I. Ensuring the Basis for an Effective Corporate Governance Framework

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

A. The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.

Israel's corporate governance framework is designed to promote market integrity and development through investor protection. The corporate and securities laws, which provide the framework for corporate governance, contain and formally codify principles of good governance with an eye to empowering and protecting the interests of minority shareholders. Many of the common law rights of shareholders and fiduciary duties of management are explicitly articulated in Israeli law and subject to civil and in many cases possible criminal enforcement. Israel is recognized by the World Bank\(^1\) as one of the highest ranked jurisdictions in terms of the provision of investor protection through the corporate governance mechanisms and disclosure requirements incorporated in its body of corporate and securities law. The Companies Law distinguishes between public and private firms allowing for flexibility in balancing the needs of economic freedom, capital formation and shareholder protection. Securities laws (including the Securities Law, the Joint Investment Trust Law and the Law for the Regulation of Investment Advice, Investment Marketing and Investment Portfolio Management) provide the basis for full

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* This report summarizes the state of corporate governance as reflected in Israeli corporate and securities law as measured against the OECD Principles of Corporate Governance, 2004. It was prepared by the Israel Securities Authority in collaboration with the Economic Department of the Ministry of Justice.

and fair disclosure and establish the regulatory framework for end-to-end supervision and enforcement (including regulation of collective investments, portfolio management and investment advice).

B. The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.

Unlike many jurisdictions, corporate governance provisions are formally codified and enshrined in corporate and securities law. The Companies Law 5769--1999, which covers both public and private companies contains provisions encompassing key principles of corporate governance, including: the establishment of corporate organs, articulation of fiduciary obligations and shareholder rights, the accountability and liability of directors and executives, qualitative and quantitative threshold director independence requirements, separation of the position of chairman of the board from that of CEO, mechanisms to safeguard minority shareholder interests against misappropriation, self-dealing and conflicts of interest, legal remedies to redress violations of the law and the fiduciary duties articulated within it. The Companies Law is administered by the Ministry of Justice and is enforceable through private civil legislation. Certain violations of corporate law are also subject to criminal enforcement as violations of the Penal Code and/or to administrative civil sanctions.

The Securities Law, in contrast, is designed to ensure the protection of the investing public. As is the case with most, if not all OECD jurisdictions, Israeli securities law is based on the principle of full and fair disclosure. The Securities Law mandates the establishment of the Israel Securities Authority (ISA), which is charged with regulating, overseeing and enforcing the transparency of public companies and with ensuring the integrity of primary and secondary markets. In addition to articulating the rules of transparency, it establishes principles of corporate and personal accountability to the investing public. In contrast to the Companies Law, this law, (as well as other laws administered by the ISA) is criminally enforceable.

Within the framework of shareholder enforcement it is worth mentioning the rights shareholders and directors have to initiate derivative actions as stipulated in the Companies Law, as well as the right of any person that has a claim pertaining to securities to initiate class actions as stipulated in the Class Action Law -2006. Israeli law has instituted a set of incentives to facilitate shareholder enforcement, including mechanisms to award plaintiffs and cover their expenses.

C. The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.

Generally speaking, the division of responsibilities among authorities in Israel is clearly and openly delineated. Given the complexity of economic legislation, however, overlap may occur. At the same time, there is considerable coordination between the regulatory bodies. Israel is not a federalist system and all corporate and securities law is
administered solely at the federal level. The current regulatory structure of the financial services sectors is broadly based on institutional rather than functional distinctions. Many regulatory agencies, such as the Bank of Israel, the Israel Securities Authority, the Anti-trust Authority are empowered and have jurisdiction over one or more dedicated laws, rendering the demarcation explicit and openly accessible to the public.

The Ministry of Justice is responsible for administering the Companies Law and overseeing corporate registration. The Companies Registrar, who is appointed by the Justice Minister chairs the Corporate Registration Board. The Registrar registers each company and compiles all documents and reports submitted for registration or filing as stipulated in the Companies Law and its Regulations. Documents filed with the Registrar are open for public inspection and any individual has the right to review and receive authorized copies of these documents. Registration is conducted for both public and private companies, however filing requirements are not identical. The requirements of public companies are minimal (change of name, address, mergers and notice of going public), in order to avoid duplication of disclosures public companies are compelled to make to the Israel Securities Authority.

The Israel Securities Authority (ISA), established under the Securities Law-1968, is the primary regulator of public companies in Israel. The ISA is responsible for overseeing both the primary and secondary markets – including approval of the publication of prospectuses for public offerings, monitoring ongoing disclosure, regulating securities underwriting practices and supervising securities exchanges (to date there is only one such exchange), licensing and supervising investment advisors and portfolio managers, regulating mutual fund managers, the use of inside information, market manipulation and enforcement of the provisions of the Law to Prohibit Money Laundering pertaining to portfolio managers and stock exchange members.

