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One door closes and another remains open: temporary lending license exemptions and alternatives for international lenders

3 minutes reading

Background

The Israeli Financial Services Supervision Law (Regulated Financial Services) 5776 – 2016 (the “Law”) came into force on 1 June 2017. The Law introduced a new regulatory regime with respect to several financial services and market participants that were not previously regulated and who have now become subject to the supervisory authority of the Capital Market, Insurance, and Savings Authority in the Ministry of Finance (the “Authority”). Notably, it includes a broadly drafted prohibition on the provision of credit without holding a license as well as requirements for a control permit of such entities.

Although most likely unintentional, significant uncertainty arose in the market as a result of the broadness of the new Law and its potential application. This is especially true in relation to the extent to which the licensing requirement applies to a non-Israeli lender conducting business in Israel or lending into Israel on a sporadic basis or otherwise and to large scale corporate loans to sophisticated borrowers.

The exemption regulations – a temporary solution

The Law authorizes the Minister of Finance, in consultation with the Minister of Justice, to exempt a specific lender, and with the approval of the Finance Committee of the Knesset, to exempt by way of regulations types of lenders from the licensing requirement. By virtue of this authority, the Authority published in 2017 Draft Financial Services Supervision Regulations (Regulated Financial Services) 5777 – 2017 (the “Draft Regulations”), which provided for certain exemptions from the licensing requirement for several types of lenders. The explanatory notes accompanying the Draft Regulations stated that in order to guarantee the proper course of business during the period pending the regulations coming into effect, the regulator does not intend to carry out enforcement actions during this period against the bodies set out in the Draft Regulations. This situation subsisted for around one year.

On 3 October 2018, the Financial Services Supervision Regulations (Regulated Financial Services) 5777 – 2017 (the "Regulations"), came into effect. The Regulations provide for exemptions from licensing requirements for certain types of lenders with certain changes as compared to those set out in the Draft Regulations.

Notable exemptions include:

- **Non-Israeli banks** - a bank incorporated in an OECD member state that holds a banking license issued by a regulator of such member state, which is bound by anti-money laundering rules of such member state, as well as corporations controlled by such banks (provided that they do not provide retail credit in Israel).
- **Non-Israeli Insurance Companies** - a company incorporated in an OECD member state that holds an insurance license issued by the regulator of such member state, that is regulated in an OECD member state in relation to credit provision, and is bound by anti-money laundering rules of such member state, provided that it is not engaged in the provision of retail credit in Israel.
- **Trading Services Providers** - a company incorporated in an OECD member state whose primary business is the provision of securities trading services (as defined in the Israeli Securities Law, 5728-1968) that is regulated in such member state and is permitted to engage in, among others, the provision of credit in order to facilitate its trading activity.
- **Business Lenders** - a corporation whose business is the provision of credit to business corporations only, provided that the following two criteria are satisfied: (a) the total amount lent in a single transaction is no less than NIS 3 million, and (b) the borrower is not a purchase group (i.e., a group of buyers organized contractually by an arranger for the purpose of purchasing an asset or service). According to the explanatory notes to the Draft Regulations the rationale of this exemption is that business borrowers that borrow large amounts have improved capabilities to choose their credit and their credit providers who will therefore be exempt from the licensing requirement.
- **Technology Startups** - this exemption applies to one who engages in the provision of credit to corporations whose primary business is in research and development or the manufacture of innovative and knowledge intensive products or processes, the investment in which carries an elevated degree of risk.

It is worth noting that the Regulations were enacted as a temporary directive set to expire on 31 December 2019. The short term directive is aimed at providing an opportunity to test-run the Regulations and examine whether the objectives of the Law are being achieved and ensure that exempt entities are not in fact conducting business that requires supervision.

Nevertheless, the temporary nature of the Regulations raises a few practical questions, e.g., regarding its implications on ongoing transactions (such as revolvers and other facilities having long availability periods extending beyond a 31 December 2019) should the Regulations expire and not be extended any further. In these circumstances it is unclear whether, for example, further drawdowns (made after the expiry of the Regulations) under an existing facility made available whilst the

Regulations were in place would be deemed granting credit that requires a license under the Law.

The position paper – an alternative route

On 1 January 2018, the Authority published a paper outlining the Authority's position on the applicability of the licensing requirement to lenders incorporated in Israel or abroad and whose lending activities take place entirely outside of Israel (the "Position"). The Position stands alongside the Regulations, having the primary focus of discussing when a credit transaction will be deemed to be outside of Israel and therefore fall outside the scope of the Law.

The Position expresses the view that a lender will be exempt from the licensing requirement, if all of the following conditions are met:

- the credit documents (except for security documents) are not written in Hebrew, signed outside of Israel and governed by non-Israeli law;
- the accounts utilized by the borrower to receive the credit proceeds are located outside of Israel;
- the lender does not solicit new clients in Israel by any way and by any means; and
- the lender does not hold meetings with clients in Israel.

The route offered by the Position may have advantages for parties to credit transactions wishing to avoid certain practical questions arising from the temporary nature of the Regulations and/or arrangers of syndicated loans which may potentially have different types of lenders and also support liquidity in the secondary market in that under this route it would not be necessary to check whether each lender falls into any of the exemptions afforded by the Regulations.

It is worth bearing in mind that while the Position reflects the regulator's view of the proper interpretation of the Law, the Position does not have the effect and authority equivalent to the Law or regulations.

The long awaited Regulations now provide more certainty than prior, however, given the short term nature of the Regulations, the market will stay tuned for the position the regulator will take towards the expiry of the Regulations at year end.

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