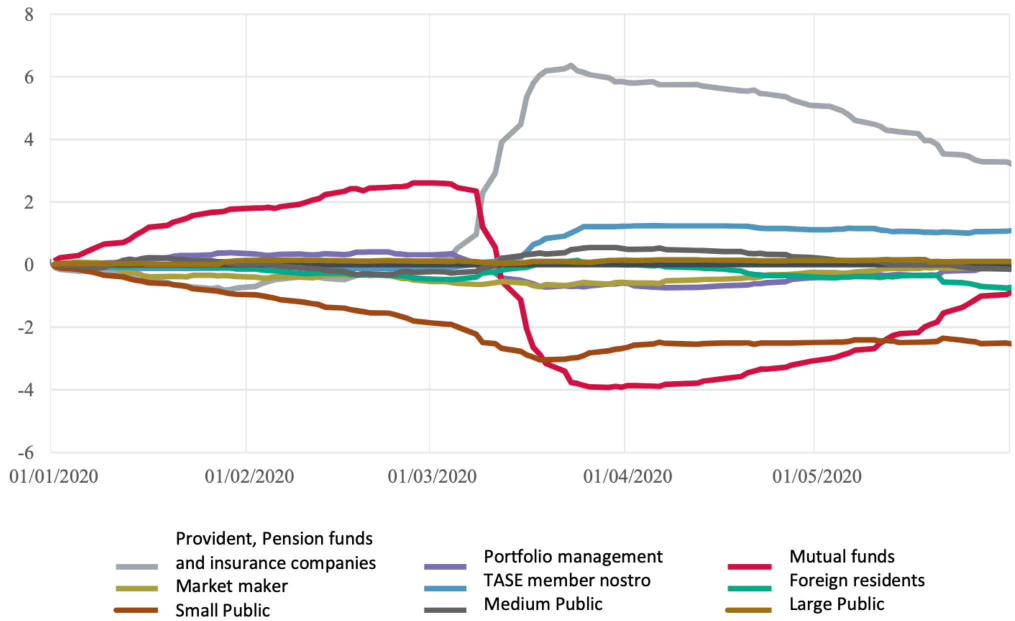



Ratings 2016). However, some research has found that domestic Israeli ratings agencies might give systemically high ratings (Machnes 2010).

Note: includes corporate bonds with remaining maturities of more than one year.

*Source: BoI 2020i, 11.*

**Figure 3: Aggregate Net Buys of Corporate Bonds, NIS billions, January–May 2020**




*Source: (BoI 2020i, 39).*

On March 18, 2020, the BoI indicated that it had "taken and [would] continue to use its policy tools to further support the Israeli economy" (Reuters Staff 2020).[5] On March 19, Deputy Governor Andrew Abir told reporters that if the BoI saw "a continuation of distress in the corporate market after the government's plan, then surely we should take into account the possibility of buying corporate bonds" (Pilot 2020). Between March and July, the BoI began purchasing government bonds, conducting repo operations, supplying credit to small businesses through banks, and conducting shekel/dollar swaps to increase dollar liquidity (BoI 2020d; BoI 2020g; BoI 2020e).

On July 6, 2020, the Bank of Israel announced its corporate bond purchase program, which would purchase corporate bonds rated A- and above on the secondary market (BoI 2020h). The BoI purchased domestically issued, fixed-rate bonds indexed to the shekel that were not convertible into equity (BoI 2020c). These criteria together covered 75% of the market value

