The following translation is intended solely for the convenience of the reader. This translation has no legal status and although every effort has been made to ensure its accuracy, the ISA does not assume any responsibility whatsoever as to its accuracy and is not bound by its contents. Only the original Hebrew text is binding and reader is advised to consult the authoritative Hebrew text in all matters which may affect them.

Directive for Fund Managers and Large License Holders[1] on Integrating ESG Factors in Investment Decision-Making or Risk Management

Under Section 97(b) of the Joint Investment Trust Law 5754-1994, and Section 28(b) of the Regulation of Investment Advice, Investment Marketing, and Portfolio Management Law 5755-1995

Explanatory Note

Capital market investors across the globe have shown a growing interest in recent years in socially responsible investing, placing increasing emphasis on environmental, social, and governance considerations. Investors' interest has risen in tandem with the increasing popularity of climate change and social goals movements and with the continued COVID-19 pandemic, which increased public

[1] In this Directive, a "large license holder" is one of the following: (1) a "large investment portfolio company," as this term is defined in Schedule One "A" of the Regulation of Investment Advice, Investment Marketing, and Portfolio Management Law 5755-1995 ("**the Advising Law**"); (2) a company that holds an investment marketing or investment advising license, as stated in the Advising Law, that had, on the publication date of the directive, together with other companies of the same group that hold an investment marketing license, more than 1,000 customers; or an individual holder of said license who had over 1,000 customers on the publication date of the directive; (3) the advisory functions in banks.

awareness of the connections between health, environment, society, and economics.[2]

In April 2021, the Israel Securities Authority ("**the ISA**") published a series of recommendations for reporting corporations in which it called for all reporting corporations whose securities are traded on the Tel-Aviv Stock Exchange ("TASE") to publish an annual corporate social responsibility ("**CSR**") report voluntarily. [3] This call was designed to promote a change that would help the public investors to take environmental, social, and governance considerations into account when making their investment decisions — that is, socially responsible investing.

Numerous countries have issued regulatory requirements, recommendations, and declarations of their intentions in their area (see additional information below under the heading "**The Global Trend**"). Inter-governmental organizations have published treaties on socially responsible investing, and non-profit organizations have published reports. For example, in its "Global Risks Report 2022", the World Economic Forum defined environmental and societal risks as the greatest threats to the global economy.[4]

Indeed, growing awareness of this issue is also evident in the markets. Total global impact investments increased from $3 trillion at the end of 2004 to $30 trillion at the end of 2018,[5] and within another two

---

[2] This conclusion arises from the book "Making Money Moral" by Prof. Judith Rodin (co-author with Saadia Madsbjerg), published by Wharton School Press. Prof. Rodin is the former President of the Rockefeller Foundation (2005-2017) and President of Pennsylvania University (1994-2004). On the connection between the COVID-19 pandemic and the rise in impact investments, see an interview with her for SIPA Magazine of Columbia University on February 24, 2021.

[3] See ISA recommendations on Disclosure on Corporate Governance and ESG Risks (April 2021).

[4] World Economic Forum, Global Risks Report 2022 (January 4, 2022).

[5] See p. 2 of the review by Witold Henisz, Tim Koller, and Robin Nuttall of the Wharton School of the University of Pennsylvania, entitled "Five Ways that ESG Creates Value" published by McKinsey (November 2019). Specifically

years, it reached $35.3 trillion by the end of 2020,[6] reflecting a 15% growth rate in two years. Moderate forecast expects this market to cross the $40 trillion mark before the end of 2024.[7]

Israel has also seen growth in the number of mutual funds that make ESG investments, especially environmental investments. As of the publication date of this directive, Israel has 37 ESG-focused funds that manage NIS 2.27 billion.

The accepted measure to define investment as "socially responsible investment", one that considers societal, environmental, and governance factors, is examine alignment with "ESG principles". **This is a set of principles and standards used to quantify an investment's impact on the environment, society, and corporate governance.** For example, these principles assess whether an investment causes climate damage and has adverse effects on biodiversity, mitigates environmental pollution, promotes sustainable land use, workplace security and employee health, employees' freedom of association, prevents corruption, guarantees employee rights, and promotes corporate compliance, transparency, ethnic and gender diversity (an issue that is assuming growing weight in corporate governance actions), and others.[8]

The Global Trend

---

see a report that reviewed to total impact investments in 2018 entitled "Global Sustainable Investment Review 2018" by the Global Sustainable Investment Alliance, 2018.

[6] See "Global Sustainable Investment Review 2020" by the Global Sustainable Investment Alliance 2020.

[7] See a study by Bloomberg entitled "ESG Assets May Hit $53 Trillion by 2025, a Third of Global AUM" (February 23, 2021).

[8] Several countries and states that have published guidelines and laws that require diversity in the composition of boards of directors based on a quota, or disclosures of corporate diversity policy. We also observe a trend in which investment entities across the world take gender diversity considerations into account in determining their voting policy in general meetings.

