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International Briefings

Israel

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THE SECURITIES LAW (REGULATING THE ACTIVITIES OF BROKER DEALERS) BILL, 5720-2020

Unlike most Western countries (eg the UK, US, EU, Switzerland, Australia, New Zealand and Canada) where brokerage activity is statutorily supervised and regulated, Israel has to date not enacted dedicated legislation or promulgated comprehensive bespoke regulation of this area.

Broker-dealer activity is partially regulated in Israel, on the basis of several different laws. The primary piece of legislation is the Securities Law 5728-1968 (Securities Law) – which is the most significant legislation that regulates the securities market in Israel. This law empowers the Israel Securities Authority (ISA) which has regulatory reach over the securities markets in Israel, and regulates electronic trading platforms (Trading Platforms), which can be seen as a narrow sub-set of broker-dealer activity. A Trading Platform is defined in the Securities Law as: (i) a computerised system through which a person buys or sells financial instruments from his customers for his own account, in an organised, regular and methodical manner – excluding where the terms of the purchase or sale of financial instruments are determined through direct negotiations between the parties; (ii) a computerised system that gives the customer dealing access to a such a system. The activities of the members of the Tel Aviv Stock Exchange (TASE), many of whom act as broker-dealers, are bound by stock exchange rules and regulations. The TASE is in turn, regulated by the ISA. TASE members that are banks are also separately directly regulated by the Supervisor of Banks at the Bank of Israel. Investment advice, and portfolio management, is governed by the Investment Consulting in Investment Marketing and Portfolio Management Law 5755-1995, (Advice Law) and regulated by the ISA. However, broker-dealer activity which falls outside the Trading Platform definition, or is undertaken by entities that are neither members of the TASE, nor regulated as an Israeli bank or as an ISA licensee under the Advice Law, are not currently subject to dedicated regulation and supervision. The one exception to this is the recently introduced s 49A General Permit regime. Since November 2018, this has permitted entities to apply for a General Permit for the provision of securities trading services through a securities trading system operated by a securities exchange outside Israel, if, in the case of a foreign entity, the ISA is convinced that they are subject to effective equivalent regulation in a foreign jurisdiction, or if they restrict the offer of their services to Qualified Clients, a term defined in the First Addendum of the Securities Law, which includes institutions of certain types. However, s 49A implements a permit regime, not direct regulation, so there is no supervision of the financial stability, financial conduct or customer service standards of broker-dealers. It can be seen from the content of the Bill that the ISA and the Finance Ministry have had regard to the provisions of MiFID 2 in the EU and are seeking to introduce measures that are similar or MiFID 2 equivalent. For example, in its 2018 White Paper, the ISA included broker-dealer reporting obligations, which parallel those found in MiFID 2.

THE BROKER-DEALER BILL

The government, with the support of the ISA, intends to enact a designated chapter in the Securities Law, to regulate broker-dealers in Israel and to subject the entities engaged in this activity to ISA supervision.

MAIN PROVISIONS OF THE BILL

Defining broker-dealer activity categories and the exceptions

The Bill defines the regulated "broker-dealer" activity. The proposed definition is broad and encapsulates two legs: "brokerage activity" and "dealer activity". The former is defined as "the receipt and transmission of orders to effect transactions for clients or implementing client orders for dealing client transactions by other means"; and the latter as "the purchase or sale of securities for its own account in order to execute client instructions". (cf. Annex 1, A, MIFID 2)

A "Foreign Broker-Dealer" is an entity holding a foreign Broker-Dealer licence. A "Registered Foreign Broker-Dealer" is an entity holding a foreign Broker-Dealer licence, as a result of which regulation and supervision, the ISA is satisfied it provides adequate investor protection, and has therefore entered it into its Register. The foreign Broker-Dealer will only approach Israeli Qualified Clients. "Large Dealers" will be entities which undertake a significant volume of "financial instrument" activity on TASE, at or above a daily value threshold of NIS (New Israeli Sheqel) 10m, or a monthly threshold of NIS100m; or dealing volume in non-financial instrument securities above a daily value threshold of NIS5m or a monthly threshold of NIS50m. A "Limited Activity Broker-Dealer" will not provide credit or loans to his client and will not offer his clients Broker-Dealer activity in "high-risk instruments" defined as "an agreement or arrangement the value of which is derived from the value of currencies, commodities, interest rates, exchange rates, indices or another financial instrument", essentially, all derivatives and structured products. There will also be "Exempt Entities": the main categories are: (i) a person who is properly engaged in investment portfolio

management; (ii) a stock exchange, with respect to its activity as a securities trading system as defined in the Securities Law; (iii) a Trading Platform; (iv) a banking corporation, or connected company, and any other corporation that is supervised by the Bank of Israel in connection with Broker-Dealer activity; (v) a market-maker; (vi) a Registered Foreign Broker-Dealer that approaches only Qualified Clients. There are also exemptions for trust managers, court appointed trustees, lawyers, and accountants.

