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## ISRAEL SECURITIES AUTHORITY

### Offer of Securities to Qualified Investors

The Securities Law stipulates that the offer of securities to the public requires publication of a prospectus. Corporations, whose securities are offered according to a prospectus or are registered for trade on the stock exchange, have to submit regular reports in accordance with the Securities Law and its Regulations.

One of the exceptions to this requirement, to publish a prospectus, is an offer to investors considered by the legislator as not being in need of protection, at the time when securities are offered to them.

These investors are characterized by their ability to make educated decisions, hence the legal protection, provided by the law, is not essential for them.

These investors are usually termed "Institutional", "Qualified" or "Classified". The term "qualified investors" is also used in other contexts in the securities laws, particularly in cases where the legislator finds it appropriate to differentiate between a "small investor", for whom all the legal protections are created, and those defined as "qualified investors". The subject of the present paper is: "Who is to be included on the qualified investors' list?"

**The purpose of this paper is to offer a definition for both individuals and corporations (that are not of the kind that are already active on the capital market and are listed under the First Appendix), under which they will be regarded as "qualified investors" under the Israeli law.**

- I Review of contexts in which the definition of "qualified investor" is mentioned or required, under the Israeli law;
- II Presentation of "qualified investor" definitions for different matters under foreign laws (under the European Directive, USA, Britain and France in light of the EU definitions);
- III Proposals for definition of individuals and corporations as "qualified investors" under the Israeli law;

#### **I. The contexts in which "qualified investors" are mentioned under the Israeli Securities Law**

- (1) According to Securities Law, Section 15A – shall not be perceived as "a public offer" for the purpose of section 15, an offer for the listed below -
  - (a) **A corporation listed under the appendix:**
    - (1) A **Fund** or a **Fund Manager** within the meaning thereof under the Joint Investment in Trust Law;
    - (2) A **Provident Fund** or a **Management Company** within the meaning thereof under the Supervision of Financial Services Law (Provident Funds) 2005,



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- (3) An **Insurer** within the meaning thereof under the Supervision of Financial Services Law (Insurance) 1981,
  - (4) A **Banking Corporation** and an **Auxiliary Corporation** within the meaning thereof under the Banking Law (Licensing) 1981, except for a joint services company, which acquire for themselves or their clients who are investors listed under the appendix to this section;
  - (5) A **Portfolio Manager** within the meaning thereof under section 8(b) of the Regulation of Investment Advice and Investment Portfolio Management Law 1995, which acquires for himself or his clients who are investors listed under the appendix to this section;
  - (6) An **Investment Adviser** within the meaning thereof under section 7(c) of the Regulation of Investment Advice and Investment Portfolio Management Law 1995, acquiring for himself;
  - (7) A **Member of the stock** exchange acquiring for himself, or his clients who are investors listed under the appendix to this section;
  - (8) An **Underwriter**, who is qualified under section 56 (c), acquiring for himself;
  - (9) A **Venture Capital Fund**; for this purpose "*venture capital fund*" – a corporation whose main business is investment in corporations whose main business, at the time of investment, is Research & Development, or production of innovative and high tech products or processes, and the risk of investing in them is higher than customary in other investments;
  - (10) A **corporation whose main business is in the capital market area**, and which is under full ownership of investors listed under the appendix to this section;
  - (11) A **corporation**, except for a corporation which was incorporated for the acquisition of securities in a particular offer, whose equity or the scope of assets is higher than 250 million NIS; in this clause "*equity*" – including foreign accounting rules, International Standards and American Accounting Standards within the meaning thereof under the Securities Law Regulations (Annual Financial Reports) 1993;
- (b) A **corporation incorporated outside Israel, where the Israel Securities Authority is of opinion that the aforesaid corporation can attain the information required for the purpose of making the decision to invest in securities and which would have been included in a prospectus, if it was published**;
  - (c) A **Controlling shareholder, a General Manager (CEO) or a Director in a corporation whose securities are being offered, or a corporation controlled by a corporation whose securities are being offered**;
- (2) According to Securities Law Regulations (Offer of Securities to the public) 2006, that were passed into law following the legislation of the regulations regulating the



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new underwriting system, it is possible to offer securities by means other than the "equable offer", in an offer where at least 70% of investors are institutional investors.

