



Report of the monetary discussion held at the Bank of Israel regarding management of the foreign exchange reserves Update of the realization rules during a passive breach of the investment guidelines.

The discussions were held on April 16, and 22, 2020.

Background:

Section 8 of the investment guidelines establishes that the Monetary Committee shall set the realization rules during a passive breach of the guidelines. The Monetary Committee determined that the Markets Department is to realize corporate bonds that have declined to below investment grade (IG), as established in the guidelines, to a rating below investment grade (HY)—Fallen Angels—within 30 days.

With the outbreak of the coronavirus crisis, the corporate sector in markets abroad endured an adverse impact as a result of the closure of services and facilities, a marked decrease in domestic and foreign demand, and a marked increase in corporate bond spreads (relative to government bonds) in financial markets abroad, preventing the possibility of rolling over debts in the capital market. The ratings companies began to examine the effect of the negative impact to economic activity on various sectors, and particularly noted the energy, cyclical consumption, transportation, and tourism sectors as those that are expected to be considerably adversely impacted by the crisis.

In light of the continuation of the coronavirus crisis, a trend, which is gathering strength, has begun recently of an increase in the number of issuers whose rating declined to below investment grade (HY)—Fallen Angels—whose bonds are included in the corporate portfolios and indices that serve as benchmarks for the reserves. This process is expected to intensify and focus primarily on companies rated BBB and on the most vulnerable sectors.

Many corporate-bond investors are forced to sell the bonds of Fallen Angels in a rapid realization process in line with investment rules or regulation that apply to them and thus strengthen the decline of corporate bond prices beyond the decline that should occur solely as a result of the rating downgrade.

In view of the continuing coronavirus crisis, and in order to balance the need to maintain adherence to the investment guidelines' limitations with the need to reduce losses from rapid realization during the crisis, the Markets Department recommended lengthening the realization period for corporate bonds that were downgraded to below investment grade, from 1 month to 3 months, with the condition that at any given time the value of the corporate bonds below investment grade does not exceed 5 percent of the total corporate bond portfolio. Lengthening the realization period will enable the Markets Department to manage the risk of rapid realization better and to realize the corporate bonds with optimal timing that will be determined based on an analysis of the robustness of the issuers, the development of the crisis, and market developments. This

is an accepted practice in the market and at times managers of investment grade corporate bonds hold a cushion of up to 5 percent of bonds rated below investment grade.

Discussion:

The Committee discussed the Department's recommendations.

Monetary Committee decisions:

The Monetary Committee accepted the recommendation to update the realization rules and to lengthen the realization period for corporate bonds whose rating declined to below investment grade, from 1 month to 3 months, with the condition that at any given time the value of corporate bonds whose rating declined to below investment grade does not exceed 5 percent of the total corporate bond portfolio value, A report on the issue is to be submitted to the Committee.

Participants:

Members of the Monetary Committee

Prof. Amir Yaron, Governor of the Bank of Israel and Monetary Committee Chairperson

Mr. Andrew Abir, Deputy Governor of the Bank of Israel

Prof. Reuben Gronau

Prof. Moshe Hazan

Prof. Zvi Hercowitz

Prof. Michel Strawczynski

Other participants

Mr. Tal Biber, Head of Markets Division in Markets Department

Mr. Mickey Blank, Markets Department (at the April 16th discussion)

Dr. Golan Benita, Chief of Staff to the Governor

Ms. Francoise Ben-Zur, Head of the Financial Division in Markets Department

Ms. Guenia de Mayo, Markets Department

Mr. Mark Yohai, Markets Department (at the April 16th discussion)

Mr. Dor Lev, Markets Department (at the April 16th discussion)

Mr. Roe Levy, Markets Department (at the April 16th discussion)

Mr. Arad May, Secretariat of the Monetary Committee and the Supervisory Council

Mr. Yoav Soffer, Monetary Policy Communication Consultant

Ms. Michal Sinai Livyatan, Legal Department

Ms. Esti Schwartz, Secretary of the Monetary Committee and the Supervisory Council