**D. Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfill their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.**

The Israel Securities Authority (ISA) is a statutory corporation structured as an independent commission that has an arms-length relationship with the Ministry of Finance as well as from the securities industry which it regulates. It is funded by the fees collected from regulated entities rather than by the government budget. Members (commissioners) are drawn from the public and/or civil service. Members of a stock exchange or securities traders and brokers and their employees are prohibited from serving as ISA members. Individuals whose business activities may engender conflicts of interest are also prohibited from membership in the ISA. The Chairman of the ISA is appointed by the Minister of Finance for an initial five-year term. After appointed, the chairman operates independently as his functions and duties are defined by law. He can not be dismissed by the Minister. The ISA staff numbers some 140 employees, the overwhelming majority (>80%) of which are professionals in the areas of law, accounting, economics and business administration, holding one or more academic degrees. ISA decision-making is highly transparent. Draft legislation, summaries of
commission resolutions, and staff opinions are routinely posted for public comment on the ISA website (www.isa.gov.il) as are all ISA plenary decisions and rulings. Regulated entities and individuals can petition the ISA staff for pre-rulings on various issues of law or accounting practice.
II. The Rights of Shareholders and Key Ownership Functions

The corporate governance framework should protect and facilitate the exercise of shareholders’ rights.

A. Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) share in the profits of the corporation.

Shareholders in Israeli public companies have all the rights enumerated above as provided in the Companies and Securities Laws. The ISA's electronic filing system (www.magna.isa.gov.il) ensures access to free and instantaneously updated information as well as all basic corporate registration documents. All documents are filed and stored electronically as mandated by law.

Regarding privately-held companies, the Companies Law enables private firms the freedom to vary its control structure. They can issue classes of shares and other securities with variable voting rights. The Company’s Law establishes that unless indicated otherwise in a company’s by-laws, all securities are transferable. Despite the freedom of variation stipulated for private firms, the Companies Law includes provisions that affirm certain inalienable shareholder rights, including inter alia: a) the right to access and review corporate documents pertaining to any item on the agenda of the general shareholders meeting and/or to any related-party transaction; b) the right to obtain specific information regarding director remuneration; c) the right to receive a copy of the company’s by-laws and financial statements d) the right to be informed of, attend and vote in the general shareholders meeting; and e) the right to receive dividends if dividends are distributed.

B. Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents of the company; 2) the authorisation of additional shares; and 3) extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.

The right of shareholders in public companies to be informed of all material developments as they occur is absolute, unqualified, and enforced. The Israel Securities Law, requires disclosure in current reports (called immediate reports) of all material developments rather than on a closed set of issues as is customary in some jurisdictions.

At the same time, shareholders in public companies have the right to participate in most decisions concerning fundamental corporate changes, including the amendment of statutes, articles of incorporation or bylaws and authorization of additional shares. Decisions pertaining to all these issues require shareholder approval.
With regard to extraordinary transactions, some qualifications exist. Extraordinary transactions, even if material and including the sale of a company's business activities, do not require shareholder approval, unless a prior contractual commitment to obtain such approval (e.g. in the company's by-laws or in a prospectus) is adopted by the company. In some cases, shareholder approval is required given the structure of the transaction. If the transaction involves an allocation of shares, or if a principal or related party is party to the transaction or has an interest in it, the Law requires shareholder approval of the transaction. If the company's activity is sold for cash, shareholder approval is generally not required.

In cases in which the transfer of assets are part of a merger which results in the liquidation of the target company, the Companies Law (generally) requires the approval of the general shareholders meeting of both merging companies. It should be emphasized that the rights outlined above pertain to shareholders in privately-held companies as well public companies. The Companies Law specifies certain issues which require shareholder approval: revision of the by-laws; the appointment and replacement of external auditors and terms of their engagement; certain related-party transactions and activities; changes to the quantity of registered share equity; and mergers. In public companies, shareholders must approve the appointment of independent directors. In addition, the Companies Law empowers the general shareholders meeting with the ability to exercise the authority of the board of directors in all instances in which the board of directors is unable to exercise this authority.

C. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings:

1. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.

Shareholders have an unqualified right to be fully informed about general meetings. The disclosure of details concerning general shareholders meetings to shareholders in public companies is anchored in both the Companies Law and the Securities Law. The meeting must be announced and agenda made public at least 21 days in advance. In addition, the company must file a current report, which is disseminated to the public on the ISA website.

For private companies, the Companies Law stipulates that the invitation to the General shareholders meeting will be delivered to anyone entitled to attend the meeting no later than seven days prior to the date the meeting is convened and no more than forty-five days prior to the date the meeting is convened, unless stipulated otherwise in the bylaws. The invitation must designate the
date and place in which the meeting is to be held as well as the agenda outlining in reasonable detail the subjects to be covered in the meeting. If the agenda includes a proposal to amend the by-laws, the text of the proposed amendment will be included.

For all companies, the Law stipulates that the general shareholders meeting can adopt resolutions only on issues included in the agenda. For private companies, resolutions can be adopted by the shareholders without invitation and without physically convening the general shareholders meeting, under the condition that they are adopted unanimously by all eligible voters.