**According to the aforesaid regulations the institutional investors are one of the following:**

- (1) An **Investor designated under clauses (1) to (3) or (11)** under the First Appendix to the Law, who is acquiring for himself;
  - (2) A **Banking Corporation** and an **Auxiliary Corporation** within the meaning thereof under the Banking Law (Licensing) 1981, except for a joint services company, which acquire for themselves;
  - (3) A **portfolio manager**, which acquires for his clients who are investors listed under clauses (1) (2) or (4), for the purpose of the aforesaid acquisition;
  - (4) A **Corporation incorporated outside Israel** whose characteristics are similar to those of the investor listed under clauses (1) or (2)
- (3) According to Securities Law Regulations (Offer of Securities to the public) 2006, that were passed into law following the legislation of the regulations regulating the new underwriting system, an offeror or an underwriter are authorized to accept an early commitment from a classified investor to submit an order for securities that will be offered according to a prospectus, prior to the publication of said prospectus, and to pay a commission for it, under certain circumstances.

A *classified investor*, for the purpose of this ruling, is an investor listed under section 15A (b)(1) or (2) of the Law; and they are:

- a. A corporation listed under the Appendix (see detailed lists under section 1(a) or above)
  - b. A corporation that was incorporated outside Israel, where the Israel Securities Authority is of opinion that the aforesaid corporation can attain the information required for the purpose of making the decision to invest in securities and which would have been included in a prospectus, if it was published;
- (4) According to the Regulation of Investment Advice and Investment Portfolio Management Law (Amendment 11) 2006, (henceforth – the Investment Advice Law), there is no obligation to acquire the investment advice license in order to engage in investment advice for a corporation listed under the First Appendix of the Securities Law (see detailed lists under section 1(a) or above). According to the proposed amendment to the Investment Advice Law, in place of reference to the aforesaid Securities Law, the amendment will contain the list of entities listed under the Appendix to the Securities Law, while the condition that requires them to purchase for themselves – will be omitted.



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**II Presentation of the term "qualified investors" in regard to various matters under foreign laws**

**In American Law:**

- (1) Two terms are used in regard to our subject matter – Qualified Purchaser and Accredited Investor, both of these terms appear in a number of Securities laws in the US.

**According to the Securities Act of 1933**

1. An issuer or an offeror to register offered securities with SEC, unless they are entitled to a certain exemption. According to the Law it is permissible to sell non-registered securities by means of a prospectus in a non-public offer. A non-public offer is, inter alia, an offer made to Accredited Investors. These investors are defined under Rule 501, Regulation D.
  - (1) Bank, Insurance Company, Investment Company registered according to the law
  - (2) Bonuses to employees plan, providing a bank is the decision maker regarding investments in the aforesaid plan, an Insurance Company, a registered Investment Adviser or it holds assets in excess of 5 million dollars
  - (3) A Charitable organization, or a Corporation that holds assets in excess of 5 million dollars
  - (4) Director, Senior executive officer or a General Partner in an issuer
  - (5) A Corporation all of whose owners are Accredited Investors
  - (6) An individual whose net worth, along with a spouse, is above one million at the time of purchase
  - (7) An individual with an income above \$ 200,000, two year prior to the time of purchase (or \$ 300,000 along with a spouse), and there is a reasonable prospect for a similar income in the present year
  - (8) A Trusteeship with assets in excess of 5 million dollars, which what not established for the purpose of purchasing the offered securities, and whose investment decisions are made by a sophisticated person.

**Amendments Proposed to the American Law**

In RELEASE 33-8766, from 27.12.2006, the SEC has published a proposal to amend the definition of a "qualified investor". The SEC had announced its intention to limit the sale



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of certain types of units, carried out by means other than prospectus for individuals with capital.