Extra-territorial reach

Entities incorporated outside of Israel can apply for and obtain a licence as a regular Israeli Broker-Dealer, so long as they can show that they are conducting business in Israel. In addition, the Bill proposes to add Registered Foreign Broker-Dealers to the list of "Supervised Entities" in s 1 of the Securities Law. The application of this statutory status enables ISA enforcement against these ISA registered foreign entities. Although they are exempt from the licence obligation, they are still committed to a number of basic duties, such as: prohibition of misleading clients; obligation to safeguard documents; accepting Israeli legal jurisdiction for their contractual relationships; and an obligation to disclose to their clients that they are not directly regulated by the ISA. For example, a Supervised Entity that gives the ISA misleading information in a report, document or notice mandated by law, when they should have known that this would mislead the ISA, would be considered to be in breach of a Securities Law provision.

Special provisions are included for proprietary dealers and entities that provide a bilateral or multilateral matching platform for investors.

Licence requirement to engage in regulated activities and threshold conditions

As in MiFID 2, Art 5, there is a requirement for authorisation. The Israeli Bill proposes that only a licensed corporation will be permitted to conduct broker-dealer activities, but the employees of the corporation themselves will not be required to have a licence in order to engage in broker-dealer activities. There are threshold conditions that must be met by all Broker-Dealer applicants: The applicant must be a legal entity; there are requirements for appropriate skills and experience; restrictions on additional occupations of the licensee; and capital requirements and insurance obligations.

Controller Permission and fit and proper test

A broker-dealer will get his licence only if its Controller secures a Controller Permission from the ISA. The ISA may refuse to grant a Controller Permission due to a defect in the credentials of the Controller applicant or a senior office holder in the broker-dealer. Passing the "fit and proper" test is a pre-requisite to obtaining a Controller Permission.

Corporate governance obligations

To ensure the stability of licensed broker-dealer and non-client facing stock exchange members, and their proper conduct, the Bill imposes organisational and corporate governance obligations. These include: a minimum of two independent directors and five board directors, eligibility requirements for independent directors and directors, supervision by the board of directors of the stability of such licensees; statutory rules on conflicts of interest, establishment of an audit committee with a minimum of three members, an obligation to establish procedures, and for the appointment of properly qualified employees.

Fiduciary duties to the client

Like MiFID 2, Art 27, which requires the investments firms to take all sufficient steps to obtain, when executing orders, the best possible result for their client, the Israeli Bill requires the licensee Broker-Dealer to always seek the best outcome for its client.

Obligations towards the regulator

The Israeli Bill requires firms to provide the ISA with periodic reports, and additional information upon request, in the same way as other ISA regulated entities. This is reminiscent of Art 31 of MiFID 2 which requires investments firms and market operators to inform their competent authority immediately of significant infringements of its rules or disorderly trading conditions or conduct that may indicate prohibited behaviour under MIFiR, or system disruptions in relation to a financial instrument.

Supervision and enforcement provisions and the granting of ISA powers

Broker-Dealers will be subject to the ISA's administrative enforcement processes. The Bill also proposes to give the ISA authority to issue specific directives to a broker-dealer on how they and their employees conduct themselves, eg providing the ISA with periodic reports and other information, and taking steps to ensure customer protection by making appropriate investment decisions on the basis of internal policies and procedures.

ISA rights to terminate a licence

The ISA can terminate a Broker-Dealer licence or a Stock Exchange member licence if: (i) the licence was given on the basis of false information; (ii) a condition for granting a licence ceases to apply to the licensee or it has violated one of the conditions stipulated in the licence; (iii) insolvency proceedings are conducted in respect of the licensee; (iv) there exists a factor calling into question the probity of the licensee; or (v) the licensee has violated a provision of the Securities Law or an ISA directive and has not rectified the violation as instructed by the ISA Chairman, or not done so within the period stipulated. These criteria apply to the licensee, the controlling shareholder and all senior officers of the broker-dealer and its controlling shareholder or interested party.

Anti-money laundering obligations

The Bill will also extend anti-money laundering legislation and regulations to licensed Broker-Dealers.

EXPECTED LEGISLATIVE TIMETABLE

The Bill is currently at the initial stages of the legislative timetable; the public consultation closed on 26 November 2020, after which the Bill will be amended to reflect public feedback, and is then considered by the Knesset ministerial legislative committee upon whose approval, it is then published in the Gazette (*Reshumot*), and then tabled for its first reading. This is expected to occur during the first half of 2021. The Bill provides that once it is fully enacted, it will come into effect six months after all the relevant enabling secondary legislation has been made by ministers. ■

International Briefings

Finland

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COVID 19: IMPACT OF, AND CHANGES TO, THE FINNISH BANKRUPTCY LEGISLATION

The ongoing global COVID-19 pandemic continues to have an adverse effect on economies worldwide and governments are looking into further measures to mitigate the negativities relating to the pandemic. In Finland these mitigating measures, introduced by the government, have included, amongst others, amendments to the employment legislation, different government grants, aids and loans as well as amendments to the Finnish bankruptcy legislation. In this briefing we concentrate on the amendments to the Finnish Bankruptcy Act (120/2004) which directly derive from the COVID-19 pandemic.

