



Forex Israel



Tel Aviv Stock Exchange



Bank of Israel

December 26, 2011

Minutes of the Telbor Committee meeting held on November 22, 2011

Present

Committee members: Sharon Lavi, Harel Cordova, Ketty Cohen, and Roy Stein

Guests: Michal Rot-Levy, Liraz Refaely, Guy Fischer, Saar Weintraub, Ofer Fox, Yishai Shalev, Eina Kornfeld (joined late)

1. Ms. Ketty Cohen replaced Guenia de Mayo as the representative of the Bank of Israel's Market Operations Department. Good luck to both.
2. Roy Stein updated those present on the deliberations of Bank of Israel management and the Ministry of Finance regarding the preferred entity to be responsible, in the long term, for the Telbor market. The Telbor market is currently at a critical point regarding its continued design and development. Roy mentioned favorably the tremendous development in the market in recent years—the volume of transactions in interest rate contracts based on the Telbor rate increased, and is currently at billions of shekels and allows effective management of interest rate risk. However it should be noted that this market is not yet based on "real money"—inter-bank loans and deposits. Against the background of these updates, a discussion of several significant issues took place. The following are the main points that were raised.

Participants noted the great importance of the composition of the committee, which includes representatives of contributor banks as well as other entities involved in the market, and especially noted the importance of the involvement of the Bank of Israel in advancing and developing the Telbor market. The accumulating confidence in the quality of the Telbor fixing based on the quotations relies on, among other things, the composition of the committee and its chairperson.

In that regard it was emphasized that the entity responsible for Libor interest rates—BBA-Libor—advises the central bank on a regular basis, especially ahead of planned decisions in general rules and definitions. As such it is appropriate that the Bank continue to take an active role in the market's design.

It was also noted that there is no concern that the Telbor Committee, or any other entity put in charge of the Telbor market, will influence the fixing. This is because the role of the committee is only to confirm that the market is operating properly, to identify problems in the market and provide appropriate solutions to them, so that this market continues to develop and become more sophisticated.

In times of crisis, during which there are liable to be too few quotations by contributor banks, although the interest rate is not set automatically, committee members do not present an opinion about it; on such days, it is set at the rate it was set at on the previous day, with no change. For an analysis of potential market failure events and possible responses at BBA-Libor, please see Appendix 1. The Telbor Committee will adopt these rules formally, with certain adjustments, and by the next regular meeting the new rules will be presented in the rules and definitions document.

3. Sharon Lavi of the Tel Aviv Stock Exchange (TASE) noted that the TASE will examine the possibility of issuing interest rate contracts during the course of 2012. If the stock exchange determines that investors, institutional investors, and major market participants

ascribe great importance to these tradable contracts, it will act to advance the issue in line with market demand and need.

4. Harel Cordova and other participants said that in their opinion it is important that the TASE examine the issue of Telbor-based interest rate contracts as soon as possible, especially in light of figures showing the volume of transactions which were sent to the committee by the contributor banks; these show that the trading volume in FRA carried out by customers (not just banks) increased significantly in 2011.
5. In the opinion of most participants, issuing floating rate government bonds indexed to the Telbor rates is expected to advance the inter-bank interest rate market in Israel—essentially a quantum leap forward with regard to awareness by institutional investors and the public at large. In addition, it is assessed that the issuance of government bonds indexed to the Telbor rate will create conditions which will make it easier for bank customers to benefit from credit and deposit facilities for extended periods of time at an interest rate based on the Telbor rate, as well as from a range of opportunities to hedge against volatility in the interest rate market. It was also discussed that when the Ministry of Finance issues Telbor-indexed floating rate bonds, institutional investors will seek an appropriate—tradable—instrument to manage credit risks, such as the tradable contracts that the TASE plans to issue. As such, it is important that the TASE and Ministry of Finance advance the issuance of assets linked to the Telbor interest rate, through cooperation between themselves and coordination of timeframes.
6. A decision was reached regarding the dates in 2012 on which the Telbor interest rate will not be fixed, as a one-time occurrence:
 - a. January 2 (Monday): Due to a postponement by one day of New Year's Day commemoration which usually falls on January 1. The day is not a business day in any major market.
 - b. May 28: According to regulations, the Telbor interest rate is not to be published on the final Monday in May, since generally that is Memorial Day in the US and Spring Bank Holiday in the UK. However, in 2012, in honor of the celebrations of the 60th year of Queen Elizabeth's reign, which will be celebrated with a special holiday on June 5, the Spring Bank Holiday in England was postponed from May 28 to June 4. However, in future years, it will return to be marked on the last Monday in May (as our examination of the issue showed). For the sake of consistency, it was nonetheless decided that this year as well, the Telbor interest rate will not be set on May 28, even if banks in the UK will be open, and will only be closed in the US.