2. **Shareholders should have the opportunity to ask questions to the board, including questions relating to the annual external audit, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.**

Shareholders have the right to ask questions, to place items on the agenda, propose resolutions and call for the convention of shareholders meetings.

3. **Effective shareholder participation in key corporate governance decisions, such as the nomination and election of board members, should be facilitated. Shareholders should be able to make their views known on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.**

The Companies Law confers shareholders the right and responsibility of appointing directors at the annual general shareholders meeting (unless otherwise indicated in the company's bylaws). It also stipulates that independent directors be appointed by shareholders, a responsibility which cannot be delegated to another party. A special majority which gives additional weight to votes of minority shareholders is required. In addition, within the framework of shareholder rights to propose resolutions at shareholders meetings, they can propose to either replace or nominate directors.

Remuneration (including equity components) of board members must be approved by shareholders at the general meeting. Remuneration and the other employment conditions of senior executives must be approved by the board of directors, and if an executive also serves on the board of directors or is a controlling shareholder, by the shareholders as well. Such approval requires a special majority as applicable for all transactions to which a controlling shareholder is party.

Shareholders are entitled to vote by proxy without the need for physical attendance or the appointment of an attorney on approval of related-party
transactions (including approval of director compensation) as well as the appointment and replacement of directors in public companies. In addition, shareholders can initiate “proxy fights” and distribute their position on proposed resolutions to other shareholders.

4. **Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.**

Shareholders in public companies are able to vote in person, through an appointed agent or by proxy. For publicly traded companies one share/one vote is mandatory. For private companies, the one share/one vote rule holds unless stipulated otherwise in the company’s bylaws. In public companies, shareholders are entitled to vote by proxy on the following issues:

1. The appointment and replacement of directors;
2. Approval of certain related-party transactions;
3. Approval of mergers
4. Any other issue brought before the General shareholders meeting for which the company’s bylaws stipulate that proxy voting is permissible;
5. Other issues and determined by the Justice Minister, including the approval of arrangements or compromises between the company and its shareholders or its creditors.

D. **Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.**

Israel's Securities Law mandates one-share/one-vote for all Tel Aviv Stock Exchange-listed companies. From 1991, when the provision came into effect, all IPOs listing on the TASE were allowed to issue one class of shares bearing voting rights equal to those of the company’s pre-IPO shareholders. This provision guarantees a proportionate degree of equity and control.

E. **Markets for corporate control should be allowed to function in an efficient and transparent manner.**

1. The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.

The rules and procedures governing the acquisition of corporate control in capital markets are codified and transparent. Israel's Companies Law governs the practices and minority shareholder rights regarding the transfer of control. It sets
three thresholds which necessitate the issuance of a tender offer. The Law requires entities acquiring for the first time more than 25% (i.e. if no other shareholder holds at least 25% interest) of the voting rights in a public company to issue a "special tender offer" to all shareholders. The second threshold is set at 45%. If no other entity already holds more than 45% in a public company, any transaction which brings the holdings of an entity to 45% or more triggers a special tender offer. Private placements resulting in one of the two types of acquisition or transfer of control are exempt from tender requirements, if the transaction is approved by the general shareholders meeting. The special tender is accepted only if approved by a majority of the disinterested shareholders responding to the tender, i.e. that are not affiliated with either a principal of the offeror or a controlling shareholder in the company. If the tender is accepted, shareholders which did not respond have four days to accept the offer. The third threshold, set at 90%, applies to any shareholder and requires a "full" tender offer, which in effect takes the company private. Any transfer of control not executed in accordance with the stipulations of either a special or full tender offer are subject to challenge. Excess voting rights are considered null and void as long as the shares remain in the control of the violating shareholder. Such violations also constitute cause for civil (including class action) suits by the other shareholders, assuming damages are proven. Regulation of and compliance with tender offer requirements are supervised by the Israel Securities Authority.

The transfer of control in private companies are also addressed in the Companies Law. Should a person offer to acquire the shares of a private company and the shareholders of at least eighty percent of the shares (or other threshold set in the by-laws) consent to the terms of the offer within a two-month period of time, the remaining shareholders can be compelled to sell their shares according to the terms offered the consenting shareholders.

As for mergers, both the Companies Law and Securities Law mandate transparency and accountability to minority/public shareholders. Mergers which entail an effective transfer of ownership are subject to the approval of the shareholders of both of the two merging parties. Mandatory shareholder approval is waived only if the target company is a wholly-owned subsidiary of the acquiring company. Approval by the acquiring company's shareholders is waived if the merger does not entail changes to the company’s charter or by-laws and if the acquiring company does not allocate more than twenty percent of its voting rights in the course of the merger and if no person becomes a “controlling shareholder” as a result of the allocation. Moreover, a special majority of disinterested shareholders is required for shareholder approval of the target company, if the merger is deemed a related-party transaction in which either the acquiring company or a controlling shareholder of the acquiring company already has an interest in the target company.
Regulations to the Securities Law contain detailed disclosure and reporting requirements at all stages of a transfer of corporate control. This includes, in addition to full disclosure surrounding the processes described above, disclosure surrounding the acquisition of 5% ownership in any of the means of control and subsequent changes in 'principal' shareholdings as well as disclosure regarding the process of seeking and obtaining approval by the Anti-trust authority, should the scope and/or potential impact of the transaction on the competitive structure of the relevant industry warrant such approval.

