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Clarifications regarding Supervision of Financial Services Law (Regulated Financial Services) – 2016

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On August 1st, 2016 the Supervision of Financial Services Law (Regulated Financial Services) – 2016 (the"**Law**") was enacted. The Law is part of a major up and coming legislative process the objectives of which are to provide comprehensive regulation in the field of financial services provided by non-institutional bodies, develop the non-institutional financial services sector in Israel and increase the competition in the financial services field by establishing an alternative to the banking system in Israel, while at the same time protecting the rights of consumers and ensuring AML compliance.

The licensing requirements under the Law came into effect on June 1, 2017 with respect to credit extension and on June 1, 2018 will come into effect with respect to services in financial assets.

According to the Law, any person (corporate entity or an individual) engaging in credit extension and/or provided services in financial assets (together "**Financial Services**"), must possess a license, granted in accordance with the Law ("**License**").

The definition of such Financial Services under the Law is quite broad and appears to cover certain scenarios and transactions that the legislator might not have intended to regulate. In particular, the wide definitions created doubt as to the applicability of the Law with respect to foreign banks, venture debt transactions and with respect to the territorial applicability of the Law in the context of Israeli related large-scale cross-border lending transactions conducted primarily outside of Israel.

In recognition of this lack of clarity, the Israeli Ministry of Finance ("**MOF**") has attempted to clarify certain aspects relating to the obligation to possess a License under the Law, by way

of draft regulations regarding exemptions from the licensing requirements as well as a position paper in relation to the territorial applicability of the Law.

Territorial Applicability

On January 1, 2018, the Commissioner of Capital Markets, Insurance and Savings published a position paper regarding the territorial applicability of the Law with respect to transactions conducted outside of Israel (the "**Territorial Applicability Paper**").

Pursuant to the Territorial Applicability Paper, engagement in credit extension activities, which is conducted in its entirety outside of the State of Israel, does not require a License under the Law, provided that each of the following conditions are met:

1. the credit documentation (excluding regarding security interests) is not in Hebrew, is executed outside of Israel, its governing law is not Israeli and interaction between lender and borrower is conducted outside of Israel (*We note that in our view, the execution of documents remotely via email or otherwise should be considered as executed outside of Israel*);
2. the accounts of the borrower into which the credit is extended are held in institutions outside of Israel;
3. the foreign entity does not contact new clients in Israel, including marketing, advertising or client recruitment, through any means; and
4. no physical meetings are conducted in Israel between the foreign entity and its clients.

Exemptions

In addition to the exemption from the Licensing requirement granted under the Law, on October 1, 2017 the MOF published the second draft of The Supervision of Financial Services Regulations (Regulated Financial Services) (Exemption from Licensing Requirement) (Temporary Order) – 2017 (the "**Draft Regulations**") which set forth certain exemptions from the licensing requirement for extension of credit under the Law.

Of particular note are exemptions provided to (i) banks incorporated in and licensed by OECD member countries, which is of relevance to international banks with respect to their banking and credit extension activities in Israel; (ii) entities engaged in extension of credit to companies primarily focused on R&D or manufacture of innovative and knowledge-intensive products or processes and where the risk of investment in such companies is larger than what is standard for investments in other companies – with respect to extension of credit to such companies. This latter exemption is of particular relevance for entities engaged in venture

lending activities with Israeli technology startups; and (iii) entities engaged in credit extension solely to commercial entities that meet the following conditions: (a) the total credit granted in each transaction is not less than NIS 10,000,000, and (b) the recipient entity is not a "purchase group" (a group of purchasers led by an organizing entity that enters into a contractual arrangement with respect to the purchase of an asset, service or right).

While the Draft Regulations are not yet in force, the MOF announced that pending the adoption of the Draft Regulations, the MOF will not take any enforcement actions against unlicensed entities falling within any of the exemptions under the Draft Regulations. Once adopted, the Regulations will be in force until the end of 2019, and thereafter the exemptions will be re-considered by the MOF.

The clarifications provided by the Territorial Applicability Paper and the Draft Regulations are of particular relevance both to foreign banks who engage in the provision of loans to Israeli companies, as well as to players in the Israeli hi-tech scene, and particularly in relation to those involved in venture debt activities.

Practical Implications

These new changes promoted by the MOF have been achieved after months of dialogue between leading industry players and the MOF and have the potential to offer comfort to foreign lenders engaged in these activities following the initial confusion that arose upon the creation of the Law.

The online link to the article can be found here.