An increasing number of countries have published regulatory rules and recommendations for private and public companies, asset management companies, investment funds, and financial advisers regarding the need to incorporate ESG considerations in their risk assessment or investment management procedures and the need to disclose how such considerations are effectively integrated into their strategic decision making. This section briefly reviews the primary obligations and recommendations that apply to asset management companies, investment funds, and financial advisers worldwide. [9]

On September 25, 2015, the **UN General Assembly ("UNGA")** published "Agenda 2030," a document designed to promote compliance with 17 global Sustainable Development Goals ("**SDGs**"). The Agenda and its global goals were ratified at the EU level by two declarations by the European Commission— the first on November 22, 2016, and the second on June 20, 2017. On November 27, 2019, the **European Union** issued the Sustainable Finance Disclosure Regulation ("**SFDR**"), requiring asset management companies, investment funds, and financial advisers to disclose how they integrate sustainability considerations in their investment decision-making and investment advising, and risk management[10] The extent of the required disclosure varies by entity type and location of the publication.[11] Asset management companies and investment funds are required to publish on their website their policy on integrating sustainability risks in their investment decision-making and how sustainability considerations are taken into account in due diligence and remuneration policies. In pre-contractual documents, they are

[9] For additional information on the obligations imposed on reporting corporations, see ISA recommendations on Disclosure of Corporate Governance and ESG Factors (April 2021).

[10] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector

[11] On April 6, 2022, the European Commission adopted regulatory technical standards ("**RTS**") that define a template for disclosure of information within the Sustainable Finance Disclosures Regulations (SFDS"). Until the RTS comes into effect (January 1, 2023), disclosures are voluntary.

required to disclose their policy on integrating sustainability risks in investment decisions; For a product defined as promoting sustainability or encouraging sustainable investing, the entity is also required to publish the reference benchmark used to measure its impact. In financial statements, the entity must disclose how financial products meet sustainability considerations and sustainable investment goals. Financial advisers are required to publish on their website their policy on integrating sustainability in investment advising and how sustainability considerations are expressed in its advising procedures and remuneration policy. In pre-contractual documents, they are required to disclose their policy on integrating sustainability risks in investment advising.[12] On June 20, 2020, the EU published the Taxonomy, which establishes a classification system that provides businesses with a common language to identify whether or not a given economic activity should be considered "environmentally sustainable" to facilitate transparency and uniformity.[13] This regulation defines six environmental goals and determines that investment is classified as an environmentally sustainable investment only if it makes a significant contribution to one or more of these environmental goals, does not harm human rights and employee rights, and meets the technical-procedural criteria defined by the European Commission for each investment field.[14] On September 23, 2022, the European Securities and Markets Authority ("**ESMA**") published a final report including new guidelines on Suitability Assessment under the Markets in Financial Instruments Directive 2 ("**MiFID 2**"). Among others, the final report requires

---

[12] The regulation for financial advisers does not define a mandatory disclosure in periodic reports.

[13] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

[14] The criteria were published on June 4, 2021. See Supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by Establishing the Technical Screening Criteria for Determining the Conditions Under Which an Economic Activity Qualifies as Contributing Substantially to Climate Change.

investment advisers and portfolio managers to integrate sustainability factors into their assessment of the suitability process.[15] For example, portfolio manager firms and investment advisers firms are required to help clients to understand the concept of sustainability preferences and explain the difference between products with and without sustainability features in a clear manner and avoiding technical language; collect information from clients on their preferences in relation to the different types of sustainable investment products and to what extent they want to invest in these products. Once the firm has identified a range of suitable products for the client, in accordance with the criteria of knowledge and experience, financial situation, and other investment objectives, the firm shall identify the products that fulfill the client's sustainability preferences. In addition, firms will need to give staff appropriate training on sustainability topics and keep appropriate records of the sustainability preferences of the client (if any) and any updates of these preferences.

With respect to implementation at the European state level, **BaFin, the German securities regulator**, for example, published recommendations on January 15, 2020, on integrating sustainability risks and social trends in risk management. Among other things, BaFin recommended that the sustainability considerations of asset management companies and investment funds should also include consideration credit, liquidity, insurance, and reputational risks stemming from physical climate changes and social changes in investors' behavior.[16]

In the **UK**, the Task Force on Climate-Related Financial Disclosures ("**TCFD**") was established on December 4, 2015, to issue recommendations for adequate disclosure of climate-related risks. On May 31, 2019, the Task Force published recommendations for public

[15] ESMA, "Guidelines on Certain Aspects of the MiFID II Suitability Requirement" (September 23, 2022).