STARTING POINT: THE FINNISH BANKRUPTCY ACT PRIOR TO COVID-19

Pursuant to the Finnish Bankruptcy Act, as in force prior to the outset of the COVID-19 pandemic, in order for a company to be declared bankrupt it must be insolvent and the nature of the insolvency may not be of a temporary nature. The past has shown that creditors have faced challenges in demonstrating the insolvency of a debtor, and, to partly mitigate these challenges the Finnish Bankruptcy Act includes several presumptions pursuant to which a debtor is deemed insolvent. A debtor may, subject to the provisions of the Finnish Bankruptcy Act, repeal a presumption of it being insolvent and thus overturn the claim of its bankruptcy put forward by a creditor. The most commonly used presumption on insolvency recognised by the Finnish Bankruptcy Act provides that a debtor is presumed insolvent if it has not paid its clear and overdue debt within seven days of receiving a demand for payment from the relevant creditor. After seven days the creditor may submit a claim to the relevant court and file for bankruptcy of the debtor – this presumption is commonly referred to as the "seven-day rule".

TEMPORARY AMENDMENTS TO THE FINNISH BANKRUPTCY ACT

Due to the COVID-19 pandemic, the Finnish Bankruptcy Act was initially amended on 1 May 2020 whereby the seven-day rule was temporarily removed and creditors were thus deprived of their right to use a bankruptcy-threatened demand for payment when recovering claims from debtors whose financial payment difficulties derive from the COVID-19 pandemic. The amendments did not however entirely deprive creditors from the right to use a bankruptcy-threatened demand for payment as the amendment included two exceptions in which creditors can continue to make use of the right. The exceptions are applicable if: (i) the debtor has received a payment demand from the creditor prior to the amendments to the Finnish Bankruptcy Act having entered into force, ie 1 May 2020; or (ii) the debtor has neglected its payment obligations towards the creditor for a period of two months prior to the amendment of the Finnish Bankruptcy Act having entered into force. The amendments were primarily intended to be effective only until 31 October 2020 and as such, of temporary nature only, but due to the COVID-19 pandemic continuing to take its toll on Finnish society and showing no signs of slowing down, their effectiveness was extended until 31 January 2021. The amendments to the Finnish Bankruptcy Act permit creditors' rights to remain in force in circumstances where the debtors' payment difficulties have commenced prior to the COVID-19 pandemic.

PURPOSE OF THE AMENDMENTS

The main purpose of the temporary amendments to the Finnish Bankruptcy Act is to provide assistance to companies facing temporary payment difficulties and which are temporarily insolvent due to the COVID-19 pandemic. The aim is to avoid bankruptcies in respect of such companies whose businesses would be viable in the absence of the pandemic as well as to avoid a wave of bankruptcies and the inevitable rise in the unemployment rate as a result. The amount of bankruptcy filings has actually decreased since the amendments initially entered into force on 1 May 2020. It should be noted that whilst the government's intention has largely been to support debtors undergoing financial difficulties, the government has also been required to take into account the interests of creditors by maintaining a balance between debtors' and creditors' interests. The right of creditors to submit a bankruptcy-threatened payment demand has traditionally been seen as the primary way for creditors to file for bankruptcy in respect of the debtor. However, the Finnish Bankruptcy Act also includes other presumptions in respect of determining debtor insolvency which are unaffected by the amendments. The extension of the temporary amendments until 31 January 2021 provide, pursuant to the Finnish government, further time for the government and other relevant parties to consider and implement additional measures to aid companies undergoing financial difficulties due to the COVID-19 pandemic.

IMPACT OF THE TEMPORARY AMENDMENTS

Pursuant to data from Statistics Finland, the amount of bankruptcies for the reference period January 2020 to November 2020 was less than the same reference period for year 2019, despite the effects of the COVID-19 pandemic. The decline in the amount of bankruptcies can be explained in part by the temporary amendments to the Finnish Bankruptcy Act even though the exact quantitative effects of the amendments are not available or easily determined. It should however be noted that the amount of bankruptcies may not, under the current exceptional circumstances, correctly reflect the actual amount of permanently insolvent companies or distinguish between permanently insolvent companies and those which are only facing temporary difficulties due to the COVID-19 pandemic. The decline of bankruptcies amidst the COVID-19 pandemic nevertheless shows that the temporary amendments have, at least in part, achieved their goals, and reflect the purpose set out by the Finnish government in the legal preparatory work for the amendments. It remains to be seen, whether the decline in the amount of bankruptcies remains only temporary or whether the amount of bankruptcies will surge after the temporary amendments cease to be effective - to the extent companies have not found the means to overcome the financial pressure of the COVID-19 pandemic. ■