

# **Final Report of the Inter-Ministerial Committee for the Study of the Establishment of a Dedicated Stock Exchange for Small and Medium-Sized Companies in Israel**



**Short Version**

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This is a translation of a short version the full Final Report. For the full original text in Hebrew (submitted in June 2018), please [Click here](#).

## 1. Introduction

On April 26, 2016, Minister of Finance Moshe Kahlon and Minister of Justice Ayelet Shaked announced the appointment of a team to study the establishment of a capital market specifically for small and medium-sized enterprises (hereinafter, “the Team”), whose members would be representatives of the Ministry of Finance, the Israel Securities Authority (hereinafter, “the ISA”), the Ministry of Finance Budget Division, and the Tax Authority.<sup>1</sup>

A review of high-growth companies and small and medium-sized enterprises (SME) in the local capital market leads to the conclusion that the stock exchange has not served as an effective alternative arena for capital raising for such firms, especially due to factors related to the companies’ size and scope of operations: the listing requirements are too high for them; the current regulatory costs are disproportionate to SME size; and more attractive alternatives for capital raising are available.

International opinion concurs that SMEs make a significant contribution to economic growth and development, and drive improvements in employment rates, innovation, and business development.

As in other countries the world over, SMEs are major drivers of growth in the Israeli economy, yet most find it difficult to obtain financing for their operations through the currently existing channels, for various reasons. The government’s policy to assist SMEs, whose success and development are important for the economy as a whole, prompted the initiative to establish a dedicated stock exchange for SMEs (hereinafter, “the SME Exchange”). The SME Exchange will give small and medium-sized enterprises access to public financing channels that have not been available to them to date. Public financing has many advantages, including relatively low costs, liquidity for investors, diversification of risks, the public directly benefits from the success of these companies, and promotion of long-term growth.

Until now, the TASE also did not constitute a significant alternative for high-growth firms,<sup>2</sup> although for slightly different reasons. High-growth firms are typically firms in

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<sup>1</sup> For the announcement by the Ministry of Finance, see: [link to the Ministry of Finance website](#).

<sup>2</sup> This term is mainly used to describe companies that are a relatively early stage in their business and maturity. Usually these companies’ business is related to the development of technological or scientific products. Most of these firms lack a significant stream of income or operating profit, they have a need

the early stage of their development, and require capital and credit to finance their business operations and develop into mature firms with stable and strong cash flows. Access to public financing gives such companies a new channel of financing and also contributes to the development of the capital market and increases the diversity of the investment vehicles available to investors. Furthermore, establishment of an SME Exchange will help increase the Israeli public's exposure to high-growth and technology-intensive firms that have accounted for an insignificant share of capital market activities until now; it will create a stepping stone to major markets for high-growth companies; it will help promote the country's interests to keep these companies in the local market, consequently enhancing Israel's competitive edge as a technological world power and contributing to increased economic productivity.

In view of these benefits, the Team was requested to present its recommendations to the ministers regarding the means and measures that will enable the establishment of an SME Exchange, in which small and medium-sized enterprises will be listed, with a view to models existing worldwide and the unique features of the Israeli market, and emphasis on removing barriers and relaxing requirements to accommodate the needs of these firms, without compromising on protection of the interests of the investor public and proper trading rules and procedures.

On November 26, 2017, the Team submitted the Interim Report of the Inter-Ministerial Committee for the Study of the Establishment of a Dedicated Stock Exchange for Small and Medium-Sized Companies in Israel (hereinafter, "the Interim Report") and published the report for public comments.

The recommendations presented in this Final Report were developed after a review of the public's comments and a comprehensive review of the experience of similar exchanges worldwide, including an analysis of the structural features, the success factors, and the lessons learned by secondary stock exchanges worldwide, and a specification of the needs of small and medium-sized firms in Israel. The Team held several meetings to discuss the findings and insights that emerged from the analysis of the review of theoretical and research literature, the meetings held with various market players, an analysis of the public comments received, the interim recommendations,

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for external financing to develop or expand their business operations, they are in the R&D stage, lack a finished product, and so on and so forth.

and the totality of implications of establishing a dedicated stock exchange, all of which were taken into consideration by the Team in developing its final recommendations.

**The members of the inter-ministerial team for the establishment of an SME exchange in Israel are:**

- Committee Chair: Ms. Anat Guetta, Chair of the ISA (who replaced Prof. Shmuel Hauser)
- Committee Chair: Attorney Meir Levine, Deputy Attorney General (Economic Law)
- Mr. Eran Yaakov, Director of the Tax Authority (who replaced Attorney and CPA Moshe Asher)
- Ms. Nirit Iby, Adviser to the General Director of the Ministry of Finance
- Mr. Yogev Gardos, Deputy Head of Budgets, Ministry of Finance

**Inter-ministerial committee coordinators:**

- CPA Ilan Zioni, Director of Disclosure and Reporting, Corporate Department, ISA
- Attorney Ronny Talmore, Senior (acting) head of Corporate Laws, Department of Consultation and Legislation (Economic Law), Ministry of Justice

In addition to the members of the inter-ministerial team, many people contributed to this report, and we express our gratitude to them: The Economic Department, the Corporate Department, and the Investment Department, ISA; The Consultation and Legislation (Economic Law) Department, Ministry of Justice; Budget Division, Ministry of Finance; professional consultation to the director of the Tax Authority and the Professional Division, Tax Authority.

For the Team's letter of appointment, see **Appendix A** to the Final Report.

## 2. Highlights of the Team’s Recommendations

Following is a brief summary of the Team’s recommendations:

### 2.1 The supervisory model

The most common supervisory model used worldwide in secondary stock exchanges is the model adopted by the AIM<sup>3</sup> in the UK, which has been applied in several variations in secondary exchanges worldwide. According to this model, the stock exchange supervises the companies listed on the secondary exchange through regulatory advisers (known as nominated advisers, or Nomads<sup>4</sup>) who perform continuous oversight, in contrast to the regulation model used by the main stock exchange, the London Stock Exchange (LSE), where the listed companies are supervised by the regulatory authority, the Financial Conduct Authority (FCA). That is to say that according to the common supervisory model used in secondary stock exchanges around the world, secondary stock exchanges play a major role in the supervision and control over accompanying regulatory advisers and over the listed companies, while the regulatory authority has residual authority only.

The Team believes that the model of supervision based on nominated advisers should also be implemented in the SME Exchange in Israel. The Team, however, found that the appropriate infrastructure required to implement such a model is current lacking. Furthermore, the current regulatory structure in Israel poses several challenges if significant supervisory and enforcement powers are delegated to such an SME Exchange, which would be a privately owned for-profit entity.

**Consequently, the Team recommends that the SME Exchange be set up under a supervisory model that is similar to the supervision that currently applies to the companies listed on the TASE (“the Primary Market”). In other words, the companies will be supervised directly by the ISA, in line with the regulation that is proposed to apply to these companies (described in this Report below), in a**

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<sup>3</sup> AIM – Alternative Investment Market, established within the LSE for small and high-growth firms.