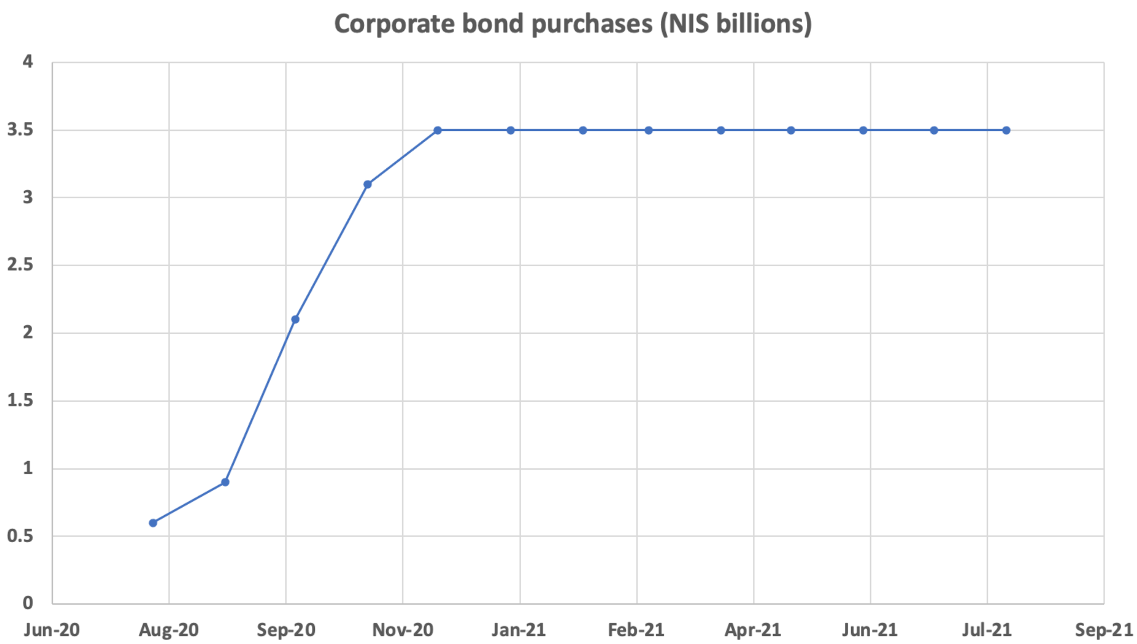
[5] The chief executive of the Israeli Association of Public Traded Companies, Ilan Flato, called on the Bank of Israel to "be the responsible adult and start intervening in the corporate bond and stock markets." Flato also emphasized that the "Bank of Israel buys foreign stocks and bonds every month and it's time to step in…and also support purchases in the local market" (Reuters Staff 2020). Throughout 2020, the BoI invested foreign exchange reserves in foreign equities and corporate bonds, a practice that began in 2012 following the adoption of the new Bank of Israel Law in 2010 (BoI 2012). As of the end of 2020, 15% of Israel's foreign exchange reserves were invested in foreign equities, 14% in spread assets, and 7% in corporate bonds (BoI 2021e).

for Israeli corporate bonds; the BoI said the breadth of these purchases would "ensure the continued orderly functioning of the corporate bond market" (BoI 2020h).

With nearly a quarter of the corporate bond market trading at double-digit yields in July 2020, the BoI intended its purchases to "[reduce] the interest rate at which companies issue credit in the capital market" (2020e) (BoI 2020j). The BoI used its corporate bond benchmark ("saman"), a broad-market target benchmark to inform its purchases (BoI 2020c).

Bond purchases began in July 2020. The BoI held NIS 3.5 billion by November 2020, when purchases stopped (See Figure 4). The program was active through December 2021, when the BoI announced that it would officially cease purchasing eligible assets (BoI 2021a). The BoI indicated that it would hold assets to maturity.

**Figure 4: Corporate Bond Purchases**




*Source: BoI 2021f.*

## Summary Evaluation

BoI reported on the positive announcement effects of CBPP in supporting the corporate bond market (BoI 2021c). Following the announcement on July 6, 2020, the Tel Bond 60 index (a broad corporate bond index) rose 2.6%, and the General Corporate Bond Index rose 2.5%. The Deputy Governor of the Bank of Israel, Andrew Abir, said the CBPP was effective in enabling companies to raise funds, citing "issuances of billions of shekels, particularly by nonfinancial companies, that were initiated in the days after our announcement" (Abir 2020). According to the Bank's 2020 *Financial Stability Report*, Israeli companies issued NIS 2.4 billion in debt in the week following the announcement. Most of those issuers were nonbanks. In comparison, Israeli companies raised NIS 7 billion in June 2020, but most issuers were banks (BoI 2020j).