The list of all dates in 2012 when the Telbor interest rate will not be set is included as Appendix 2.
7. In continuation of discussions that were held in recent meetings of the committee, regarding increasing the size of commitments for derivative transactions—OIS, FRA, and IRS—the current meeting established the following regulations: (1) Increase the commitments to NIS 50 million for IRS transactions and to NIS 100 million for FRA and OIS transactions. (2) Contributor banks commit to conclude up to three transactions with one of the other contributor banks, provided there is the opportunity to change quotes between transactions. If the total number of transaction requests received by a contributor bank exceeds ten in one day, the contributor bank then is not obligated to accept further requests for transactions.¹ In line with that, a change will be made in section 4.3.5 of the document which gathers together the definitions and general rules set by the committee. The new version will state, "The contributor bank's commitment is to carry out up to three transactions with another contributor bank which asks to carry out a

¹ This limitation was added after the meeting, following objections from some contributor banks.

transaction with it. A contributor bank is not committed to conclude transactions on any day in which it already carried out ten transactions within its commitment." It should be emphasized that the goal of these commitments is to provide an incentive to the contributor banks to quote interest rates based only on appropriate considerations, without attempts to influence the Telbor interest rates based on considerations of their positions. With that, the commitment to carry out transactions was not intended to serve as an instrument to create liquidity. Related to that, members of the committee request to remind the contributor banks that if they have difficulty in carrying out transactions with other contributor banks at interest rates quoted by the latter, they have the option of submitting a letter of complaint to the committee.

Based on the definitions and general rules according to which the committee operates, these decisions will come into effect within 30 days—at the beginning of January 2012.

8. Representatives of the contributor banks requested to submit a request to the Banking Supervision Department—that it consider the cancellation of the reserve requirement for contributor banks if they borrow from foreign contributor banks (Deutsche Bank and Barclays), under the framework of commitments set by the Telbor interest rate committee. The local banks will be able to mark these transactions as transactions between contributor banks, and thus remove the market constraints stemming from the reserve requirement of banks vis-à-vis their customers. This easing by the Banking Supervision Department will lead other foreign banks to enter the Telbor market, which will contribute to its development.

**Record of Roy Stein meeting with BBA-Libor representative John Ewan
London, November 3, 2011**

In early November I met with the BBA-Libor² representative in London, in order to discuss several important issues related to the Telbor market, Israel's version of the Libor market. The Libor rate, which serves as a reference point for bank loans and deposits and various other products, is fixed based on quotes by several banks (herein, "the contributor banks"). Interest rate derivative instruments have been developed around this market, and bonds are issued at floating rates. We note that in Israel there are nearly no inter-bank loans or deposits of more than one business day, and the only activity which is based on longer term (up to a year) Telbor rates is interest rate derivative contract transactions. In order to provide an incentive for banks quoting the Telbor rate to act with commitment and transparency, a committee for establishing the Telbor market was set up, which set general rules and definitions, as well as the commitment to carry out transactions at the interest rates quoted by the contributor banks. In contrast, in the Libor market no commitment to conclude transactions based on the quotes was set, because this market is based (at least until the crisis broke out) on real money—bilateral transactions for interbank loans and deposits. On the basis of the significant decline in inter-bank loan volume, which has been ongoing since the recent crisis, BBA-Libor's management is considering how to increase the credibility of this market, even including setting a commitment to ask for transactions at the interest rates quoted by the contributor banks—transactions involving the actual asset, (not derivatives).³

The volume of transactions in Telbor interest rate contracts increased in recent years, and today reaches billions of shekels. This developed interest rate derivative market allows efficient management of interest rate risks, even though it still is not based on real money—two sided transactions for interbank loans and deposits. In addition, it appears that the Ministry of Finance and Tel Aviv Stock Exchange (TASE) are interested in changing the terms of floating rate government bonds and of short term interest rate futures contracts and to create products based on the Telbor interest rate, which are more attractive—as is accepted in developed markets. The Telbor market is thus today at a critical point in its development and design. The members of the Telbor Committee will continue to act with dedication and the appropriate care for the continued establishment of the Telbor market. I note that the John Ewan was very impressed both by the work of the committee for the advancement and development of the Telbor and by the readiness of the contributor banks to carry out binding transactions in order to increase the credibility.

