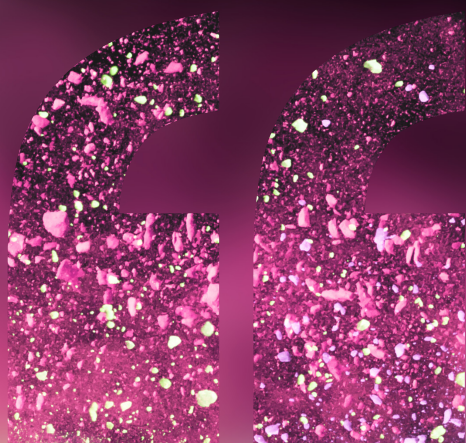


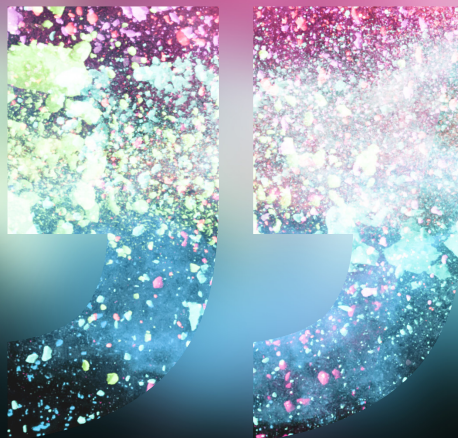
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**FINTECH IN ISRAEL –
AN OVERVIEW**



– THOUGHT LEADERSHIP

DECEMBER 2018



FINTECH IN ISRAEL – AN OVERVIEW

Israel, with its expertise in technology such as big data analytics, artificial intelligence, blockchain and computer vision, has established itself as a global centre for fintech. Its relatively small size, the large number of start ups and its reputation for entrepreneurship mean that it is an excellent testing ground for innovation. Israeli regulators, including the Bank of Israel and the Commissioner of the Capital Markets, Insurance and Savings (CMIS), have expressed the view that technology is key, and a number of regulatory changes are coming into effect or being explored to further boost the market. Here we describe the latest regulatory developments and what we are likely to see next.

Distributed ledger technology and digital currencies

Activities related to virtual tokens and cryptocurrency (including issuing, marketing, selling and buying, exchanging, storing, transferring and using cryptocurrency) have until recently, been unregulated. However, as of October 1, 2018, cryptocurrency services – sale, exchange and safekeeping, for example, are to be regulated under the Supervision of Financial Services (Regulated Financial Services) Law 2016.

Under this law, businesses providing services in financial assets require a licence; the new definition of ‘financial assets’ under the law explicitly includes ‘virtual currencies’ (without further definition), and the term ‘service’ in a financial asset includes exchange, redemption, change, conversion, sale, transfer, management or safekeeping of financial assets.

Such services may also be regulated by the Israeli Securities Authority, as certain cryptocurrencies and tokens may be considered securities. A committee established by the Authority to examine the need for cryptocurrency regulation has published an interim report recommending that, as a general rule, cryptocurrencies that confer rights similar to the rights conferred by traditional securities (eg, shares, bonds and participation units) should be deemed

securities. As part of the interim report, the committee recommended exploring the possibility of setting up a regulatory ‘sandbox’ to provide close regulatory monitoring alongside regulatory easing for a limited period. However, to date no regulatory sandbox has been initiated and, as this is an interim report, we can expect changes.

In 2018, a circular (05/2018) was issued by the Israeli Tax Authority (ITA) – “Taxation of Activity Involving a Decentralized Payment Method (known as “Virtual Currencies”) (the “Payment Methods Circular”). The ITA noted that the transfer of a cryptocurrency such as Bitcoin is generally treated as the sale of an asset for income tax and VAT purposes. However, it should be noted that the Payment Methods Circular does not address the issue of activity in tokens which are smart contracts but only in tokens which are a “Decentralized Payment Method” (such as Bitcoin or Litecoin).