2. Anti-take-over devices should not be used to shield management and the board from accountability.

The Companies Law requires director and executive accountability in takeover situations. An officer (including executives and directors) of a target firm who undertakes any activity designed to defeat or hinder an impending special tender is liable to both the offeror and the shareholders for damages ensuing from his/her activities. In addition, the board of directors of the target firm is required to disclose to shareholders its position on the offer. Each director is required to reveal any interest he/she may have in the takeover.

F. The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.

1. Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights.

The Joint Investment Trust Law – 1994, which regulates the mutual fund industry under the supervision of the Israel Securities Authority, addresses issues of corporate governance. For example, the Law stipulates the functions of a fund manager's board of directors including: supervision of the functioning of the CEO and implementation of the board's decisions; approval of internal control mechanisms, appointment of an internal controller and discussion of his/her findings; deliberation over material transactions or transactions that may engender conflicts of interest; and stipulation of procedures for portfolio selection and internal auditing of the investment decision making process.

All institutional investors, including mutual funds, provident funds, pension funds and insurance companies, are obligated to attend and actively vote (i.e. not abstain) on all resolutions, the outcome of which, could be deemed detrimental to the interest of participation unit holders. Their voting decisions are disclosed to the ISA and disseminated to the public through the MAGNA website.
2. Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

According to the Joint Investment Trust Law any transaction that engenders a potential conflict of interest must be approved by the fund manager's board of directors. The Law stipulates a closed list of such matters, including:

- Block trading between funds managed by the same manager;
- Subscribing to an offering for which a party holding 5% or more interest in the fund manager, or a company controlled by said party ("related parties") are either offerors or underwriters.
- Block trading with "related parties" that serve as portfolio managers for others of the securities held in their portfolios.
- The fund's trustee can deem other transactions as bearing potential conflicts of interest, which necessitate board approval.

G. Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.

Institutional shareholders are not limited in any manner or prohibited from consulting with each other on corporate governance matters, including their basic rights as shareholders in portfolio companies.

Regarding issues for which the Companies Law mandates that proxy voting be allowed, the Companies Law enables shareholders to conduct proxy fights by distributing position statements to all shareholders for the purpose of influencing their vote on a proposed resolution. The company is responsible for distribution and is entitled to charge only a nominal fee for this service.
III. The Equitable Treatment of Shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

A. All shareholders of the same series of a class should be treated equally.

1. Within any series of a class, all shares should carry the same rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected.

The Securities Law requires that all TASE-listed companies have one class of shares with equal voting rights. Veteran firms (prior to 1991) that have more than one class of shares are required to fully disclose all rights attached to all series and classes of shares. This information is publicly available through the ISA's online electronic filing database. These disclosure requirements pertain to all reporting companies and not just those listed on the TASE.

The Companies Law stipulates that a company's by-laws cannot be amended in a manner that is detrimental to the rights of a certain class of shares without the approval of the shareholders of that class, (unless otherwise set in the by-laws). All provisions of the Companies Law that pertain to the general shareholders meeting apply to class meetings as well.

2. Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.

Israel's Companies Law provides safeguards and civil remedies for minority shareholders from abuse by controlling shareholders. The Companies Law protects minority shareholders from majority abuse in several manners. It stipulates that shareholders have a duty to act in good faith towards the company and other shareholders, specifically when voting for certain key issues. Controlling shareholders, any shareholder holding the critical vote or having a right to nominate or veto a nomination of an officer are required to act fairly.

Related-party transactions between a company and controlling shareholders must be approved by a special majority favoring minority shareholders. Moreover, in cases of alleged abuse, minority shareholders can petition the court to order the company to cease, desist and/or prevent abusive conduct and to compel it to change its bylaws to ensure equitable treatment of minority shareholders. The court's authority includes the ability to compel majority shareholders to buy out minority shares.
Regarding public companies, many of these abuses carry criminal liability as well, since the abuse frequently involves disclosure violations, which according to the Securities Law are enforceable both through private litigation (including class action) and criminal prosecution. In addition, to facilitate private action, the ISA is authorized to assist in the funding of class action suits and is currently promoting legislation that will enable it to provide financial assistance for derivative actions as well. Key forms of abuse include (but are not limited to the following):

- **Related party transactions:** All extraordinary transactions between a public company and controlling shareholders require approval by the audit committee, the board of directors and by special majority of the general shareholders meeting.