<sup>4</sup> Briefly stated, the supervisory model in the AIM is structured such that the AIM has direct supervision over the firms, and such supervisory powers are effectively exercised through a mediator, the NOMAD. The NOMAD is an entity that is licensed by the LSE, after meeting certain qualifications and other criteria, and is subject to the LSE’s supervision, and the firms are obligated to appoint a NOMAD over the entire course of their lifetime as firms listed on the AIM. The NOMAD’s main duty is to verify and ensure that the company complies with the exchange rules and to provide oversight on regulatory matters and corporate governance issues. For the regulatory structure of the AIM, see Appendix B to the Final Report.

**manner consistent with the nature of these companies, their size, and other features, and with other globally accepted models in which the regulator is the primary regulatory entity.**

Such a supervisory model is in place in the Canadian exchanges — the Toronto Stock Exchange (TSX) and its secondary market, the Toronto Stock Exchange Ventures (TSXV). These markets are supervised by the regulator, similar to the situation in Israel.

In the future, the Team proposes to revisit implementation of a NOMAD-based supervisory mechanism for the SME Exchange.

Direct supervision by the ISA obviates the need to appoint nominated advisers. Under this supervisory model, an obligation to do so would only constitute an additional regulatory burden and added costs for companies listed on the SME Exchange.

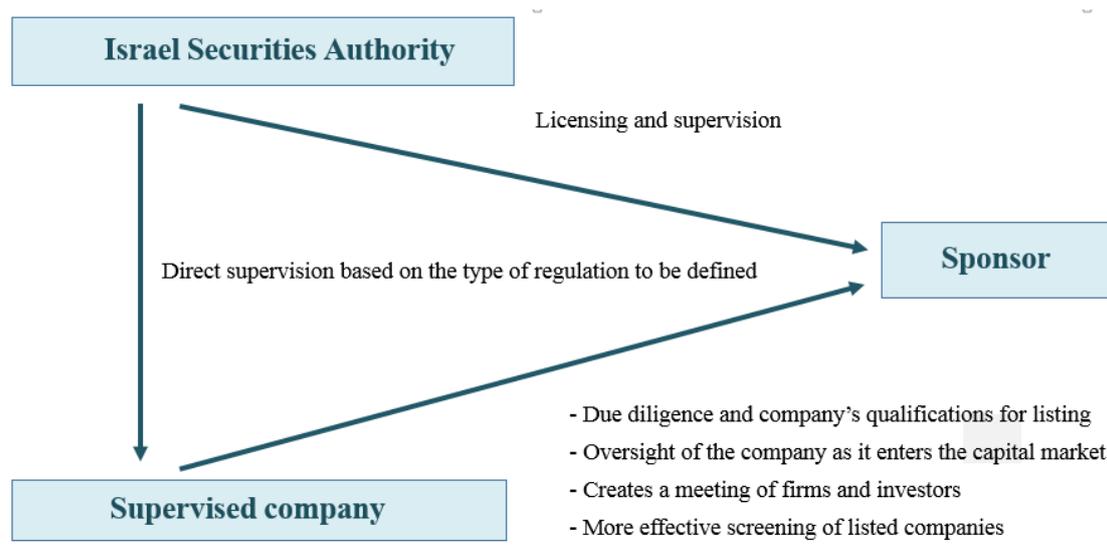
At the same time, in view of the assumption that a considerable number of the companies that will apply for listing on the SME Exchange will be smaller and have a distinct risk profile; the information available on them is more limited; their officers have relatively limited experience with the capital market; and they companies lack sufficient resources to establish the regulatory and marketing system required for capital market activities; and in view of the findings of a comparative legal review, which emphasize the significance of effectively screening companies for listing on the SME Exchange — the Team considers it important to create a support system of an appointed sponsor, which is similar to the supervisory model adopted by the Canadian Stock Exchange. The sponsors will help these companies implement the regulatory adjustments and business preparations for an IPO and subsequent rounds of capital raising. The sponsor's main role will be to conduct due diligence on the companies, thereby functioning as a gatekeeper in the process. The sponsor will also oversee the companies' issues and capital raising activities, and help them reach out and meet the investor public and promote the issuing. The sponsor's duties will end after a company's initial public offering and will not include any element of regulatory oversight.

In addition to the benefits of such a function from the companies' perspective, and the assistance to them in their initial steps in the capital market, the sponsor also makes a

contribution to the capital market in general, on several counts. By definition, the sponsor will help create a more effective screening procedure, filtering out companies that are unsuitable or unready to enter the capital market, and reducing the public's exposure to such companies. The sponsor might also enhance the image of the SME Exchange and encourage institutional investors to enter this market and invest in the listed companies, thereby contributing to the perfection of the capital market and to its enhanced efficiency.

The sponsor will be subject to supervision by the ISA and will be licensed by the ISA, similarly to the licensing and supervisory regime that applies to underwriters.

The following figure describes the division of roles in the proposed model (until the SME Exchange adopts the nomad-based supervisory model, subject to future review):



For additional information on the supervisory model, see Chapter 6 of this Report.

## **2.2 Profile of the target investors**

The Team recommends that no restriction be imposed on the type of investors who may invest in the SME Exchange, in view of the desire to increase the demand side in this venue and give access to the SME Exchange to all types of investors.

For additional information on the profile of target investors, see Chapter 7 of this Report.

### **2.3 Eligibility to register for trade on the SME Exchange**

The Team recommends that listed companies must have a minimum operating history of one year.

The Team recommends that no restrictions or limitations related to sector or industry should be defined.

The Team recommends that no minimum financial requirements should be defined, and companies should not be required to maintain a business model.

For additional information on listing eligibility, see Chapter 8 of this Report.

### **2.4 Conditions for listing and trading**

#### **Public shareholding spread**

For an IPO

- The Team recommends that a minimum public shareholding rule should be defined (in multiples of 20% and 30%, depending on the company's market capitalization for the IPO).
- The Team recommends that the minimum number of investors in the IPO should be defined as 50.

#### **Trading activity**

The Team recommends that the minimum public shareholding should be set at 15% during continuous trading, similar to the requirement that currently applies at the Primary Market, in order to ensure trading in the shares.

Furthermore, the Team recommends to use the same definition of the term "public" that is currently used in the Primary Market, for the purpose of calculating the minimum public shareholding.

#### **Setting minimum requirements for scope of capital raising**

##### **Minimum capital raising requirement**

The Team recommends that securities should be issued for a minimum of NIS 6 million, which is the maximum amount for raising capital on a crowdsourcing platform.

### Maximum capital raised

The Team recommends that no maximum amount should be set for the capital raised, although a company's post-money valuation should not exceed NIS 300 million on the issue date.

### **Restrictions on trading by related party shareholders**

The Team recommends that blocking regulations should apply to interested parties from the date of the IPO, similarly to the restrictions that currently apply to the Primary Market.