The Securities and Exchange Commission claims that sums stipulated under clauses 6 and 7, pertaining to assets and incomes of individuals, were determined in 1982 and that during the last 25 years the personal wealth of individuals had risen, a fact that allowed many more individuals to enter the "Accredited Investors" category, whilst the financial instruments in which they can invest without prospectus became far more complex - with very limited information about them, available to the public. In particular complex composition of commissions, structural conflicts of interest, and higher risk related to yields expected from the aforesaid financial instruments.

In SEC's opinion the protection required by an individual investor and suitable for the matter at hand, already exists under the Investment Company Act 1940, in regard to a "Qualified Purchaser" (see - section 4 henceforth). It, therefore, proposes a new category – "**Accredited Natural Person**" pertaining to investors in certain "**private investment vehicles**". The investor will be defined as whoever satisfies requirements stated under the aforesaid clauses 6 and 7, and holds 2.5 million dollars worth of assets, as an additional provision. Companies regarding which the investment possibilities of individuals will be reduced are - investment companies that would have come under the Investment Company Act 1940, if they were offering securities or units to the public and owned by less than 100 individuals, as well as companies that come under exemptions according to the 1933 Law (offers to qualified investors only).

The Securities and Exchange Commission also proposes to update the sums stipulated under clauses 6 and 7, due to increases in the living index in the US since 1982, to 1.9 million dollars, \$ 388,000 individual income and \$ 582,000 income for a couple.

In SEC's estimation the 1982 sums had referred to about 1.87% of the US population, while currently they refer to about 8.47%.

In SEC's estimation the adoption of the 2.5 million dollar requirement in investment, regarding a single individual, relates to about 1.3% of the population and in SEC's view it is an appropriate percentage of individual investors who are apt to invest directly in the complex financial instruments that exist on the market, including Hedge Funds, and therefore should be permitted to do so.

1. According to the Securities Act 1933, Rule 144, it is permissible to sell blocked securities (securities allocated to the offeror as part of exemptions from publishing a prospectus, according to the Securities Act 1933, and are not subject to free sale on the stock exchange) to Qualified Institutional Buyers (QIB). QIB are – entities that hold or manage large amounts of securities, between 10 - 100 million dollars.
2. According to the Securities Act 1933, under state laws there are no registration requirements for Covered securities that, inter alia, are offered to Qualified purchasers.<sup>1</sup>

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<sup>1</sup> SALES TO QUALIFIED PURCHASERS.—A security is a covered security with respect to the offer or sale of the security to qualified purchasers, as defined by the Commission by rule.



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The SEC was authorized to define a "Qualified purchaser" for the purpose of this ruling and it chose to adjust it fully to the definition of an "Accredited investor" from the 1933 law.

The interpretation given by the SEC to this term is – a qualified investor, capable of protecting himself in a way that makes legal protection redundant. An investor who has access to information that has to be revealed under the law. With such relevant parameters as – financial sophistication, financial worth, knowledge, experience in financial matters and a range of managed assets.

### According to the Investment Company Act 1940

- 4 A corporation will not be considered an investment company for the purpose of the application of the law, if it's owned by Qualified purchasers only. For this purpose Qualified purchasers are – those holding investments of a certain amount. According to SEC this parameter serves as an indicator of the level of financial sophistication required for investment in an investment company.**

The size of the investment required to qualify as a Qualified purchaser is – 5 million dollars for an individual and 25 million dollars for a corporation.

According to SEC these high amounts are required in order to insure the understanding of the special risks embedded in Pooled Vehicles.

### According to the Advisors Act 1940

- 5 There is a limited exemption from the prohibition of the law to charge the clients commissions related to performance. The exemption allows to collect commissions from whomever has \$ 750,000 managed by an investment adviser, or whoever possesses a capital in excess of 1.5 million dollars, or whoever is defined as a Qualified purchaser under the Investment Company Act 1940.**

### (2) In European Directives

The European directive (**Prospectus Directive** 2003/71/EC) defines basic disclosure requirements mandatory for issuers of securities offered for public acquisition or registered for trade on a regulated market in one of the EC countries. According to this directive a public offer requires publication of a prospectus and issuers/offerors are exempt from this obligation if they offer securities to Qualified Investors.

