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Israel Bonds: A strategic asset for the country

By ISRAEL TAPOOHI

For Israel to have the support of Israel Bonds – a dedicated, independent financial pipeline – is without a doubt an invaluable and strategic national resource.

When I made the decision to leave Israel's private sector to serve as president and CEO of Israel Bonds, I came to an organization widely recognized – from ratings agencies to the Bank of Israel – as an important factor in building Israel's economy.

Since starting at Bonds late last year, I have become increasingly aware of its continued relevance as a vital, indispensable asset for Israel's economy, particularly in light of continued geopolitical uncertainty in the Middle East and fiscal difficulties plaguing many euro zone countries.

Indeed, if Greece, Italy, Spain and other failing eurozone countries had a dependable, proactive asset like Israel Bonds – with approximately $1.2 billion in annual worldwide sales – they would be better positioned to work their way out of their economic problems, as they could turn to a strategic support network providing the advantages of a large client base and considerably lower borrowing costs. This is why the Bonds story – with over $34b. in total worldwide sales – has generated queries from other countries, as well as the World Bank, seeking to replicate the Israel Bonds business model.

There are myriad reasons for the importance of the Bonds organization. First, when the Israel Treasury issues bonds on the overseas public market, such as Yankee Bonds, they are often long bonds with 10-year maturities. The Treasury endeavors not to raise funds more than once a year in order to maintain financial credibility with the market and rating agencies. Securities offered by Israel Bonds, on the other hand, complement Treasury-issued bonds by including short and medium-term maturities.

These instruments take advantage of the low rates prevalent in the current economic climate, with a resultant interest rate differential against government long bonds of approximately 2.75 percent – an annual savings of approximately $80 million on a comparable $3b. Israeli government bond issue – a major benefit to the Israeli economy.

Furthermore, when compared to the Israeli public market, Israel bonds are sold at rates that are extremely competitive and cost-effective. For example, a 3-year bond sold at 1.24% is more than 1% less than what Israel's Treasury offers in the Israeli public market. (The higher Israeli domestic rate is a hedge against possible future inflation and exchange rate differentials.)

Additionally, upon maturity, there is no exchange rate risk to the Israeli economy, as Israel bonds are purchased primarily in dollars and repaid from dollar sales proceeds.

However, even though the State of Israel is successfully utilizing public markets for debt financing, it almost certainly would not be able to rely solely on capital markets in times of economic or security challenge. Under either of those circumstances, it is more than likely Israel's credit rating would drop, and, consequently, the cost of financing would become excessive.

In terms of international financial assistance during a crisis, there is only one country Israel could truly rely on, and that is the United States. Nonetheless, its current economic difficulties and debt burden would make it challenging for the US to reinstitute a significant civilian aid program for Israel.

Consequently, the large, diverse Israel Bonds client base represents a significant, truly irreplaceable asset even the largest financial services and technology companies would envy. Were the State of Israel not to have access to this sizeable client base and subsequently need to reestablish it, the cost of necessary interim credit lines from commercial banks would be quite substantial, and these credit lines would most likely become unavailable in times of crisis.

The operational costs of the worldwide Israel Bonds organization – approximately 3% of bonds sold – compare favorably when measured against any attempt to replace the Bonds retail operation. Whether through its own efforts or via an independent brokerage firm, the Israeli government would incur major expenses that would include not only the direct expenditure of the Israel Treasury's capital-raising department domestically and abroad, but also underwriting fees paid to investment banks, the costs of maintaining a large retail client base and the loss of the more favorable Israel Bonds rate differential.

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Moreover, the Bonds enterprise is comprised of a professional team with a unique skill set. Similar to the staff of leading financial firms, yet far more cost-effective, Israel Bonds' human capital is a valuable resource for the organization. This is particularly true in times of crisis. Losing the Bonds sales and management team and then attempting to re-create it during a national emergency would take at least 18 months due to financial industry regulations and required examinations. Obviously, the idea of Israel trying to weather an economic and security crisis for 18 months is inconceivable.

Complementing the Bonds professional team is its lay leadership, which, through extensive networking, volunteer work and valuable introductions, has facilitated numerous accomplishments for the organization.

The effective Bonds network is augmented by highprofile institutional investors – states, municipalities, financial institutions, universities and more – who offer the added value of opening doors for the sale of Israel's public instruments, as well as corporate IPOs and secondary issuance on Wall Street. The immediate name recognition of these investors provides confidence for our retail clients, and the assurance they are acquiring a wise investment.

Israel Bonds also allows its retail clients – the individuals and Jewish organizations comprising approximately 75% of worldwide annual sales – greater ease of access when purchasing bonds than is typically offered by the capital bond market, and Israel bonds can now be purchased online.

The Bonds e-commerce site has been exceptionally successful since its fall 2011 launching, with online sales currently exceeding $13m., comprising more than 3,600 purchasers. The organization's proactive use of new technologies proves today's Israel Bonds is clearly not "your grandfather's Israel Bonds."

The success of online sales, coupled with the fact that 2012 sales remain strong, demonstrates that during tough economic times, when it is becoming increasingly difficult to find reliable financial instruments that preserve capital and pay a competitive return, Israel bonds are a sound, dependable investment – a far cry from the outdated misconception of Israel bonds as "charity." Investors of every kind value that Israel has never defaulted on payment of principal or interest on Israel bonds, a clear indication of the strength and resilience of the nation's economy.

So does Israel really require a free-standing organization like Israel Bonds when its debt can be raised in the public markets? The above facts prove the answer remains an emphatic "yes."

For Israel to have the support of Israel Bonds – a dedicated, independent financial pipeline – is without a doubt an invaluable and strategic national resource, especially since only Bonds clients have proven time and again that when Israel is in the midst of a crisis, they do not walk away.

The writer is president and CEO of the Development Corporation for Israel/Israel Bonds.