### **Encouraging money making**

The Team recommends that companies that elect to appoint a market maker should have a minimum of 35 investors in their IPO, rather than 50.

The Team recommends that trading in securities of companies that elect to appoint a market maker should be conducted in continuous trading (rather than trading once or twice a day).

### **Nature of trading**

The Team recommends that the model of companies listed on the SME Exchange should be modified to allow the entry of e-brokers.

The Team recommends to set up an electronic IPO system for participating in IPOs.

### **Dual listing arrangement**

The Team recommends implementation of a dual listing model on the SME Exchange, subject to a specific review of each foreign exchange, similarly to the procedure used to determine the list of foreign exchanges under the dual listing arrangement in the Primary Exchange. Such a review will not be necessary for foreign exchanges that have already been approved for include in the dual listing arrangement in the Primary Exchange: For these exchanges, adoption of a dual listing arrangement will be automatic, subject to compliance with the listing rules of the Primary or SME Exchange, as relevant.

For additional information on registration requirements and trading conditions, see Chapter 9 of this Report.

## **2.5 Securities offerings**

The Team proposes that permit should be permitted to offer securities at different prices in their IPOs, by defining the entities to which the securities will be issued, and the allotment rate with respect to each bid.

For additional information on the structure of the SME Exchange, see Chapter 10 of this Report

## **2.6 Securities listing transfers**

### **Transferring a listing from the Primary Market to the SME Exchange**

The Team proposes to consider whether companies should be permitted to transfer their listing, according to rules to be determined at the end of a 3-year trial period, which will begin at the establishment of the SME Exchange, during which the implications of permitting such transfers will be studied.

### **Automatic listing transfer from the SME Exchange to the Primary Market**

The Team proposes that no mandatory listing transfer be defined for companies listed on the SME Exchange, under any circumstances, independent of company valuation or type of issued security. It is nonetheless proposed that companies whose market capitalization exceeds NIS 600 million (twice the valuation of a “Small Corporation”, as defined in Securities Regulations (Periodic and Immediate Reports) 1970) will be subject to the regulation rules (disclosure, reporting and corporate governance) that apply to companies in the Primary Market, and a transition period should be defined during which the companies will make the proper arrangements for implementing these rules.

### **Approval of voluntary transfers from the SME Exchange to the Primary Exchange**

The Team proposes to determine that voluntary transfers from the SME Exchange to the Primary Exchange are subject only to approval of the board of directors.

For additional information on listing transfers, see Chapter 11 of this Report.

## **2.7 Types of securities that may be issued on the SME Exchange**

### **Debt securities**

The Team proposes that companies may issue debt securities, provided that the companies have already issued or are concurrently issuing equity securities on the SME Exchange.

The Team proposes that debt securities issuances in the SME Exchange should be limited to amounts between NIS 6 million and NIS 36 million, and in any case, never to exceed 100% of the equity issued and raised on the SME Exchange.

It is concurrently proposed to establish a track for small debt issues of up to NIS 36 million on the Primary Market, subject to full regulatory oversight.

Finally, it is proposed to revisit the need to modify the format for debt issues three years after the establishment of the SME Exchange.

**Issues of instruments that do not conform to the “one share one vote” principle (“equalization of voting rights” rule) under Section 46B of the Securities Law 5728-1968 (hereinafter, “the Securities Law”)**

It is proposed to retain the “one share one vote” principle, including the option of issuing preference shares, based on the issuing restrictions that apply to all reporting corporations on the Primary Market, as defined in the TASE Articles of Association.

For additional information on the types of securities that may be issued, see Chapter 12 of this Report.

## **2.8 Disclosure and reporting requirements**

### **Periodic reports**

Frequency of publication – The Team proposes that companies that issue equity securities should be subject to a requirement to publish semi-annual periodic reports, similarly to the relaxed reporting requirement that currently applies to “Small Corporations” that issue only equity securities on the Primary Market. It is further proposed to determine that companies that did not generate income in the period of the financial statements must provide information on their “burn rate” only, on a semi-annual basis, in lieu of financial statements. Similarly to the model adopted by the Primary Market, it is proposed that companies that issue bonds be subject to a requirement to file quarterly reports, in order to provide information to bond investors

at a greater frequency, and due to the inherent features and risks that debt versus equity securities represent.

The information accompanying financial statements – The Team proposes that companies be required to publish an “extended management report” (in other words, a management report pursuant to the Financial Reporting Improvement Project, which provides a more extensive description of the nature of their business), and not to require them to publish a description of the company’s business in the format defined in the First Addendum to the Securities Regulations (Details of Prospectus and Draft Prospectus) 5729-1969 (hereinafter, “the Prospectus Detail Regulations”).

Attached documents – The Team proposes not to impose a requirement to attach valuations and solo financial statements. It is also proposed to increase the criterion for inclusion of affiliates’ financial statements to 40%, also with respect to annual financial statements, with the aim of reducing to a minimum the requirement to attach various documents and statements. The remaining attachment requirements that currently apply to companies listed on the Primary Market will continue to apply to the SME Exchange without modification.

Report of the effectiveness of the internal control on financial reporting and disclosure (ISOX) – The Team proposes not to impose this regulation on the SME Exchange.

Accounting standards - The Team proposes to permit implementation of IFRS, US GAAP (excluding a note on adjustment to IFRS) in the companies’ financial statements.

Presentation of comparative financial statements – The Team proposes not to require presentation of more than a single comparative period (subject to compliance with generally accepted accounting principles).

Disclosure of executive compensation – The Team proposes to exempt corporations from the requirement to provide a detailed disclosure of the remuneration of their five highest paid executives. The required disclosure will be in aggregate rather than individual terms, as is currently the requirement.

### **Immediate reports**

Content and scope of duty of immediate disclosure: The Team proposes to define a general disclosure requirement concerning material events that are outside a company’s

ordinary course of business, due to their nature, scope, or potential results, and which have or potentially have a material impact on the company; and concerning events or interests that may have a significant impact on the price of the company's securities, similarly to Regulation 36 of the Securities Regulations (Periodic and Immediate Reports) 5730-1970 (hereinafter, "the Reports Regulations"), and to exempt the companies from all other immediate reporting requirements.

Furthermore, it is proposed to accompany the regulation with publication of a document referring to a non-exhaustive list of events that require reporting.

Timing of immediate reports: It is proposed to define that immediate reports must be published no later than 48 hours after the relevant event.

### **Reporting Language**

The Team proposes to permit hi-tech companies<sup>5</sup> that are traded on the SME Exchange to file their statements and reports in the English language. Reports include IPO prospectus and all subsequent prospectuses, as well as all reports required pursuant to the company's status as a reporting company. Companies that elect to report in the English language and transfer to the Primary Exchange may continue to report in the English language.

For additional information on disclosure and reporting requirements, see Chapter 13 of this Report.