| Context: Israel 2019–2020 | |
|---|---|
| **GDP**<br>**(SAAR, Nominal GDP in LCU converted to USD)** | $398.22 billion in 2019<br>$408.04 billion in 2020 |
| **GDP per capita**<br>**(SAAR, Nominal GDP in LCU converted to USD)** | $43,951.00 in 2019<br>$44,169.00 in 2020 |
| **Sovereign credit rating (five-year senior debt)** | Data for 2019:<br>Moody's: A1<br>S&P: AA-<br>Fitch: A+<br><br>Data for 2020:<br>Moody's: A1<br>S&P: AA-<br>Fitch: A+ |
| **Size of banking system** | $291.97 billion in 2019<br>$331.61 billion in 2020 |
| **Size of banking system as a percentage of GDP** | 73.32% in 2019<br>81.27% in 2020 |
| **Size of banking system as a percentage of financial system** | Data not available for 2019<br>Data not available for 2020 |
| **Five-bank concentration of banking system** | Data not available for 2019<br>Data not available for 2020 |
| **Foreign involvement in banking system** | Data not available for 2019<br>Data not available for 2020 |
| **Government ownership of banking system** | Data not available for 2019<br>Data not available for 2020 |
| **Existence of deposit insurance** | No in 2019<br>No in 2020 |
| *Sources: Bloomberg; FRED; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset.* | |

## Key Design Decisions

1. **Purpose: The Bank of Israel (BoI) stated that the purpose of the facility was to promote liquidity in the corporate bond market, strengthen monetary policy passthrough, and expand credit for all industries.**

The Bank of Israel (BoI) announced the CBPP in a July 6, 2020, press release, stating that the purpose of the facility was to "to ensure the continued orderly functioning of the corporate bond market, and to strengthen the passthrough from monetary policy to the credit market, by reducing the interest rate at which companies issue credit in the capital market, and making additional sources of credit available for all industries" (BoI 2020h). The BoI's Monetary Policy Report indicated that "even though there wasn't a market failure [in corporate bonds] at the time," the bond-purchasing program could usefully serve other goals including credit-easing and monetary policy passthrough (BoI 2021).

2. **Part of a Package: The program was announced alongside two additional Monetary Committee decisions.**

The CBPP was announced with two other Monetary Committee decisions that shared the goal of extending credit to corporations. The first decision expanded a program to provide 0.1% interest (the primary credit rate), three-year loans to banks, contingent on their extending credit to small businesses.[6] The program was first announced on April 6, 2020, and extended NIS 4.6 billion to banks through the end of May. The press release announced that it would continue the program indefinitely, with no limits on total program size. The second decision was to establish "an operational and legal infrastructure to enable banks to put up mortgage portfolios as collateral against credit" (BoI 2020h). By expanding collateral, the BoI hoped to enable "banks to extend credit under this plan at lower cost while maintaining high liquidity" (BoI 2020h).

Prior to July 6, the Bank of Israel announced a number of emergency measures to ensure market functioning:

- March 15: government bond purchases in the secondary market (BoI 2020d)
- March 15: repo transactions with government bonds as collateral (BoI 2020d)
- March 16/18: dollar/shekel swaps to provide dollar liquidity to the financial sector (BoI 2020e)
- March 23: NIS 50 billion Asset Purchase Program for government bonds (BoI 2020f)
- April 6: NIS 5 billion in 0.1% interest, three-year loans to banks, contingent on credit extensions to small businesses (extended indefinitely July 6) (BoI 2020g)

[6] Later, the BoI announced that it would provide loans at a negative interest rate (-0.1%) and set caps on the interest rates that banks could charge businesses (BoI 2021c, 4).