- **Misrepresentation in a prospectus, proxy statements, periodic and other filings:** The inclusion of misleading or false statements or material omissions are also subject to criminal enforcement. In addition, shareholders can file individual suits or class actions against companies for these violations.

- **Right to place items on the agenda of the general meeting:** The right of shareholders to add an item to the agenda of a general shareholders meeting is anchored in the Companies Law. If a shareholder introduces an item to the agenda and it is not discussed at the shareholders meeting, the shareholder can turn to the court to repeal the decision relating to the tabled item. The Israel Securities Authority cannot directly intervene in this matter, but can demand immediate disclosure and explanation of why a shareholder-proposed item was tabled.

- **Corporate opportunity:** The sale of undervalued assets to insiders constitutes abuse of a conflict of interest, usurpation of a corporate opportunity or illegal use of inside information. The Companies Law stipulates that transactions with insiders that are not approved according to Law are considered null and void. Damage to the company can be redressed through a derivative action, and in severe cases of shareholder abuse, direct action.

- **Access to corporate information:** The right of shareholders to receive information and inspect books is anchored in the Companies Law. These include minutes of general shareholders meeting, the shareholders registry, article so incorporation, financial statements and public filings. Denial of these rights can be redressed in court

- **Merger and acquisition:** Failure to disclosure merger and acquisition activity or the failure to conduct tenders as required by law, carries criminal liability as a violation of the Securities Law. In addition, shareholders can
take civil action either through individual or class action if damages can be established.

3. Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.
Shareholders can vote directly or through an attorney duly appointed by the shareholder. Custodians or nominees who do not have an explicit power of attorney from the beneficial owner are prohibited from voting.

4. Impediments to cross border voting should be eliminated.
There are currently no impediments to cross-border voting in public companies. Regulations to the Companies Law (Proxy Voting and Position Statements) require stock exchange members to distribute proxy ballots to their clients prior to the shareholders meeting. The law also accommodates the option of voting over the internet, although there is no requirement that public companies make online voting available.

5. Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.
The institution of proxy voting and the requirement that all proxy materials be disseminated to shareholders through the financial intermediaries in which accounts are held renders voting virtually effortless and costless for all shareholders in public companies.

B. Insider trading and abusive self-dealing should be prohibited.

Chapter 8A of Israel's Securities Law, which originally came into force in 1981, is dedicated to the prohibition of the "use of inside information". This prohibition is not restricted to insiders alone and relates to the use of inside information by any party. The rules and penalties regarding the use of inside information are stricter for insiders, primarily for senior executives, who under certain circumstances may be required to positively prove non-use to avoid conviction. In addition, criminal penalties are heavier for insiders than for others. The ISA has successfully enforced its insider trading provision. A significant body of case law has accrued covering a wide array of violations by both insiders and third-party offenders that have been tried, convicted and upheld on appeal.

C. Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

All corporate officers and controlling shareholders are required to immediately disclose to the company any material interest they have in a given transaction. Interested directors in a transaction are not allowed to vote on it in the board of directors meeting. In
addition, shareholder approval is required for certain related party transactions. In public companies, extraordinary transactions with controlling shareholders require shareholder approval under special majority conditions which enables disinterested shareholders to block approval of the transaction. Related party transactions must be immediately disclosed to the public.
IV. The Role of Stakeholders in Corporate Governance

The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

A. The rights of stakeholders that are established by law or through mutual agreements are to be respected.

The rights of stakeholders are respected, regardless if they are mandated by law or the result of private contracting.

B. Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

Stakeholders have the opportunity to redress violation of rights through individual or class action.

C. Performance-enhancing mechanisms for employee participation should be permitted to develop.

Employee option plans as well as other schemes for employee profit-sharing are well developed in Israel.

D. Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.

The ISA online filing system (www.magna.isa.gov.il) guarantees access to relevant, sufficient and reliable information to the entire public.

E. Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.

The Employee's Protection Act (Exposure of Violations, Misconduct, or Administrative Impropriety) 5757 – 1997 prohibits employers from dismissing or adversely affecting the working conditions of employees that have submitted or aided others to submit complaints against the employer or a fellow employee. The burden of proof in such cases is placed on the employer.

The Companies Law compels companies to appoint an external auditor, who by law must disclose any deficiencies uncovered in the course of the audit to the Chairman of the Board. Public companies are compelled to appoint an internal auditor as well, who, by law must report audit findings to the chairman of the board of directors, the CEO and the chairman of the audit committee.
F. The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.

The Companies Law and the Bankruptcy Ordinance comprise the framework for insolvency proceedings and creditor rights. Israeli bankruptcy law articulates the kind of claims a creditor can place on debt obligations, due process in debt recovering, foreclosure procedures, waiver of liens on assets and the division of assets under receivership. These regulations also categorize and prioritize creditor rights in cases of insolvency. This framework is transparent, efficient and enforceable under civil law.

The Companies Law contains various provisions that extend the protection afforded creditors beyond those stipulated in common law.