Following are several issues that were raised in the meeting:

1. Agreement—there is an agreement between the BBA-Libor and each one of the contributor banks. The agreement is based on a request letter (signed by each of the banks) in which the bank declares its readiness to adopt the general rules and definitions set by the organization (similar to the letter committee asked the banks to sign in the

² BBA-Libor is a subsidiary of the BBA organization, with a separate member of management. This separation was carried out several years ago in order to prevent the possibility for conflict of interest between the good of the banks and the good of the public and other investors who are active in the Libor market.

³ The Telbor committee rates the contributor banks based on their volume of transactions in interest rate derivatives, while BBA-Libor rates contributor banks based on volume of loans/deposits that they carry out in the relevant period, and one-fifth of interest rate swap transactions—between domestic interest rates and foreign interest rates.

beginning of the process). It is important to note that the contributor banks are not formally required to contribute their quotes. With that, if a specific bank decides not to quote, the organization can remove it from the list of contributor banks. In this case it is plausible that the report of the removal of that bank from the list of contributor banks will be seen as a negative occurrence, which will greatly impact the bank in other areas of activity as well.

2. If there are less than five contributor banks which quote an interest rate, there is no automatic setting of the interest rate (similar to the Telbor interest rate committee decision); it was decided that Libor interest rates for that day will be identical to those that were set the day before. As part of our discussion on the possible effects of this decision, Mr. Ewan analyzed possible scenarios under this situation:
 - a. A serious market failure, across various markets: In this case, it is plausible that the central bank will declare a vacation day, in which there will be no trading in financial assets, and may not even be considered a business day. Events such as this are liable to occur during periods of war, plague, natural disasters, and obviously terror attacks, such as the World Trade Center disaster, following which the Federal Reserve announced several days off in the US. Based on rules of the ISDA others, the transaction should be priced according to the last published interest rate.
 - b. A market failure connected with only the Libor market: This case is not at all likely, in his opinion, since he cannot imagine reasons for it to happen. If, nonetheless, such a scenario would occur, the BBA-Libor has decided that interest rates will remain as they were beforehand.
3. The decision-making process: BBA-Libor does not hold open-door meetings (such as Telbor Committee meetings), and thus does not make decisions based on a vote by contributor banks. He claims that each contributor bank has narrow interests in specific decisions, and there would be as many opinions expressed as there would be participants. The decision making process is internal, but with consultation both with central banks and with contributor banks. Consultation meetings are personal and not publicized. At the end of the process, BBA-Libor notifies the contributor banks of the changes made, and grants a limited time for their official response.
4. BBA-Libor considerations for adding the shekel to the Libor market: The main consideration is if the underlying asset has enough transaction volume, that is, interbank loans and deposits, for the market to be attractive enough and interest investors. If there are no transactions in the underlying asset, such as is the case with the Israeli market, there is no possibility of adding the currency, since it is impossible to extend to that currency the same general rules that were set for other currencies. With that, BBA-Libor provides consultants for committees and organizations who deal with inter-bank interest rates in various countries. The organization will continue to study the Telbor market, and it is likely that by the end of the year they will present the Telbor Committee a proposal for serving as consultants.

Appendix 2

Dates in 2012 on which the Telbor rate will not be set, in addition to Saturdays and Sundays

Date		Hebrew Date		Day of week	Observance
Date	Month	Date	Month		
2	January	7	Tevet	Monday	Overseas holiday
8	March	14	Adar	Thursday	Purim (outside Jerusalem)
13	April	21	Nissan	Friday	Last day of Passover
26	April	4	Iyar	Thursday	Independence Day
28	May	7	Sivan	Monday	Overseas holiday
17	September	1	Tishrei	Monday	Rosh Hashana (1 st day)
18	September	2	Tishrei	Tuesday	Rosh Hashana (2 nd day)
25	September	9	Tishrei	Tuesday	Yom Kippur eve
26	September	10	Tishrei	Wednesday	Yom Kippur
1	October	15	Tishrei	Monday	Sucot
8	October	22	Tishrei	Monday	Shemini Atzeret
25	December	12	Tevet	Tuesday	Overseas holiday
26	December	13	Tevet	Wednesday	Overseas holiday

January 2 (Monday): According to the general rules, the Telbor interest rate is not published on January 1. In 2012, January 1 falls out on Sunday, and January 2 is not a business day in any market which generally closes on January 1.

May 28: According to regulations, the Telbor interest rate is not to be published on the final Monday in May, since generally that is Memorial Day in the US and Spring Bank Holiday in the UK. However, in 2012, in honor of the celebrations of the 60th year of Queen Elizabeth's reign, which will be celebrated with a special holiday on June 5, the Spring Bank Holiday in England was postponed, for this year only, from May 28 to June 4. We examined the issue and confirmed that in future years it will return to be marked on the last Monday in May.