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In prescribing such rule, the Commission may define the term “qualified purchaser” differently with respect to different categories of securities, consistent with the public interest and the protection of investors.



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For this purpose Qualified Investors are:

1. Legal entities authorized to act on the capital market, including - credit institutions, investment companies, other supervised financial entities, trust funds and their managers, insurance companies, pension funds and their managing companies, and other corporations which were incorporated for investment on the capital market.
2. Governmental institutions, central banks, international financial entities
3. Corporations complying with two of the three conditions, listed below:
  - Employs more than 250 employees
  - The balance is over 43 million Euro
  - Turnover or scope of activities are over 50 million Euro
4. Certain individuals – subject to mutual agreement, the EC member state can permit an individual, who is not a resident of the country and who applies to be recognized as a Qualified Investor, to be recognized as such if he complies with two of the following conditions:
  - Carries out significant transactions on the securities market at the average rate of at least 10 transactions in a quarter, during the last 4 quarters
  - His investment portfolio is over 0.5 million Euro
  - He is employed or has been employed in the financial sector for at least one year, in a professional capacity requiring understanding of investment in securities.

The European Directive – Markets and Financial Instruments (**MiFID**) 2004/39/EC – obligates providers of financial services, in the EC member states, to classify their clients according to three categories: **professional clients, eligible counterparties and retail clients**; and to ensure that the financial instruments offered to each client correspond with that client's ability to understand it and the risks it carries. The last group of investors is supposed to enjoy the broadest protection, while making investments.

According to the aforesaid directive the "**retail client**" is – any client who is not professional. The definition of **professional clients** includes the following:

1. Legal entities authorized to act on the capital market, including - credit institutions, investment companies, other supervised financial entities, trust funds and their managers, insurance companies, pension funds and their managing companies.
2. Corporations that comply with two of the three conditions, detailed below:
  - Own funds that worth 2 million Euro
  - Have a balance above 20 million Euro
  - Have a turnover or scope of activities over 40 million Euro
3. Governmental institutions, central banks, international financial entities
4. Other corporations, incorporated for the purpose of investment in financial instruments or for securitization of assets or other financial transactions



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5. Certain individuals – the EC member state can permit an individual, who is not a resident of the country and who applies to be recognized as a Qualified Investor, to be recognized as such if he complies with two of the following conditions:
  - Carries out significant transactions on the securities market at the average rate of at least 10 transactions in a quarter, during the last 4 quarters
  - His investment portfolio is over 0.5 million Euro
  - He is employed or has been employed in the financial sector for at least one year, in a professional capacity requiring understanding of investment in securities.

### **(3) Qualified Investor in the British Law**

Prospectus Directives were adopted in Britain in May 2006, (The Prospectus Regulations 2005), in accordance with FSA directive deals with the registration list of qualified investors that will be available to all issuers and investors.

- 1 **A person will be considered a QI if he is registered on the aforesaid list and if complies with two of the following requirements:**
  - 1) Carries out significant transactions – at least 1000 Euro and at least 10 transactions in a quarter, during the last four quarters.
  - 2) The value of his investment portfolio is over 0.5 million Euro
  - 3) He is employed or has been employed in the financial sector for at least one year, in a professional capacity requiring understanding of investment in securities.
- 2 **A Corporation will be considered QI only if it is registered on the aforesaid list and if complies with two of the following requirements:**
  - 1) Employs over 250 people
  - 2) Its Balance is over 43 million Euro
  - 3) Its turnover or scope of activities are over 50 million Euro

**The Qualified Investors also include legal entities authorized to act on financial markets (investment companies and insurance companies), governments and international bodies.**

### **(4) Qualified Investor in the French Law**

**As part of the legislation for the adoption of the Prospectus Directive, the definition of a Qualified Investor has been broadened in France, in May 2006. (Decree no. 2006-557 of May 16 2006). Following the aforesaid legislation, exemptions from prospectus for private allocation of securities that are not fund units, had also become broader.**