- April 6: acceptance of corporate bonds rated AA or higher in repo transactions (BoI 2020g)

**3. Legal Authority: Chapter 5, Section 36(2) of the Bank of Israel Law gives the BoI the authority to purchase securities consistent with its objectives.**

The BoI did not cite the legal authority upon which it relied for the CBPP. Chapter 5, section 36(2) of the Bank of Israel Law of 2010 specifies that to achieve its objectives the BoI may:

> Perform, on the stock exchange or in another regulated market or off-market, an action or transaction of any kind that is customary in the capital, money, and Foreign Currency markets, including in the derivatives' markets, all of which apply to securities, currency, gold, or any other asset or instrument as are customary in said markets. (Government of Israel 2010, chap. 5.36[2])

The BoI has three primary objectives, as specified by the Bank of Israel Law: (1) maintaining price stability; (2) supporting the "Government's economic policy, especially growth, employment, and reducing social gaps"; and (3) supporting financial stability (Government of Israel 2010, chap. 2.3). The corporate bond purchase program was perceived as an unconventional monetary instrument consistent with the BoI's objectives.

Parliament passed the Bank of Israel Law of 2010 to reform the relationship between the Government and the BoI by granting the bank more independence and legally solidifying its mandate of price stability. Efforts to strengthen the BoI's powers began in 1985, following a period of high inflation and a high degree of government involvement in the BoI's policies (Krampf 2015).

**4. Governance: The Monetary Policy Committee (MPC) authorized and specified key operational details of the program. The Governor was required to submit a report on the facility to an Advisory Council, including members of the public.**

The Monetary Policy Committee (MPC) within the BoI authorized the program and specified key details of its operation (BoI 2020h).

The Bank of Israel Law of 2010 sought to formalize the BoI's publication of data to increase transparency and accountability (OECD 2011). Section 55 of the Bank of Israel Law requires that the BoI publish a report on monetary policy, "price stability and economic developments" at least twice yearly (Government of Israel 2010, sec. 11.55). These reports were discussed by the Governor before the Knesset (Israel's parliamentary body) Finance Committee (Government of Israel 2010, sec. 11.55). The Bank of Israel Law also mandates that the BoI report twice a year on management of foreign exchange reserves to the Minister of Finance (OECD 2011). Section 57(g) of the Bank of Israel Law requires that the Financial Stability Committee report on emergent systemic risks to the Prime Minister and the Minister of Finance (Government of Israel 2010, sec. 57[g]). The BoI published financial stability reports for both the first and second half of 2020 (BoI 2020j; BoI 2021d).

The Governor of the BoI was additionally required to submit a report on programs related to monetary policy to the Advisory Council, a group made up of members of "banks, private sector, academic settings, the accounting profession, the Ministry of Finance, the Israel Security Authority (ISA), and the public" (OECD 2011).

**5. Administration: The BoI purchased corporate bonds directly and did not rely on a financial intermediary.**

The BoI purchased corporate bonds directly, and did not rely on a financial intermediary (BoI 2020c). The BoI's Market Department/Dealing Room staff executed purchases. The BoI purchased corporate bonds consistent with a broad portfolio of bonds, representative of the market at large (BoI 2020h). The Information and Statistics group within the BoI published corporate bond aggregates, by grouping marketable bonds by industry and rating (Bachar and Last 2019). The BoI created a specific, "tailor-made" benchmark for this program ("saman") (BoI 2020c).

The BoI did not rely on financial intermediaries to execute its corporate bond purchases (BoI 2020c).

**6. Communication: The Deputy Governor of the BoI communicated the goal of the CBPP to ease credit in the broad economy.**

On March 19, Deputy Governor Andrew Abir told reporters that if the BoI saw "a continuation of distress in the corporate market after the government's plan, then surely we should take into account the possibility of buying corporate bonds" (Pilot 2020). On March 18, 2020, the chief executive of the Israeli Association of Public Traded Companies, Ilan Flato, called on the Bank of Israel to "be the responsible adult and start intervening in the corporate bond and stock markets" (Reuters Staff 2020).[7] The BoI did not indicate that it would start buying corporate bonds on March 18, though it stated that it had "taken and [would] continue to use its policy tools to further support the Israeli economy" (Reuters Staff 2020).