## **2.9 Corporate governance and interested party transactions**

### **Controlling shareholder transactions**

The Team proposes not to modify the provisions that currently apply under the Companies Law regarding the approval mechanism required for transactions with controlling shareholders or in which controlling shareholders have a personal interest; Such transactions will require the approval of an independent committee (see 2.9.6 below), the board of directors, and the general meeting (based on a majority vote that includes a majority of the minority shareholders).

The Team, however, proposes to determine that terms of service and employment or terms of services rendered by a controlling shareholder or a relative thereof, will be

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<sup>5</sup> According to the sectorial classification used by the TASE.

approved once every five years (in lieu of the current requirement defined in the Companies Law to issue approvals once every three [3] years).

### **Rules concerning executive remuneration and remuneration policy (Amendment 20 to the Companies Law)**

The Team proposes that companies be required to define a remuneration policy, but such policy will not be subject to approval by the general meeting.

The Team proposes not to exempt companies from the requirement to obtain approval of the general meeting for the terms of service of the CEO where these terms are consistent with the company's remuneration policy.

### **Additional proposed arrangements that constitute a relaxation of the laws currently applicable to public companies**

The Team proposes to permit dual tenure as chairman of the board of directors and as CEO of a person or his/her relative (subject to no special approval mechanisms).

The Team proposes to require companies to appoint a single independent committee only (in lieu of three distinct committees required by the Companies Law — an audit committee, a financial statements committee, and a remuneration committee) and to relax the cumulative requirements that apply to the composition of the committee.

The Team to exempt companies from the requirement to conduct a competitive proceeding according to Section 117(B1) of the Companies Law regarding transactions with controlling shareholders, or transactions in which controlling shareholders have a personal interest.

For additional information on corporate governance and controlling shareholder transactions, see Chapter 14 of this Report.

### **2.10 Structure of the SME Exchange**

In the most common model used in other countries, the secondary exchange constitutes part of the primary exchange, either as a separate stock exchange or market under the primary exchange, or as a separate list on that market. In only few countries the secondary market is a stand-alone entity that is unrelated to the primary exchange.

The Team believes that the regulatory arrangement for establishing the SME Exchange should be structured in a manner that allows it to be established under the Primary Exchange, whose legal status is a separate corporate entity, but without eliminating the option that it may also be established as a separate exchange if an appropriate initiative emerges. In any case, the Team believes in the significance of creating a brand for the SME Exchange, distinguished from the Primary Exchange. Such branding will help market the SME Exchange to its target groups: the firms, which include high-growth companies and small and medium-sized companies, and the investors. A distinct brand will also create differentiation between the two markets, and it is also important in protecting investors, in view of the different risk levels in each market.

The Team also believes that adjustments should be considered to the application of Chapter H of the Securities Law, to a license to operate a dedicated stock exchange, to the dedicated stock exchange, as well as additional adjustments to licensing and corporate governance requirements of entities already licensed to operate a stock exchange.

For additional information on structure of the SME Exchange, see Chapter 15 of this Report.

## **2.11 Incentives**

### **Economic incentives**

#### Incentives to companies

- The Team proposes to reduce or cancel the fees that the ISA charges, for a period of up to two years beginning from the date a company is listed on the SME Exchange, and to reduce the securities listing fees during that period.
- The Team proposes to operate a program to subsidize the cost of analyses, which will be published and available to all potential investors, subject to an appropriate budgetary allowance.
- The Team proposes to study relaxation of other requirements, such as deferring the refunds of government grants.
- The Team proposes to explore participation in issuing costs, including the costs of drafting prospectuses for public offerings.

### Incentives to institutional investors

The Team proposes to monitor the development of the SME Exchange, and if it appears that the requirement imposed on institutional investors to attend general meetings constitutes a barrier to entry, a relaxation of this requirement should be considered.

### Encourage market making

The Team proposes to encourage market making by granting economic incentives to market makers.

### **The Team studied the following tax incentives:**

The Team studied various tax incentives for companies that list their securities on the SME Exchange.

There is uncertainty regarding the number of firms that will elect to list their securities for trade on the SME Exchange at its establishment. Therefore, the Team concurred that certain tax incentives may encourage companies to list their securities in the initial phase of the SME Exchange's operations. Such tax incentives would be defined for a period of two years under a temporary order.

The Team recommends the following tax incentives, under a temporary order<sup>6</sup>, to companies that list their securities on the SME Exchange during the Establishment Stage:

To companies: The company's listing costs will be recognized as allowable expenses for tax purposes in the year the expenses were incurred.<sup>7</sup>

To controlling shareholders<sup>8</sup> and investors in listed companies:

- Controlling shareholders who are employed by companies that list their shares on the SME Exchange during the Establishment Period may elect to apply a capital gains tax track under Section 102 of the Income Tax Ordinance (New Version) 5721-1961 (hereinafter, "the Ordinance") to any gain in value of options they

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<sup>6</sup> To clarify, the tax incentives proposed in this section, which already appear in a current temporary order, will apply to the SME Exchange as long as the temporary order is in effect, and will remain in effect for future periods only if the temporary order is extended.

<sup>7</sup> This incentive was approved as a temporary order in March 2018 and applies to all the companies that issue securities on a stock exchange in Israel.

<sup>8</sup> Controlling shareholder – as defined in Section 32(9) of the Income Tax Ordinance (New Version) 5721-1961.

received before the company listed on the SME Exchange and that were awarded under employee option plans.

- Investments of up to NIS 5 million by investors who purchase shares in an IPO of a **qualifying R&D company** will be recognized as a capital loss for tax purposes in the tax year in which the investment was made or in the subsequent tax year (in lieu of recognition upon sale of the shares).

For additional information on incentives, see Chapter 16 of the full Report.

## **2.12 Enforcement**

In view of its recommendation to have the ISA oversee the SME Exchange, the Team believes that the enforcement model adopted should essentially correspond to the existing enforcement model under the Securities Law. Accordingly, enforcement will be performed through the existing enforcement channels (monetary fines, administrative enforcement, criminal enforcement). The Team does, however, believe that the maximum fines that may be imposed in an administrative enforcement processing should be reduced, and a more lenient enforcement policy should be applied to the SME Exchange, which takes into consideration the size of the regulated entities, the financial position of the defaulting companies and individuals, their operating history in the capital market, and the potential harm.

For additional information on enforcement in the SME Exchange, see Chapter 17 of the full Report.

## **2.13 Regulatory stability**

The proposed arrangements concerning the establishment of an SME Exchange constitute a new, comprehensive regulatory model that the Team adapted to small and medium-sized firms, to enable and encourage them to list and trade on this exchange. As it comes into effect, the suggested regulation based on the Team's recommendations will be an innovative regulatory framework in the capital market. Against this backdrop, the Team believes that once the new framework is adopted, the parties involved in the regulation be attentive to the importance of including considerations of regulatory stability with respect to subsequent legislative reforms. The stability and ability to anticipate regulatory action are one of the major considerations of firms when deliberating whether to participate in the capital market, and even greater weight and

attention should be given to these considerations when small and medium-sized firms are involved, as they have a significantly smaller capacity to adapt to regulatory reforms and allocate the necessary financial resources compared to relatively large firms.