**Lifting the corporate veil** – The Court is entitled to assess corporate debt to a shareholder of the company, if it finds that the circumstances warrant this, in extraordinary cases in which the separate legal entity (*ultra virus?*) doctrine was employed in a manner designed to defraud discriminate against a creditor or in a manner deemed detrimental to the company's objectives in which an unreasonable risk was taken which affected the ability of the company to service its debts.

**Dividend distribution or acquisition of treasury shares** – Companies are entitled to distribute dividends from its earnings, and only if there reasonable certainty that the distribution will not prevent the company from meeting existing and anticipated liabilities. Companies are entitled to distribute dividends from other sources only if authorized by court order and only if the court is convinced that the distribution will not prevent the company from meeting existing and anticipated liabilities. The company is required to notify creditors of their application to the Court and the latter are entitled to object to the application to approve the distribution. Moreover, creditors are entitled to initiate derivative actions on the company's behalf in the case of unauthorized distributions.

**Mergers**—Mergers require both board of director and shareholder approval. In their deliberation of a proposed merger, the board must consider the financial condition of the merging companies and whether it reasonably believes that in wake of the merger, the acquiring company will be able to meet its financial commitments to creditors. If the assessment is negative, the proposed merger must be rejected. Merging companies are required to send the merger proposal to their secured creditors and inform non-secured creditors of the content of the merger proposal as stipulated in their bylaws.

The Court is entitled, at the petition of a merging company, to grant a delay or stay for the execution of the merger, if it finds that there is reason to believe that in wake of the merger, the acquiring company will not be able to meet the financial commitments of the target company. It is also entitled instruct the parties to take measures to secure creditor rights.
V. Disclosure and Transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

A. Disclosure should include, but not be limited to, material information on:

Israel's Securities Law has established a disclosure regime which is recognized as conforming to the highest international standards. The scope, quality and timeliness of disclosure regulation, the efficiency of the supervision and enforcement of disclosure requirements, and the immediacy and equity of public dissemination provide the information infrastructure required to promote market efficiency and integrity.

1. The financial and operating results of the company: In addition to prospectuses at the time of public offerings, public companies are required to file audited annual reports and unaudited quarterly reports, as well as current reports on material financial and operating events.

2. Company objectives: All prospectuses and periodic (i.e. annual and quarterly) reports must include a qualitative and updated description of the company's business activity, including its objectives. Prospectuses must include as well a statement outlining the intended use of proceeds from the offering.

3. Major share ownership and voting rights: The ownership structure of the company must be disclosed in prospectuses and periodic reports. All changes in the holdings of principals (including shareholders holding more than 5% of share equity, directors and the CEO and parties related to these) require the filing of a current report and a revised outline of the ownership structure.

4. Remuneration policy for members of the board and key executives, and information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board: Companies must disclose all remuneration (including assumption of liabilities and retirement/severance conditions) for each of its five highest paid employees in the prospectus and in periodic reports. In addition, any benefits given by the company to a principal (including shareholders with more than 5% holdings in the company) must be disclosed. All new contracts or revisions of contracts, including employment or service contracts, with corporate officers and controlling shareholders must be disclosed immediately as well.

Disclosure requirements (prospectuses and periodic reports) regarding directors and key executives include full identifying information, address, membership in board committees, status as independent ('external') director or
employee of the company or affiliated companies, educational background, history with the company, occupation during the previous five years, list of corporations in which he/she serves as director, and relationships to other principals (including directors and/or key executives).

5. **Related party transactions:** Disclosure of related party transactions is required in both periodic and current reports. The Securities Law and its regulations stipulate a series of well-defined disclosure requirements pertaining to transactions with related parties. In addition, the Israel Securities Authority actively monitors compliance to ensure that all relevant information is properly disclosed in practice. Some of the major provisions for related party disclosure include:

- Transactions with principals (directors, CEO and shareholders with 5% or more interest, relatives of and entities controlled by any of these) must be disclosed in annual reports.
- All company decisions requiring special shareholder approval according to Article 270 of the Companies Law, which deals with related party transactions, including extraordinary transactions between the company and corporate officers and transactions pertaining to exemptions from liability, insurance and reimbursement, must be disclosed in current and periodic reports.
- Transactions with controlling entities must be disclosed in current as well as periodic reports.
- Transactions with subsidiaries must be disclosed in current and periodic reports. Transactions with affiliates that do not fall within the above must be disclosed in annual reports.

6. **Foreseeable risk factors:** Prospectuses and annual reports must include a summary and analysis of risk factors facing the company. In addition, the "Board of Directors Report" (MD&A) requires a discussion of the company's exposure to risk, including a description of its risk management policy. This information must be updated in quarterly filings.

7. **Issues regarding employees and other stakeholders:** All material corporate developments and events must be disclosed immediately in current reports. This includes issues regarding employees and other stakeholders, which must also be included in prospectuses and annual reports as part of the disclosure of the company's business development.