On July 28, after the program's creation, the Deputy Governor of the Bank of Israel, Andrew Abir, articulated the goal of the CBPP at a Tel Aviv University conference:

> We decided on the program within the framework of the activities we are carrying out in order to ease the terms of credit in the economy. As such, the program is integrated with our other steps—reducing the interest rate, purchasing government bonds, the plan to increase the supply of credit to small businesses, which we decided to renew in view of the increased severity of the crisis, and in addition the corporate bond purchase program. These need to be seen as a range of steps, all of which are aimed at the same

[7] Flato also emphasized that the "Bank of Israel buys foreign stocks and bonds every month and it's time to step in…and also support purchases in the local market" (Reuters Staff 2020). Throughout 2020, the BoI invested foreign exchange reserves in foreign equities and corporate bonds, a practice that began in 2012 following the adoption of the new Bank of Israel Law in 2010 (BoI 2012). As of the end of 2020, 15% of Israel's foreign exchange reserves were invested in foreign equities, 14% in spread assets, and 7% in corporate bonds (BoI 2021e).

overall target. (Abir 2020)

In the annual report for 2020, the BoI explained that the goal of the program was “to assist in lowering the costs of financing to large businesses that raise credit in the capital market,” a slight departure from the program’s original purpose of helping monetary passthrough and improving market liquidity (BoI 2021c).

The BoI published aggregated data on corporate bond purchases once a month, as it did with its other COVID-19 programs, though it was not required to by legislation (BoI 2020c).

**7. Disclosure: On a voluntary basis, the BoI published monthly data on the program. Consistent with the Bank of Israel Law of 2010, the BoI published reports semi-annually, summarizing its operations.**

The BoI published aggregated corporate bond purchase data each month on its website (BoI 2021f). The BOI published its FX and other asset purchase operations monthly on a voluntary basis. The BoI additionally submitted reports semi-annually on monetary policy, foreign exchange reserve management, and systemic risk and financial stability.

**8. Use of SPV: N/A**

**9. Size: The BoI could purchase NIS 15 billion of eligible corporate bonds.**

The CBPP was authorized to purchase NIS 15 billion of eligible corporate bonds (BoI 2020h). Ultimately, the BoI purchased NIS 3.5 billion of eligible bonds (BoI 2021f).

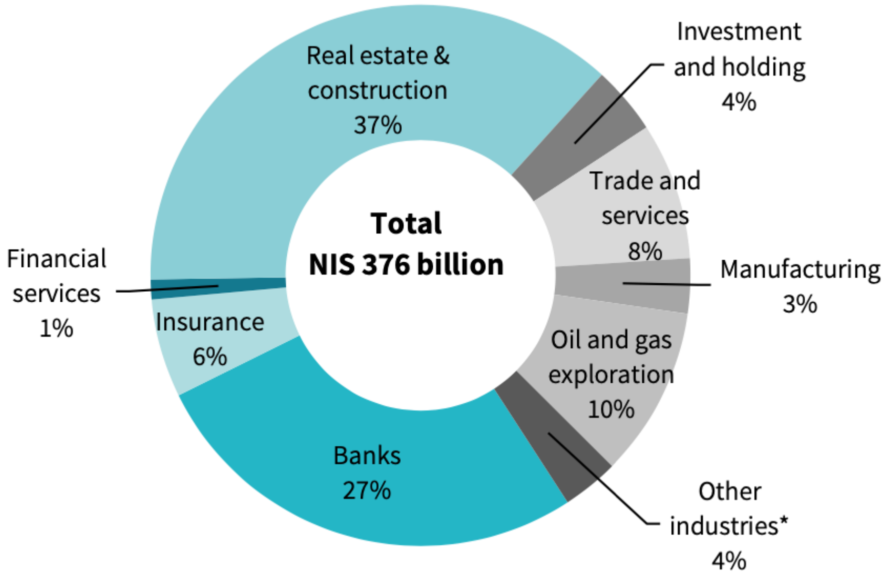
**10. Source of Funding: Purchases were funded through an expansion of the BoI’s balance sheet.**

