רשות ניירות ערך

ISRAEL SECURITIES AUTHORITY

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Staff Notice
Incentives to Encourage Reporting Entities' double credit rating

Background

The world is experiencing the significant macroeconomic implications stemming from the spread of the coronavirus in many countries across the world, including Israel ("the Coronavirus Crisis"). This crisis, and the restrictions on movement imposed by Israel and other countries in efforts to prevent the spread of the virus, have created enormous challenges for the economy, which are reflected in an unprecedented decline in both the level and pace of business activity. Israel and other countries have recently taken various steps to address the economic consequences of the Coronavirus Crisis, including interest cuts, government bond purchasing programs, grants, subsidized loans, tax relief, and other measures.

Recent weeks have been characterized by sharp movements in securities prices across the world's major exchanges, and on the Tel Aviv Stock Exchange, the prices of commodities and various risk assets are showing increasing volatility. In addition, we are seeing the beginning of a trend to downgrade bonds or suspend credit ratings, and it is reasonable to assume that this trend will continue in the near future in view of the implications of the developing crisis for real economic activity.

Double credit rating

Double credit rating has become common in many of the world's developed markets. Credit rating reports are occasionally issued by multiple rating agencies in response to demands of institutional or other investors, or at the initiative of issuers who believe that multiple ratings will expand their potential investor base. A study by ISA staff on North American and Western European issued bonds found that approximately 87%, in monetary terms, of all bonds issued, are rated by one of the three major rating agencies (S&P, Moody's, and Fitch), and 77% of the value of these series are rated by at least two of these three rating agencies.

In Israel, however, no significant market for double credit_rating has developed, and only few companies have adopted a double rating standard. For example, 46% of the monetary value of the bonds issued to the public have a double rating – yet these bonds were issued by a mere 15% of all reporting entities that issue bonds, and most belong to the financial sector (banks and insurance companies).

A double credit rating system has several advantages:

- Double credit rating provides accessible information and a second opinion on a company's financial position, and improves investment decision making and efficient pricing of the credit risks that bonds represent.
- Double credit rating offers two opinions based on different methodologies. For example, Midroog may rate bonds directly, using a local rating scale, while Ma'alot may first calculate a global rating scale, which it then converts to the local scale, using the conversion table published on Ma'alot's website.[1]
- A credit downgrade by one of the two rating agencies constitutes a warning indication that informs investors' decision making. This information is of increased importance during a capital market crisis, and specifically during periods of significant uncertainty in the capital market.
- Double credit rating reduces concerns of the inherent conflict of interest that accompanies ratings shopping, taking into account the terms of the agreements between rated and rating agencies. It also improves price discovery in markets, especially in the Israeli debt market that is characterized by continuous trading.[2]
- In Israel, investors' reliance on credit ratings has a significant impact on the design of deeds of trust with respect to stress events, including financial covenants and terms for demanding immediate repayment based on changes in a bond's credit rating. Therefore, defining adequate protective mechanisms in deeds of trust, including a double rating requirement, should improve investors' positions.
- Encourage competition in the rating market - markets that established a multiple rating regime have created business environments that encourage additional rating agencies to assess the economic feasibility of operations in the target market.

Double credit rating may, however, have shortcomings, mainly in terms of the added costs to which corporations may be subject, and in view of the current rating market in Israel, which comprises only two rating agencies. Double credit rating may also create subpar activity of the rating companies because in a double credit rating system, ratings of two companies will typically be identical or will differ by no more than one notch.

[1] According to the conversion table, the global rating of A- is equivalent to the highest local rating of ilAAA.
[2] In contrast to OTC transactions among institutional investors, as is the case in the majority of the developed bond markets across the globe.

In considering the totality of the aforementioned factors, the ISA is encouraging the reporting entities as well as the institutional investors (including mutual funds under the ISA's supervision) to prefer double credit rating for their bond series. Double credit rating will not only extend the information available to investors, it will also serve as decision-supporting tools to assess companies' creditworthiness and default probabilities, and the risk of investing in their bonds.

It is clearly of importance that such double credit rating be maintained over the entire life of a bond. Investors can ensure that this is the case through their formative influence on trust deeds.

The ISA recently published a series of documents on hybrid bonds and securitized debt instruments, and illustrated the enormous importance of double credit rating at issuance.

To encourage the market to expand its use of double credit ratings, the ISA is offering several incentives to entities that choose double credit rating rather than a single credit rating. These incentives will allow the entities to simplify and streamline capital raising procedures, reduce their regulatory costs, and shorten their time-to-market.

Incentives to encourage double credit rating:

1. Extension of timelines for filing a prospectus: Entities with double credit rating may file an application to publish a prospectus 45 days before the end of a quarter, in lieu of 60 days prior to the end of a quarter, which gives these entities an additional 15 days to prepare for the prospectus filing compared to other entities.
2. Reduced review time for prospectuses/shelf offer reports: Shelf prospectuses, issue prospectuses, and shelf offers of entities with double credit rating will undergo an expedited review procedure that includes a fast track timetable and rapid review of the professional issues in the prospectus by ISA staff.
3. Shortened timetables for public tenders - If an entity files an application to reduce the interval to its public tender, its double credit rating status will be taken into consideration in determining these timetables.

The ISA stresses that in the decision to invest in a company, a double credit rating is not a substitute for the comprehensive analysis of all the information that an entity makes available.

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