## **How the proposed model differs from the current situation in the Primary Market**

For the sake of convenience, the following table presents a summary of the differences between the rules that currently apply to public companies trading on the Primary Market, and the proposed model for small and medium-sized firms that will trade on the SME Exchange:

<b>Topic</b>	<b>Current state in the Primary Market</b>	<b>Proposed model for the SME Exchange</b>
Supervisory model	Supervised directly by the ISA	Supervised by the ISA, with sponsors being appointed for companies' IPOs
<b>Listing requirements<sup>9</sup></b>		
Operating history	One year	One year
Minimum public holding	Between 7% and 25%, depending on the value of public holdings on the issue date	Between 20% and 30%, depending on the company's valuation on the issue date
Minimum number of investors	100 (or 35 if the company appoints a market maker)	50 (or 35 if the company appoints a market maker)
Minimum scope of issue	NIS 20 million (effective)	NIS 6 million
Company valuation/equity	Over NIS 25 million in equity after the issue. Effective valuation of NIS 100 million or more.	Company valuation of up to NIS 300 million (after the money) on the issue date
<b>Trading conditions</b>		
Minimum public holding	15% (or 12.5% if the company appointed a market maker)	15%

<sup>9</sup>The listing requirements that apply to R&D firms are different: R&D firms are not required to show an operating history or pre-IPO equity; the required post-IPO equity is NIS 8 million; value of public shareholding as a result of the IPO– NIS 16 million; where the value of public shareholding is over NIS 16 million, the value of public shareholding must be at least 10%, or NIS 50 million and 7.5%, respectively; the minimum number of shareholders is 35, and the minimum value of an individual shareholding is NIS 16,000.

<b>Topic</b>	<b>Current state in the Primary Market</b>	<b>Proposed model for the SME Exchange</b>
Value of public holdings	Over NIS 5 million (or NIS 4 million if the company appointed a market maker)	---
Blocking rules	Blocked period of 18 and 9 months for interested parties and others, respectively	Blocked period of 18 and 9 months for interested parties and others, respectively
Continuous or daily / twice-daily trading sessions	Continuous trading	1-2 daily trading sessions (or continuous trading if a company appointed a market maker)
Securities offering method	Uniform offering	IPO may offer different prices to different investors
<b>Types of securities and listing transfers</b>		
Debt issues	Over NIS 36 million (effective). It is also proposed to establish a debt issue track on the Primary Market for small issues, subject to full regulation.	NIS 6-36 million, provided that equity was already issued or is also issued on the same date, and is no less than the debt.
Classes of shares	Ordinary and preference shares can be listed for trading (according to the restrictions defined in the articles of association)	Ordinary and preference shares can be listed (according to the restrictions defined in the articles of association)
<b>Disclosure and reporting requirements</b>		
Frequency of publication of financial statements	Quarterly reporting.	Semi-annual reporting (annual reporting for companies with no sales).

<b>Topic</b>	<b>Current state in the Primary Market</b>	<b>Proposed model for the SME Exchange</b>
	Semi-annual reporting for small firms that only issued shares	Quarterly reporting for firms that issued bonds.
Information accompanying financial statements	Description of the company's business Chapter and report of directors	Extended executive report. Furthermore, attachment of valuations and solo financial statements is not required.
Accounting standards	IFRS (and in some cases, financial reporting based on US GAAP is permitted)	IFRS / US GAAP (excluding an adjustment note)
Reporting periods	Two comparative periods	A single comparative period (subject to GAAP)
Disclosure of executive salary – Regulation 21	Disclosure concerning 5 highest-paid executives	Disclosure concerning 5 highest-paid executives aggregate sum, with no detailed individual disclosure
Immediate reports	Pursuant to specific disclosure regulations and Regulation 36 of the Reporting Regulations (defined above)	General requirement to disclose material events and issues that are outside the company's ordinary course of business (similar to Regulation 36 of the Reports Regulations) plus publication of guidelines to assist implementation of this requirement.
Timing of immediate reporting requirement	Between 3.5 and 24 hours, depending on the time the information was discovered	Maximum 48 hours

<b>Topic</b>	<b>Current state in the Primary Market</b>	<b>Proposed model for the SME Exchange</b>
Reporting language	Hi-tech companies that belong to the Tech-Elite Index may report in English.	All hi-tech companies listed on the SME Exchange may report in English.
<b>Corporate governance and transactions with interested parties</b>		
Mechanism for approving controlling shareholder transactions	Transactions are approved by the audit committee, the BOD, and the general meeting (majority of minority shareholders)	Transactions are approved by the independent committee, the BOD, and the general meeting (majority of minority shareholders)
Approval of terms of service or employment or service provision by controlling shareholder or relative	Once every three years	Once every five years
Remuneration policy	Remuneration policy must be defined and approved by the remuneration committee, the BOD, and the general meeting (majority of minority shareholders)	Remuneration policy must be defined and approved by the independent committee, the BOD
CEO's remuneration is consistent with remuneration policy	Terms of service and employment approved by the remuneration committee, the BOD, and the general meeting (majority of minority shareholders)	Terms of service and employment approved by the independent committee, the BOD
CBOD-CEO	Dual service (of a single individual or an individual	No restriction on dual service as CEO and CBOD (by an

Topic	Current state in the Primary Market	Proposed model for the SME Exchange
	and his or her relative) approved by the general meeting (by majority of minority shareholders) once every three years	individual or his or her relative)
Composition of the BOD	2 external directors must be appointed	2 external directors must be appointed
BOD committees	<p>Audit committee, remuneration committee, and balance sheet committee must be appointed</p> <p>*A small corporation for which fewer than 5 years elapsed from the date it first offered its securities to the public, may refrain from appointing a balance sheet committee, and consequently its financial statements are approved by the BOD alone, all subject to certain conditions.</p> <p>Furthermore, according to the law, the audit, remuneration, and balance sheet committees may be merged, provided that the merged committee meets all the requirements that apply to each committee</p>	One independent committee must be appointed (based on the qualifications required of the audit committee)

Topic	Current state in the Primary Market	Proposed model for the SME Exchange
Competitive proceeding	The audit committee must conduct a competitive or other proceeding before entering into a transaction with the controlling shareholder or a transaction in which the controlling shareholder has a personal interest	No requirement to apply
<b>Enforcement</b>		
Enforcement model	Three levels of enforcement (fine, administrative enforcement, and criminal enforcement). Maximum fine in an administrative enforcement procedure is NIS 5 million for corporations and NIS 1 million for individuals.	Three levels of enforcement (fine, administrative enforcement, and criminal enforcement). Maximum fine in an administrative enforcement procedure is halved and reduced to NIS 2.5 million for corporations and NIS 0.5 million for individuals.  Implementation of a lenient enforcement policy that takes into consideration size, financial position, length of operations, and potential damage.
<b>General meetings</b>		
Mandatory attendance for institutional investors	Mandatory attendance in general meetings that require an extraordinary	Monitor the development of the SME Exchange and if mandatory attendance is a

<b>Topic</b>	<b>Current state in the Primary Market</b>	<b>Proposed model for the SME Exchange</b>
	majority and other general meetings listed in the law.	barrier to entry, consider limiting this obligation.