8. **Governance structures and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented:** There is currently no requirement for companies to adopt or disclose a corporate governance code or policy. As indicated above, key good governance provisions are mandated in the Companies Law.
For private companies disclosure requirements are more limited. Private companies must submit an annual report to the Companies Registrar, which includes the following information: the date on which the annual general meeting was held, the division of shareholders equity, the identity of the shareholders and their shareholdings, bearer shares in circulation, details concerning serving board members, directors which began their terms since the date of the previous annual report, the name of the external auditor and the company’s chief executive. In cases in which the company’s bylaws do not place conditions on the transferability of shares or do not prohibit public offerings or do not restrict the number of shareholders to fifty, the company is required to attach the balance sheet included in its financial statements.

In addition, a private company must report to the registrar the following: changes to the by-laws (including changes of name, which is subject to the approval of the Registrar), changes in registered share capital and addresses changes for the registered office. In addition the company must disclose: appointees to the board of directors and changes in board composition, all share placements or transfers, mergers or change of status from public to private company.
B. Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.

Israel has officially adopted IFRS for public companies, to be fully implemented by January 2008. Major companies have already opted for early adopt of these international standards. Israel's disclosure regime for public companies requires the disclosure of all financial and non-financial information material to the process of investment decision-making.

Disclosure requirements according to the Securities Law apply solely to companies that issue securities to the public in Israel. For private companies disclosure requirements are more limited. Private companies must submit an annual report to the Companies Registrar, which includes the following information: the date on which the annual general meeting was held, the division of shareholders equity, the identity of the shareholders and their shareholdings, bearer shares in circulation, details concerning serving board members, directors which began their terms since the date of the previous annual report, the name of the external auditor and the company’s chief executive. In cases in which the company’s bylaws do not place conditions on the transferability of shares or des not prohibit public offerings or does not restrict the number of shareholders to fifty, the company is required to attach the balance sheet included in its financial statements.

C. An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.

The Companies Law requires the appointment of an independent external auditor. Similarly, regulations under Israel's Securities Law require that annual reports be audited by an independent external auditor. Auditor independence is defined in Accountants Law Regulations (Conflicts of Interest and the Injury to Independence Resulting from Other Engagements) issued by the Ministry of Justice, in the Israel Securities Authority's decision on external auditor independence and in directives issued by the Israel Institute of Certified Public Accountants.

In addition to the external auditor, the Companies Law requires that public companies appoint an internal auditor who cannot be either a principal of the company, a director or senior executive or a relative of any of these.

D. External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.

Under the Companies Law the external auditor is appointed by the shareholders at the general shareholders meeting. If the auditor discovers deficiencies, he reports them to the
chairman of the board of directors, who by law must convene a board meeting to discuss these issues. The board is also charged with negotiating auditor fees and with discharging an auditor if his independence from the company is compromised. Auditors are required under the Securities Law to sign annual reports and prospectuses of public companies and accordingly are liable to the shareholders for the accuracy of financial information.

E. Channels for disseminating information should provide for equal, timely and cost efficient access to relevant information by users.

Information is disseminated to investors by several means. Laws are published in the Official Gazette, which is disseminated to the public at large through the Ministry of Justice's website (www.justice.gov.il). Earnings reports and all other required disclosures are distributed in real time through the Israel Securities Authority website (www.magna.isa.gov.il). The information on this website is free to all non-commercial users. Content is keyword searchable and can be downloaded at no cost. Financial data can be downloaded to Excel® spreadsheets, facilitating cross-sectional and time-series comparisons. Certain information and announcements must also be published in widely-circulated newspapers, including two major financial daily papers.

F. The corporate governance framework should be complemented by an effective approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest that might compromise the integrity of their analysis or advice.

The Law for the Regulation of Investment Advice, Investment Marketing and Investment Portfolio Management 5755–1995 requires investment advisors to be objective in their advice and to disclose any conflict of interest they may have in rendering their advice. Financial analysts currently fall under the heading of investment advisors and are subject to licensing and the provisions of the Law. Financial analysts working in an investment marketing firm are not required to be objective, however, their affiliation must be disclosed and prominently displayed.
VI. The Responsibilities of the Board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders.

A. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

The Companies Law stipulates that the all corporate officers, i.e. directors and executives, must act in good faith and care to the benefit of the company. They must avoid undertaking activities bearing potential conflicts of interest or which compete with the company's activities. They can approve activities in which there is an apparent conflict of interest or corporate opportunity only if it is deemed that the officer acted in good faith and that the activity is not harmful to the company, and only if the officer disclosed his/her interest in advance.

B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

The one share/one vote rule imposed on listed companies by virtue of the Securities Law limits the ability to differentiate shareholders of public companies in Israel. In addition, the Companies Law prohibits the company from undertaking any action that discriminates against all or some shareholders. A shareholder can petition for a court order to prevent or repeal discriminatory actions.