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**In the French law, the definition of QI relates to a legal entity in possession of qualifications and capabilities required for the understanding of risks embedded in transactions involving financial instruments.**

The list includes:

- 1) Banks
- 2) Insurance companies
- 3) Investment companies acting on behalf of funds or qualified investors
- 4) Brokers
- 5) A number of governmental institutions

The new list adds:

- 1) Companies whose main occupation is acquisition and management of assets of insurance companies
- 2) Investment companies – trust funds and other bodies that are engaged in investments (RIT, UCITS, Securitization Funds)
- 3) Various Pension funds
- 4) Assets' management companies authorized to act on behalf of clients
- 5) Entities complying with at least two of the following provisions:
  - Employ more than 250 employees
  - Balance above 43 million Euro
  - Its turnover or scope of activities are over 50 million Euro

**(An entity that complies with only one of the aforesaid requirements can be considered as a Qualified Investor if it appears on the AMF<sup>2</sup> list)**

- 6) Individuals complying with the following provisions:
  - Are part of this list of QI
  - Active in independent acquisition
  - Comply with one of the following:
    - Hold an investment portfolio of more than 0.5 million Euro
    - Carry out transactions in financial instruments of more than 600 Euro per transaction, and perform more than 10 transactions, on average, in a quarter during the last four quarters

**The Qualified Investors, on the French list, also include those defined as QI in other member states of the EC.**

### **III Proposal for defining the term "qualified investors" under the Israeli law**

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<sup>2</sup> A list compiled by the Ministry of Economy in September 2006, it is not published but it is possible to receive confirmation that a certain entity is on the list. Whoever is on the list can ask to be removed from it, at any time.



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The purpose of this proposal is compile a list of entities and individuals in regard to which it will be possible to state that they are capable of protecting themselves in a way that makes a legal protection redundant; since they have access to information that must be available to investors under the protection of the law.

The criteria relevant to the examination of entities that might be included on the aforesaid list, of Qualified Investors, consists of – financial sophistication, equity or assets, knowledge, experience in financial matters and the extent of managed assets.

The aspiration is to define a number of simple and clear rules, in order to maximize the definitiveness required in planning capital raising activities, and to use the most fitting criteria for the characterization of whoever is able to make educated investment decisions on his own, in a way that makes legal protection over him redundant.

The reservations were related to the following issues:

Decision on the criteria relevant for being designated as a Qualified Investor (QI), was based on the following – is the asset examination relevant in regard to an individual and the equity criteria for a corporation, or is it surplus annual income for an individual and assets or investments in financial are – for a corporation?

Is the ability of an individual to estimate the profitability of a financial investment, or his ability to engage someone to make this investment for him – relevant criteria? Or is the scope of financial investments that the investor manages by himself, or are the surplus sums available to him for financial investments?

Should the QI definition apply to all corporations or public companies only? Or is it correct to stipulate that any corporation with certain equity or assets shall be designated as a QI?

Are the numerical values stipulated regarding individuals and corporations, pertaining to their designation as QI, fit the Israeli capital market? Do these definitions hedge correctly the population being defined as Qualified Investors?

**In light of the aforesaid the following recommendations have been formed:**

**Qualified Investors will include all those presently listed under the First Appendix of the Securities Law**

**(1) The following will be added to the list under the First Appendix of the Securities Law:**

**1) An individual with financial investments of 15 million NIS;**



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- 2) **A corporation with the equity capital of 50 million NIS (in place of a corporation with the equity capital of 250 million NIS listed under the First Appendix);**
  - 3) **Private Investment Fund – for this purpose "*private investment fund*" – a corporation whose main business is investment in corporations and those who invest in it are listed under the First Appendix;**
  - 4) **A corporation incorporated outside Israel with characteristics similar to those listed under the First Appendix;**
- (2) **It is proposed (for the purpose of the Investment Advice Law) to stipulate that - those listed under the list provided above will also be allowed to provide investment advice without a license.**