#### Changes from the recommendations presented in the Interim Report

Issue	Recommendation in the Interim Report	Recommendation in the Final Report
Mandatory sponsor nomination	Mandatory nomination at IPO and all public issues,	Mandatory nomination only at IPO.
Accounting standards	IFRS / US GAAP / Israeli standards	IFRS / US GAAP
Disclosure of executive remuneration – Regulation 21	Disclosure of three highest paid executives	Disclosure of five highest paid executives, without individual disclosures
Reporting language	None included	All hi-tech firms listed on the SME Exchange may report in English
Internal auditor	Mandatory nomination of an internal auditor only for firms above a specific value or number of employees, to be determined	Mandatory nomination of an internal auditor for all firms listed on the SME Exchange.
Enforcement model	None included	Three levels of enforcement (fine, administrative enforcement, and criminal enforcement). Maximum fine in an administrative enforcement procedure is halved and reduced to NIS

		2.5 million for corporations and NIS 0.5 million for individuals.
Structure	Separate company distinct from the primary exchange (not as a new list)	Separate company distinct from or under the Primary Exchange, including a review of the adjustments in the application of Chapter H of the Securities Law regarding licensees to operate the SME Exchange, and adjustments to licensing and corporate governance requirements concerning entities that are already licensed to operate a stock exchange.
Dual listing arrangement	None included	Permit dual listing subject to a specific review of foreign exchanges
Tax incentive for investors in R&D companies	None included	Recognition of an investment of up to NIS 5 million as a capital loss for tax purposes in the year the investment was made or in the consecutive tax year (in lieu of recognition on the date the shares are sold)

### **3. Review of the Team’s work**

The Team’s work focused on three main issues: (a) a review of literature and research, including an analysis of the structural features, advantages, and shortcomings of secondary stock exchanges worldwide; (b) meetings with capital market players, and identification of the needs of small and medium-sized firms in Israel; (c) Team meetings, in which findings and insights that emerged from the analysis of literature and research and meetings with market players were discussed, and public comments to the recommendations of the Interim Report were studied and discussed, and all the aspects related to the establishment of an SME exchange were analyzed; Finally, the recommendations presented in this Report were developed into a program outlining the establishment of an SME exchange in Israel.

This study was performed to establish a prototype that would be based on models that have proven success worldwide, yet are compatible with the features of the local capital market.

#### **3.1 Review of research literature, empirical findings, and comparative law**

To develop the proposed model, the Team conducted a review of international models currently used in the major exchanges for small and high-growth firms in Europe,<sup>10</sup> England, Poland, the US, Canada, Singapore, South Korea, India, China, and Hong Kong (hereinafter, “the Selected Sample” or “the Selected Secondary Exchanges”); professional and academic studies that discuss incentives for establishing secondary markets, their features, and the factors underlying their success or failure; and an empirical study of various parameters of the Selected Secondary Exchanges, in order to learn from the relatively extensive experience accumulated worldwide on the establishment of secondary exchanges and to correctly implement the insights that emerge from this experience. Notably, over 35 capital markets worldwide have established secondary exchanges for small and medium-sized firms.

Several major findings emerge from the review of professional literature and the empirical study of data from the Selected Secondary Exchanges:

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<sup>10</sup> First-North and Alternext.

### Profiles of the firms

- The firms that are listed on secondary exchanges are relatively smaller than those listed on primary markets. The average market cap of listed companies<sup>11</sup> is EUR 55 million, in contrast to an average of EUR 1,332 million for companies listed on primary markets.
- The initial scope of equity that companies raise in secondary markets is relatively small – EUR 24 million per issue, in contrast to EUR 290 million per issue on primary markets.
- Companies listed on secondary markets are relatively young. On average, the age of these firms is one third the age of companies listed on primary markets.
- Foreign companies account for 14% of the IPOs on secondary exchanges, which is twice the share of foreign companies in primary market IPOs.
- Pre-IPO pricing of companies in secondary markets is more optimistic than pre-IPO pricing of companies listed on primary markets.
- Secondary markets vary across economies on multiple parameters, including their relative market share (compared to the market share of the main market in their country). Nonetheless the following can be stated:
  - In most countries in the Selected Sample, the number of firms in secondary markets is between one third and one half of the total number of firms that are traded in the capital market.
  - The total market value of firms listed in the secondary market is as high as 5% of the total market value of the main market firms (exceptions are China and South Korea, in which secondary market firms' value is higher).
  - The average size of firms in a secondary market ranges from 0.4% to 10% of the average size of firms in the primary market (the exception is China, with significantly larger firms in the secondary market).

### Listing, capital raising, ongoing trading

- In general, we can state that dedicated SME Exchanges are designed mainly to give small and high-growth firms access to the capital market. Thus, in most countries, listing requirements are significantly reduced in comparison to main market requirements. Still, a review of the regulatory regime, and specifically, issues

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<sup>11</sup> According to the value of assets in their financial statements immediately prior to the IPO date.

related to corporate governance, interested party transactions, and disclosure requirements, indicates that in several countries, the listing requirements on the secondary market are similar or identical to the requirements for listing on the primary market, while other countries allow more relaxed implementation in practice, for example, under a “comply or explain” regime.

- Most countries that were studied have a minimum operating history requirement of 2 or 3 years, and a minimum public shareholding requirement (these countries have similar requirements for the primary market). There is a statistically significant but not very large difference between the average public shareholding in secondary market firms (30%) and in primary market firms (35%).
- Most countries have no restrictions on listing transfers (for additional information, see Chapter 11 of the Report, on listing transfers).
- Listing fees and ongoing commissions are lower in secondary markets than in primary markets. Several countries adopted additional economic incentives such as tax benefits. In some cases, the reduction in fees is subsidized by the primary market.
- More issues are performed in secondary markets than in primary markets. Approximately 80% of all issues take place on secondary markets. The amount of capital raised per issue is lower (on average, a mere 8% of the capital raised per issue on primary markets) but the total capital raised in the secondary markets is significant and accounts for 22% of the total capital raised in the capital market.

#### Companies’ performance

- Several studies show that, on average, performance of firms in secondary markets is significantly inferior to the performance of comparable firms in main markets. The main findings refer to the performance of firms in secondary markets in Europe including the AIM in London, compared to the primary markets in those countries and in the US, between 1995 and 2009.<sup>12</sup> These comparisons show that companies trading in secondary markets have inferior performance and lower returns compared to companies, venture capital funds, or alternative funds trading on primary markets.