C. The board should apply high ethical standards. It should take into account the interests of stakeholders.

The fiduciary duties articulated in the Companies Law require all corporate officers, including board members to exhibit high ethical standards which render the interest of the company and its stakeholders as taking precedence over other interests the officer may have.

D. The board should fulfill certain key functions, including:

The Companies Law articulates a set of basic board responsibilities, which cannot be delegated to a third party, including the Company's CEO and in some cases, even board of director committees.

1. Determine corporate strategy, major plans of action, risk policy, annual budgets and business plans; set performance objectives; monitor implementation and corporate performance; and oversee major capital expenditures, acquisitions and divestitures.

According to the Companies Law, the board of directors is vested with the authority to outline company policy and set a company's action plan, as well as the method of financing its implementation. It is charged with monitoring the company's financial situation and in determining the financial leverage the company will undertake.
2. **Monitor the effectiveness of the company’s governance practices and making changes as needed.**
The board of director audit committee, (the appointment of which is compulsory for public companies) is charged with addressing deficiencies in the management of the company's business, which could be interpreted to include governance practices.

3. **Determine organizational structure and remuneration policy and, when necessary, replace key executives and oversee executive succession.**
The Companies Law authorizes the board of directors to set organizational structure and to appoint and dismiss the CEO. The Law also stipulates the directors' fiduciary duty to align its actions to benefit the company and its shareholders.

4. **Ensure a formal and transparent board nomination and election process.**
The conditions and qualifications for nominating and electing board members are articulated in the Companies Laws, including provisions applicable to public companies, which require the appointment of independent directors and the appointment of directors with expertise in finance and/or accounting. In public companies, the board is required to set the minimum number of directors that must possess financial expertise.

5. **Monitor and manage potential conflicts of interest of management, board members and shareholders, including misappropriation of corporate assets and prejudice in related-party transactions.**
The Companies Law charges the board of directors with the responsibility of monitoring the performance of the CEO and his/her activities. This includes monitoring conflicts of interest, the misappropriation of corporate assets and abuse of related party transactions. In public companies, the CEO of the company cannot concurrently serve as its chairman of the board and the responsibilities of the CEO cannot be assigned to the chairman of the board.

6. **Ensure the integrity of the corporation’s accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.**
The Companies Law mandates that the board of directors be accountable for the preparation and approval of financial statements. It is required to report to the general shareholders meeting on the state of the company and its business performance. The board must also approve the company's financial statements.

7. **Report to shareholders and oversee the process of disclosure and communications**
The Companies Law requires that the board report to the annual shareholders meeting on the condition of the company and its business performance. The Securities Law requires the boards of public companies to oversee the process of disclosure and communications. Directors are personally liable for the scope and accuracy of statements disclosed in prospectuses and other filings to the public.

8. **Determine financial structure and dividend distribution**
The Companies Law requires corporate boards to monitor the company's financial structure and set its credit framework. The board is responsible for initiating and approving all securities issues, including shares, bonds and convertible securities. Dividend distribution is also subject to board approval.

9. Approve related-parties transactions
The Companies Law mandates that all related-party transactions must be approved by the board of directors. Other transactions may also require board approval, as set in the company's by-laws.

10. Render opinions on special tender offers
The Companies Law requires that in incidences in which the transfer of control in public companies necessitates a special tender offer, the board of directors must make public its opinion regarding the offer.

11. Set board policy on issues subject to approval by the general shareholders meeting
The Company's Law requires that the board of directors adopt a stance on all issues placed before the shareholders for their approval.

E. The board should be able to exercise objective independent judgment on corporate affairs.

1. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are ensuring the integrity of financial and non-financial reporting, the review of related party transactions, nomination of board members and key executives, and board remuneration.

   The Companies Law stipulates that public companies appoint at least two independent directors, at least one of which must have expertise in accounting and/or finance. In addition, all independent directors must also be members of the board's audit committee (the appointment of which is compulsory for public companies.

2. When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.

   The Companies Law empowers the board of directors to establish committees as it deems fit, unless the company's bylaws stipulate otherwise. The Law prohibits the board from delegating some of its responsibilities to a committee and stipulates that if a certain responsibility is delegated to committee, all members of that committee must be board members and at least one member is an independent (external) director. Public companies are compelled to appoint an audit committee. The composition, responsibilities and procedures for audit committee meetings are stipulated in the Companies Law.
3. **Board members should be able to commit themselves effectively to their responsibilities.**

The Companies Law mandates that the board of directors of public companies meet at least once every three months. There are no limitations on the number of other positions a director may have. At the same time, the duty of care mandated by the Companies Law requires him to act at a level of expertise that a reasonable corporate officer in the same position and facing equivalent circumstances would act and to take reasonable measures to obtain information regarding the activity under approval.

**F. In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.**

The Companies Law guarantees the right of all directors to examine and receive copies of corporate documents and to examine the company's assets in order to fulfill his/her duties as a director. Independent directors can request a court order granting directors these rights with regard to affiliated companies as well.