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28 Adar 5780

March 24, 2020

To: Eli Bavli, Chairman of the Association of Mutual Fund Managers

By email

RE: **Temporary abstention of enforcement measures due to a deviation from the value listed for trading as the result of a bond buyback**

In the inquiry of the Association dated March 15th 2020, we were requested to refrain from taking enforcement measures with regard to the value listed for trading bonds held by a fund (hereafter: permitted rates), as a result of the buyback of bonds and a deviation from the value listed for trading, which is in violation of Regulations 6(a1) and 6(b1) of the Joint Investment Trust Regulations (Assets that May Be Purchased and Held by a Fund and their Maximum rates) 5755-1994 (hereafter: Asset Regulations).

The background to the request

The world is currently experiencing an event with macroeconomic implications which is the result of the spread of the COVID-19 virus in many countries throughout the world. The State of Israel is taking significant and unprecedented steps as a result of this event in an attempt to stop the spread of the virus, as in other countries.

Recent weeks have been characterized by sharp declines in the prices of securities in many of the leading stock exchanges around the world, including the Tel Aviv Stock Exchange, accompanied by an increase in volatility in the prices of commodities and various risk assets. The mutual funds industry is experiencing exceptionally large volume of redemptions, on a scale that has not been seen in the past, even in previous crises. Furthermore and in view of the trend in the market, the funds' assets are suffering declines in value.

Reasons for the request

Regulations 6(a1) and 6(b1) of the Asset Regulations allow the purchase of bonds up to a maximal rate of their value listed for trading. Currently, in view of the event affecting the market, many companies that have issued bonds are in the process of analyzing the event. According to past experience (such a phenomenon also occurred during the crisis in the markets in 2008), we are

seeing that in periods of crisis some of the companies can be expected to formulate plans for the buyback of their bonds, which is motivated by the desire to exploit the low prices at which their bonds are traded.

Such an action will lead to the reduction in the capital listed for trading of those bonds. As a result of the buyback, and in view of the restrictions regarding the permitted rates, fund managers may be forced to sell part of their holdings in the bonds in which a buyback was carried out—not based on investment criteria—and sometimes based on prices that are significantly lower than those that are likely to prevail on the conclusion of the event, which is liable to cause a loss to the holders of the fund units.

We would mention that similar requests were submitted to the ISA in the past and the the ISA staff granted those requests for the reasons listed in this document and in the ISA staff positions that were issued.^{1 2 3 4}

ISA staff position

The ISA staff has decided to grant the request of the Association at this time for the reasons listed above and will refrain from proceedings due to a deviation from the maximum proportion permitted, subject to the following conditions:

- a. The value of the bond that is held by the fund will not exceed twenty-five percent of the value listed for trading of that bond.
- b. The value of the bond held by funds that are not tracker funds and are managed by a fund manager will not exceed fifty percent of the value listed for trading of that bond.
- c. The deviation from the permitted rates created passively, as a result of the reduction in the value listed for trading due to the buyback of the bonds by the issuing company, and from the moment it is created and as long as it exists, the fund manager will not take any action that is liable to increase the deviation, including the purchase of bonds from that same series.
- d. The fund's managing board of directors will receive all of the information required concerning the deviation that has been created, will discuss it and will decide whether the fund manager will be permitted to maintain such a deviation and whether in practice it is necessary.
- e. The trustee of the fund will ensure that the decision was made according to the aforementioned and will verify that the fund manager acted as required.
- f. The fund manager will submit a public report on the change in the percentage of the held bond within the value listed for trading, as a result of the buyback of the bonds (by means of form k-123) and will list all of the circumstances required in this matter, including the approval of the holding by the board of directors and the trustee, the details of the buyback, the value of the security held and its percentage within the value of the fund's assets.

¹ http://www.isa.gov.il/Download/IsaFile_4455.pdf

² http://www.isa.gov.il/Download/IsaFile_5931.pdf

³ http://www.isa.gov.il/Download/IsaFile_6951.pdf

⁴ http://www.isa.gov.il/Download/IsaFile_7186.pdf

Without detracting from the aforementioned, fund managers are of course required to continue to be particularly vigilant with regard to the risks implicit in the activity of the funds under their management and also to make every effort to comply with the instructions of the law and to minimize to whatever extent possible these deviations from the restrictions established by the law.

This position will remain valid for a period of three months from the date of its publication and its extension will be considered from time to time according to the circumstances.

This position is based on the facts and evidence presented in your request and on the assumption that your request includes all of the details and data required to respond to the question you submitted. Any change in the facts or circumstances submitted to us may lead to a different conclusion with respect to the question submitted.

This letter expresses the position of the ISA staff regarding enforcement activity and is not intended to express any other conclusion or legal position regarding the question presented to us. The position of the ISA does not constitute any defense for the inquirer or a third party that relies on its decision in response to legal exposures that are liable to arise and including claims made by third parties or decisions of the courts that are not in alignment with the decision of the ISA.

In addition, we hereby inform you that according to the procedure for dealing with pre-ruling inquiries made to the ISA (published on the site of the ISA in June 2008), this pre-ruling inquiry and the response may be published on the ISA site.

Yours sincerely

Maya Gerti Gilboa
Legal Counsel
Unit for Supervision of Mutual Funds