In the Payment Methods Circular, the ITA expresses its opinion that a Virtual Currency does not meet the definition of “Currency” or “Foreign Currency” for the purpose of the Israeli Income Tax Ordinance (New Version), 1961-5961. Accordingly, under the Circular, the sale of Virtual Currency shall be regarded as the sale of an asset for Israeli tax purposes, giving rise to capital gain or loss, and to capital gain tax liability (where applicable). The analysis is

different in the case of a taxpayer whose activity is regarded as a business activity (including, but not limited to, a taxpayer who obtained Virtual Currency by way of “mining”). The Circular also provides certain rules regarding the tax treatment of transactions in which Virtual Currency is used as a payment method.

In addition, the ITA issued Circular 7/2018 – “ICO – the Issuance of “Digital Tokens” for the Provision of Services and/or Products under Development (Utility Tokens)”, which addresses the issues related to the issuance of utility tokens. Security tokens and smart contracts tokens are not addressed in either of the circulars.

Alternative Financing (including crowdfunding)

During 2017, new regulations were implemented in Israel to regulate the raising of equity and debt through crowdfunding.

In respect of equity, the regulations enable online platforms to register with the Israeli Securities Authority as offering coordinators and licence their activity as crowdfunding platforms. Licenced crowdfunding platforms offer public investors the opportunity to invest up to approximately NIS 1 million to NIS 1.5 million in certain companies, without limitation on the number of investors. This equity-funding route is expected to materially grow over the next few years.

For debt crowdfunding, as of February 2018, the operation of a ‘credit intermediation system’ requires obtaining a relevant licence from the CMIS, and is regulated and supervised under the Regulated Financial Services Law. A ‘credit intermediation system’ is defined under the law as an online system operating through the internet or by other technological means prescribed by the Ministry of Treasury, which is used to mediate between lenders and borrowers in order to execute transactions for granting credit and for operating such transactions. The credit intermediation system is used primarily for individual borrowers and may be used only for incorporated borrowers under certain conditions specified under the law and for loans not exceeding NIS 1 million.

Digital Payments

Digital payments were previously unregulated in Israel. However, digital remittances and foreign exchange have been regulated under the Prohibition on Money Laundering Law 2000 and as of October 1, 2018, digital remittances and foreign exchange are regarded as services in financial assets and are regulated under the Regulated Financial Services Law.

Investment, asset and wealth management – robo advice platforms

The provision of investment advice and portfolio management services in Israel are regulated activities under the Regulation of Investment Advice, Investment Marketing and Investment Portfolio Management Law 1995 (the “Investment Advice Law”) and require a licence, other than certain exceptions listed in the law. With regard to the provision of investment services or advice using technological means, the Israeli Securities Authority published the ‘Directive on the Provision of Investment Services with the Use of Technological Means’ which states that this activity should be licenced under the Investment Advice Law.

Data protection and cybersecurity

The main Israeli legislation relating to the processing and transfer of data (in general) is the Israeli Protection of Privacy Law 5741-1981. This law defines, among other things, obligations regarding the collection of personal information, registration and maintenance of databases containing personal information. Specific regulations promulgated under this law deal with the transfer of personal data outside of Israel (the Protection of Privacy (Transfer of Data Abroad) 5761-2001). There are also rules regarding outsourcing services for personal data processing which are set out under the Protection of Privacy (Data Security), 5777-2017 and specific guidelines issued by the Israeli Protection of Privacy Authority.

There are specific Proper Conduct of Banking Business Directives, issued by



the Israeli Supervisor of Banks, which deal with the processing and transfer of data by banking entities. For example, Directive 357 provides guidance on the management of information technology, and specifically relates to outsourcing that may include the processing of data by third parties (this directive will be replaced by Directive 359A, which sets out broader provisions regarding outsourcing, which will enter into force on March 31, 2020). Directive 362 deals with cloud computing and limitations on storing data in a cloud environment. These directives apply to banks and other regulated entities, but may be significant for fintech operations offered to banking institutions.