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<sup>12</sup> In 2008, significant modifications were made to AIM rules. Most studies reviewed in this document are based on the period preceding these modification, and therefore do not necessary reflect the situation in the AIM after these modifications were introduced.

- Still, several studies report different findings and dispute the above conclusion.
- The empirical study that we performed indicates that secondary markets indices achieved lower returns, in most cases, compared to primary market indices, although specific shares on these secondary markets generated significant higher returns.

#### Listing patterns and transfers

- One of the main goals of secondary exchanges is to help small and medium-sized firms grow and eventually transfer to the primary markets.
- Studies show that only 1%-5% of all firms eventually make such a move. Approximately 64% of the firms that transferred to a primary market noted “investors’ interest” as the main reason for the transition, and 36% of the firms noted “exposure to the public.”
- Comparing the failure rate (delisting due to bankruptcy or financial distress) of firms on secondary and primary markets, findings are inconsistent, but in general, it appears that the percentage of firms delisted due to bankruptcy or financial distress is similar in secondary and main US exchanges.
- There is some evidence that listing transfers take place. In the period of the study, 18% of the delisted firms from LSE transferred to AIM. In some years, this share reached 25%.
- The companies that transferred their listings from LSE to AIM noted the following reasons for their transfer: low costs (32%), opportunities for mergers and acquisitions (31%), growth potential (29%), and flexibility (20%).

#### Liquidity

The literature review shows that insufficient liquidity is one of the problems that plagues most secondary exchanges. Studies indicate that the level of liquidity in secondary exchanges is 20%-30% the level of liquidity in main markets.<sup>13</sup>

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<sup>13</sup> Various secondary markets took different steps to address the liquidity issue. For example, in one half of the countries, firms are required to appoint a market maker in order to ensure liquidity and trading. In other exchanges, a subsidy is granted to analysts. In most markets, a minimum public shareholding is required.

### Investors

- Most secondary exchanges have no restrictions on the type of investors who may invest, or on investment amounts.
- Most investors in secondary markets are local investors.
- The share of holdings of private investors is relative high in secondary markets. In several of these markets, the presence of institutional investors is insignificant, which may reduce liquidity, undermine a correct allocation of investments, and lead to insufficient control of companies' activities.
- In several secondary markets, private investors are eligible for tax benefits in respect of their activities on these markets.
- Evidence shows that underperformance of shares in these markets stems from private investors' behavioral biases in pricing the shares.

### Corporate governance

- Many studies have examined the corporate governance features of companies that trade on secondary versus primary markets. Some studies acknowledge that optimal corporate governance should vary from firm to firm (including firms in secondary and primary markets).
- Findings show that companies on AIM and other secondary exchanges adopted similar models that feature extensive "comply or adopt" mechanisms. As a result, the corporate governance regimes they adopt are less extensive than the regimes adopted by companies listed on primary markets. In anticipation of their transfer of listing to the main market, AIM firms gradually adjust their corporate governance regimes to the standards conventionally accepted on the primary market. The reverse process occurs in firms that transfer their listing from the primary market to the AIM.

### Important success factors in secondary markets

- As noted, it is internationally recognized that companies trading on secondary markets make a significant contribution to the growth and economic development of their economies, and serve as drivers that improve levels of employment, innovation, and entrepreneurship. Therefore, a regulatory infrastructure that ensures the success of these markets is critical for economic growth and prosperity. The

principles underlying success in secondary markets are: defining appropriate size and growth rate criteria for firms seeking to trade on secondary markets. Secondary markets should focus on high-growth firms with expanding trading volumes and growing the number of employees over an extended period, and whose trading volume meets a predefined criterion.

- Organizational structure – The establishment of a secondary market that is subordinate or linked to a primary market allows the secondary market to maintain low trading costs and to benefit from the reputation of the primary market. This type of structure is critical for the success of an exchange in cases where the secondary market is not expected to become profitable in its initial years of operation and will require the support of the primary market. At the same time, the organizational structure must allow managerial separation. Another point is that a secondary market that is a non-profit organization may be inefficient.
- Effective screening of companies interested in listing – Ineffective screening may lead to scandals that damage the reputation of the secondary market, which was the case concerning the Emerging Companies Market (of the Cyprus Stock Exchange). Secondary markets use various measures to address the screening challenge, such as listing requirements and appointment of nomads.
- Strict regulation and sanctions on licensed advisers/intermediaries in the issues.
- Correct balance between regulatory burden and protection of investors – by lowering costs for firms while maintaining the regulatory requirements necessary to protect investors' interests, and adding new requirements as such interests require.
- Trading method: The trading method should aspire to support maximum liquidity. According to the literature, there is no agreement whether a dealer market or an auction market is preferable.
- Listing of private placements – Permitting private placements to be listed or setting relaxed requirements for their listing is helpful to companies because it lowers costs and reduces the length of time required to complete the listing process.
- Reduced information asymmetry between companies and investors.
- Simplification and downsizing of reporting requirements: Since most secondary markets are controlled by private investors, and since companies on secondary markets are smaller, have less resources and are less complex, the reporting requirements for these companies should be simple and succinct.

- Research or analyses of firms: Research is essential for the success of secondary markets because it promotes investors' interest and improves liquidity. Analysts typically do not cover small firms, both due to the limited financial expediency and the challenges in obtaining information about them. Therefore, many secondary exchanges subsidize research in various ways. Subsidizing research may, however, cause distortions in the market and therefore must be performed with caution.
- Increased regulatory enforcement against manipulations, fraud, and insider trading: Closer regulatory enforcement of these offenses, with the aim of protecting investors' trust in the exchange and protecting its reputation.
- Branding: Branding has a significant effect on the success of a secondary market. Many secondary markets chose an integrated branding approach – branding themselves both as a market for high-growth companies and a market for small companies. Such a branding approach also must address the fact that investors' underestimation of the risks entailed in secondary markets may increase their “sense of loss,” deter investors, and create an unfavorable reputation for these markets. Furthermore, another challenge for secondary markets is that, over time, private investors increasingly prefer passive investment strategies and prefer to invest in large rather than small firms.
- Government incentives and support
  - Incentives, benefits, and grants that are typically given to firms and/or investors
  - Raise companies' awareness: informing companies of the benefits of listing and refuting incorrect beliefs related to listing.
  - Training, advice, and support for companies: training for firms on topics such as corporate governance and disclosure. Support and advice on preparing the documents required for listing, and the valuation and pricing process, how to attract investors and manage investor relations, and compliance with exchange requirements.
  - Raising investors' awareness: seminars, courses, and symposia on investments in secondary market for investors.
  - Cooperation with government ministries: highlighting the significance and contribution of a secondary market to the economy, and encourage

investments in a secondary market through cooperative activities with government entities.