Purchases were funded through an expansion of the BoI’s balance sheet (BoI 2020a). Prior to 2009, the BoI had a policy of sterilizing bond purchases by issuing one-year treasury securities (“makam”) so that the monetary base remained unchanged. After April 2009, the BoI reduced makam issuance and since then excess liquidity has been absorbed through increased bank deposits at the BoI (OECD 2011). In 2020 bank term deposits declined NIS 171 billion (BoI 2021c, 123). The BoI used NIS 33 billion in makam (BoI 2021c). In recent years, sterilization of FX and APP operations is done via deposits, while the stock of makam is relatively stable.

**11. Eligible Institutions: The CBPP only purchased bonds issued by Israeli companies.**

Only Israeli companies’ bonds were eligible for purchase through the program (BoI 2020h). Bonds rated A- and above were eligible for the facility, which as of December 31, 2019, encompassed 92% of the market, including both investment-grade and high-yield bonds (Bachar and Last 2019). As of year-end 2019, the majority (64%) of marketable corporate bonds came from the real estate and construction, and banking sectors (See Figure 5).

**Figure 5: Distribution of Market Value of Corporate Bonds, by Major TASE Sectors**




*Source: Bachar and Last 2019, 7.*

**12. Auction or Standing Facility: The BoI purchased bonds bond-by-bond on the stock exchange.**

According to a representative of the BoI, the Bank conducted purchases via the stock exchange throughout the trading day, purchasing bond-by-bond, and did not use passive instruments like ETFs.

**13. Loan or Purchase: The BoI purchased eligible corporate bonds in the secondary market.**

The BoI purchased corporate bonds in the secondary market (BoI 2020h).

**14. Eligible Assets: The BoI purchased NIL-issued, fixed-rate, nonconvertible Israeli corporate bonds rated A- or above.**

The BoI purchased only corporate bonds rated A- and above by the local ratings agencies (Midrog or Maalot), with maturities over six months (BoI 2020c). Israeli corporate bond ratings differ from international ratings: the program covered all investment grade and some high-yield bonds. Eligible bonds could not be issued by foreign companies and could not have an option to convert to shares (BoI 2020c). The BoI would not purchase contingent convertibles (CoCos), foreign currency denominated bonds, or non-fixed-rate bonds (BoI 2020c). The BoI said it would purchase bonds from insurance companies that constituted secondary or tertiary capital so long as the bonds were not convertible into shares (BoI 2020c). The BoI would not sell bonds that were downgraded after purchase (BoI 2020c).

These criteria covered 75% of the market value for Israeli corporate bonds (BoI 2020h). Approximately 92% of marketable bonds in March 2020 were rated A- and above (Bachar and Last 2019).

The BoI aimed to purchase a broad portfolio of bonds, representative of the market at large. To this end, the BoI constructed a marker ("saman"), or a benchmark, that had a sectoral breakdown that represented the distribution of the market, excluding debentures. The bonds in the marker changed over time, and the BoI published the marker characteristics (BoI 2020c).

15. **Purchase Price: N/A.**

16. **Haircuts: N/A.**

17. **Interest Rates: N/A.**

18. **Fees: N/A.**

19. **Term: N/A.**

20. **Other Eligibility Restrictions: N/A.**

21. **Regulatory Relief: N/A.**

22. **International Coordination: N/A.**

23. **Duration: The BoI stated that it would continue purchases under the program until market conditions improved. The BoI Indicated that it would hold purchased assets to maturity.**

In the BoI's questions-and-answers sheet published shortly after the decision, the BoI said that it would continue purchases depending on market conditions (BoI 2020c). Ultimately, it made purchases only between July 2020 and November 2020 (BoI 2021f). On November 22, 2021, the BoI stated in a press release that the program would be formally wound down by December 2021, though the bank would continue to hold assets to maturity (BoI 2021a).

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