There are several sector-specific restrictions on cloud computing that may also apply to different aspects of the fintech industry.

Instructions have also been issued by the CMIS relating to the management of cyber-risks in institutional entities. The instructions relate to cybersecurity and data protection, specifically in regulated entities in the insurance and pension sectors, and may be significant for fintech operations offered to companies in these sectors.

Financial Crime

There is no specific anti-money laundering law or order that refers to fintech companies. Fintech companies are subject to the general prohibition on money laundering activity and terrorist financing, which apply to any entity in Israel. However, Israeli anti-money laundering legislation also imposes substantial identification, registration and reporting duties under anti-money laundering orders on certain business sectors (a closed list), including financial entities engaging in certain financial activities (eg, banking corporations, insurance and pension management companies, portfolio managers and providers of financial services (including credit providers)). Accordingly, if a fintech company's activity falls within the closed list of the regulated activities

under anti-money laundering law, it will be subject to the applicable anti-money laundering order.

In addition, two new drafts of anti-money laundering orders applicable to the fintech industry were published in early 2018. These draft orders are pursuant to the new Regulated Financial Services Law and include:

- an anti-money laundering order that applies to credit intermediation systems (including peer-to-peer platforms); and
- an anti-money laundering order that applies to financial assets services providers (including virtual currencies and other financial assets).

These draft orders also include identification, registration and reporting requirements paying heed to the anti-money laundering complexity and challenges that these industries pose. The market anticipates the finalisation of the legislative process of these orders as, among other things, their absence poses regulatory challenges for financially supervised entities in complying with the anti-money laundering regime.

In addition, Israel plays a significant role in the fintech industry, and many companies in Israel are engaged in this field (eg, the Israeli Money Laundering and Terror Financing Prohibition Authority hold roundtables from time to time with fintech companies and virtual currency companies). Further, in 2017, the Israeli Ministry of Finance issued a manifesto regarding its intention to consider establishing a regulatory sandbox for fintech companies.

Consumer protection laws

The Consumer Protection Law 5741-1981 regulates the protection of consumers. 'Consumer' is defined as any person who purchases a product or service from a dealer within the framework of the dealer's business, mainly for a personal, home or family use. The law does not apply to commercial activities as between two businesses. It sets out various principles and

requirements which may be applicable to the offering of fintech products and services, including, among other things:

- the prohibition of misleading consumers with respect to the material aspects of a transaction;
- rules regarding ongoing transactions;
- transactions entered into remotely;
- indication of prices for services; and
- disclosure of payment requirements.

Antitrust

The Israeli Antitrust Authority is considering competition law aspects of digital platforms in general and has commenced a public hearing for that purpose. There is currently no specific competition law regulation concerning fintech.

Government financing

The government provides direct funding for research and development (R&D) in various fields of technology through the Israeli Innovation Authority (IIA) (formerly the Office of the Chief Scientist at the Ministry of the Economy). Many of the programmes are available for companies looking to innovate in the fintech field (ranging from start ups, at various stages of growth, through to mature and well established companies and financial institutions), as long as they meet the

criteria set out in the various programmes. Additionally, for early stage start ups, the Israeli Innovation Authority also supports funding through technology incubators, a number of which are open to invest in fintech companies, depending on their internal investment committee's discretion. From time to time, the authority has also offered special funding programmes for multinational corporations to establish R&D centres or innovation labs in Israel.

Similarly, tax incentives for technology companies, in particular those operating in certain geographical areas in Israel, may also be available to fintech companies or their investors (eg reduced corporate tax rates, accelerated deduction of R&D expenses, and tax benefits for angels investing in start-ups) as long as they meet the general criteria prescribed under the law.

The Israeli government arranges delegations of Israeli companies for roadshows and meetings with relevant potential partners and investors. The government also supports marketing and export activities and cooperation with non-Israeli corporations through various funding programs. These opportunities may apply also to fintech companies.

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