### Comparative law

Due to the significance and formative function of the supervisory model applied to companies trading on the SME Exchange, the Team devoted extensive efforts to study the supervisory models applied in various countries, and specifically in exchanges that adopted the private supervisory model, where supervision is performed through nomads, who mediate between the firms and the market, while the regulatory authority exercises its authority on various aspects of the market's operations, especially enforcement. The countries that apply a regulatory model of this kind include England, Singapore, Hong Kong, Europe (First North), and Poland. In the other countries studied by the Team, the relevant regulatory authority supervises the market in conjunction with the primary stock exchange. The Team mainly studied the model in the AIM, which served as the model for stock exchanges in many other countries, especially those that adopted the nomad supervisory model, as well as other supervisory regimes, such as the Canadian model (TSX), where the Canadian Securities Authority supervises the market.

Below is a brief summary of the main points of the model applied to AIM, England's secondary market. This was the model on which the Team based its recommendations (for additional information, see Chapter 6 of the Report on the supervisory model), including the adjustments necessary in view of the unique features of the Israeli market and its regulatory structure.

- The London Stock Exchange operates two trading platforms: (a) the AIM (Alternative Investment Market); and (b) the Main Market. The AIM was established in 1995 for small and high-growth firms.
- **Supervisory model:** Firms that trade on the AIM are subject to the AIM Rules for Companies, and are regulated through Nomads (nominated advisers). The firms are also subject to some rules of the FCA. Nomads and the LSE supervise the firms and their compliance with AIM Rules, while the FCA supervises specific aspects related to the applicable FCA rules. The FCA also has residual authority. For the sake of comparison, companies that trade on the LSE are subject to FCA rules and LSE rules, and are subject to ongoing regulation by the FCA.

- **Listing transfers from one exchange to another:** Firms may transfer from the AIM to the LSE. When a firm wishes to do so, it is required to meet LSE listing requirements. There is no criterion that obligates a firm to transfer its listing from the AIM to the LSE. Firms may transfer from the LSE to the AIM in two stages: delisting from the LSE and listing on the AIM. Notably, delisting from the LSE requires approval of 75% of the firm’s shareholders.
- **Additional arrangements:** The main requirement for listing on the AIM is an accounting history of at least 3 years. Firms must also appoint a NOMAD to accompany it as long as it is traded on the AIM. No other listing requirements apply (in line with the global trend to minimize listing requirements). Securities are generally offered through a listing document (rather than a prospectus), which is more concise than a prospectus. Firms must appoint a market maker and must submit semi-annual financial statements.

For additional information on the review of literature and empirical examination and comparative law, see Chapter 4 and Chapter 5 of the Report.

### 3.2 Initial Advisory Round

In January 2017, the ISA Staff published a Call for Public Comments which suggested ideas regarding various aspects of establishing a dedicated SME Exchange.<sup>14</sup> The ISA also kick-started meetings and “round-table” discussions with a broad range of stakeholders from various capital market sectors, including entrepreneurs, underwriters, financial advisers, law firms that have experience with hi-tech firms and issues of Israeli companies active on secondary exchanges overseas, accounting firms, investment banks, investment portfolio managers, incubators and accelerators, credit funds that finance small and medium-sized businesses, representatives of foreign stock exchanges, the Innovation Authority, the Institute of Certified Public Accountants, and the Ministry of Economics — in order to enrich the Team’s knowledge of market barriers, shed light on the needs of high-growth companies, the market potential, and offer suggestions on the broad range of topics noted in the Call.

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<sup>14</sup> <sup>14</sup> See:

<http://www.isa.gov.il/%D7%92%D7%95%D7%A4%D7%99%D7%9D%20%D7%9E%D7%A4%D7%95%D7%A7%D7%97%D7%99%D7%9D/Corporations/Legislation/Paper/Documents/SmallEntitiesTradingList.pdf>

Furthermore, hearings were conducted to hear the positions of various representatives from the economy and the capital market on key issues underlying the establishment of the SME Exchange.

Representatives of the following agencies and firms appeared at the hearings before publishing the Interim Report:

1. The TASE
2. Representative of the Toronto exchange (TSX) in Israel
3. Representatives of the law firm Doron, Tikotzky, Kantor and Ass.
4. The Small and Medium-Sized Business Agency
5. The Innovation Authority
6. Deputy Chair of NASDAQ
7. Representatives of the Haifa Economic Company and Haifa Municipality

The picture that emerges from an analysis of the public comments and the impressions from these meetings is that a broad range of opinions exist in the capital market, with little agreement on the topics noted in the Call. Nonetheless, the commenters expressed a clear belief that to be successful, the new exchange should not be based solely on cosmetic adjustments: It is essential for the new market to be revolutionary and involve significant changes compared to the existing primary market, which create significant differentiation from the primary market. The new model must also be simple, accessible, and appealing to high-growth firms.

### 3.3 Publication of the Interim Report for Public Comments

On November 26, 2017, the Team submitted the Interim Report on Examining the Establishment of a Dedicated SME Exchange in Israel<sup>15</sup> to the Ministers, and concurrently published the report for public comments. See Appendix B to the Final Report for additional information on the public comments that were submitted.

The public comments that were received referred to most of the recommendations appearing in the Interim Report, and primarily to the proposed supervisory model; the

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<sup>15</sup> The Interim Report is available at:  
[www.isa.gov.il/הודעות2017/פרסומים/Reports/177/Documents/Designated\\_Stock\\_Exchange.pdf](http://www.isa.gov.il/הודעות2017/פרסומים/Reports/177/Documents/Designated_Stock_Exchange.pdf)

listing requirements; the structure of trading; the type of securities that may be issued; and the requirements related to disclosure, reporting, and corporate governance.

The Team conducted comprehensive discussions on all the public comments that were submitted, and conducted a further round of hearings before drafting the final recommendations presented in this Report.

### 3.4 Finalizing the recommendations

Based on the conclusions and the insights emerging from the Team's work, described above, the Team jointly developed a series of recommendations and suggestions regarding various aspects entailed in laying the regulatory foundation and the regulation necessary to establish an exchange for small and medium-sized firms in Israel. The Team aspired to develop a holistic outline that optimally balance the needs of these firms and the needs of investors, to ensure that the SME Exchange is considered an appropriate investment alternative. The Team believes that implementing these recommendations will contribute to a market that will constitute a significant financing alternative for small and medium-sized firms in Israel.

It should be stressed that in developing its final recommendations, the Team took into consideration lessons and findings of a study of secondary markets in other countries, including the regulatory mechanisms in place, their operations and structure, and the main factors that explain the lack of success of these markets. These lessons and findings received the most weight in developing the Team's recommendations to set up a more successful secondary market, with emphasis on the need to point to the risks of investing in SMEs and adjusting the supervisory model to the features of the Israeli market.

The main issues that were stressed in developing the structure of the proposed model were:

- Regulatory efficiency: simple, accessible regulation that matches the scale of small and medium-sized firms.
- Effective screening of firms for the SME Exchange
- Significant reduction of regulatory costs
- Quality (rather than quantity) of reporting information
- Protection of investors in line with the size of the firms

- Ensure liquidity and marketability of the secondary market
- Propose solution for various barriers currently existing at the capital market
- Provide incentives to companies and to investors