[16] BaFin, "Guidance Notice on Dealing with Sustainability Risks" (January 15, 2021).

corporations on reporting standards related to climate change, and these recommendations were adopted into UK law on October 29, 2021.[17] Additionally, in October 2021, the HM Treasury pledged that Britain would become a leader in sustainable investments. Therefore and as a supplement step to the TCFD recommendations on corporate disclosures, on November 3, 2021, the Financial Conduct Authority ("**FCA**") published a discussion paper ("**DP**") on ESG disclosure requirements of investment managers firms and investment advisers firms and sustainable investment labels.[18] on October 24, 2022, a public consultation paper ("**CP**") proposing regulation on this issue was published.[19] The CP presents the core elements of the upcoming regulation: sustainable investment labels which distinguish between different types of investment products based on their sustainability-related objectives and features, qualifying criteria that investment managers firms and investment advisers firms must meet to use a label, product-and entity-level disclosures, and naming and marketing rules. Those elements give consumers the information they need to make informed choices about which products meet their needs and preferences, facilitate the flow of information along the investment chain, increase market transparency and help to prevent "greenwashing". Notably, the CP proposes a general 'anti-greenwashing' rule reiterating requirements for all regulated firms that sustainability-related claims must be clear, fair, and not misleading.

Two bills on this topic were introduced in the **US**. The first is a bill amending the Investment Advisers Act of 1940, which is expected to require large investment advisers to adopt and implement investment

[17] Press release "UK to Enshrine Mandatory Climate Disclosures for Largest Companies in law" (October 29, 2021).

[18] DP 21/4: Sustainability Disclosure Requirements (SDR) and investment labels (November 3, 2021).

[19] CP22/20: Sustainability Disclosure Requirements (SDR) and investment labels (October 24, 2022). The document is open for public comments until January 23, 2023, and the final version of the regulation is expected to be published in 2023.

policies that take ESG factors into account in their investment decisions.[20] The Second is a bill to amend the Employee Retirement Income Security Act (“**ERISA**”) which is expected to require pension funds to publish and follow socially responsible investment policies, including policies related to their corporate governance procedures, work procedures, and human rights.[21] Additionally, on May 25, 2022, the Securities Exchange Commission (“**SEC**”) published a statement on a proposed rule to require enhanced disclosures by investment advisers and asset management companies on how they incorporate social and environmental factors into their practice. The amendment promotes a uniform disclosure standard to allow investors to compare products and financial mediation services and make informed decisions about ESG issues. Among other things, the proposed effective disclosure requirements differentiate between types of investment products and determine that investment advisers that take ESG factors into account must disclose how they do so in the informative brochures they provide to potential investors and in annual disclosures.

Notably, from time to time, criticism has been drawn to the fact that companies that highlight their incorporation of ESG factors do not necessarily comply with high standards of practice and, in effect, overemphasize specific aspects of their operations while playing down other, more problematic aspects. In response to these concerns, international efforts have recently focused on creating a uniform standard for labeling socially responsible investments. The EU issued regulation on the rules for classifying environmentally sustainable investments, and the UK adopted the goal of creating a uniform standard for classifying green investments (“**UK Green**

---

[20] See Sustainable Investment Policies Act of 2020 to amend the Investment Advisers Act of 1940.

[21] See Retirees Sustainable Investment Policies Act of 2020 to amend the Employee Retirement Income Security Act of 1974.

Taxonomy").[22] The entities are expected to incorporate ESG factors in their practices and make informed investments or provide informed investment advice based on the same decision-support processes that are used with respect to other investment and risk management considerations. It is important for investors to be able to understand what each entity takes into consideration in its procedures, products, or services that it offers.

In summary, there are various approaches as to how asset managers, investment funds, and financial advisers worldwide incorporate ESG factors, either in their investment decision-making or risk management practices, or a combination of both. Existing and proposed rules in various countries reflect the conviction that enhanced transparency of financial entities' practices related to environmental, social, and corporate governance issues potentially increases investors' awareness of these issues (whether or not they seek such investments) and prevent misleading representations or ambiguous claims relating to ESG policies.

Israel

Following the ISA's recommendations on disclosure by reporting corporations of corporate governance and ESG risk factors, from April 2021, the ISA allows reporting corporations to publish CSR reports on the ISA's website. Currently, 36 reporting corporations have published CSR reports on the ISA's website.[23]

On November 18, 2021, the Capital Market Insurance and Savings Authority ("**CMISA**") published an amendment to the Unified Circular Directive that assembles provisions on how institutional investors determine their future investment policy and its

---

[22] On October 18, 2021, the British Treasury published a Roadmap to Sustainable Investing, which set a goal of creating a new sustainability disclosure regime ("**SDR**) and development of a standard for labeling green investments ("**Green Taxonomy**").

[23] See ISA recommendations on Disclosure on Corporate Governance and ESG Risks (April 2021).

publication. The main points of the proposed amendments refer to the requirement of the institutional investor's investment committee to determine an investment policy regarding ESG factors within its overall investment policy, insofar as these factors are relevant to and potentially affect the performance of its investment portfolio; In its published investment policy, the institutional investor must provide details of the ESG factors it takes into account in its investment management practice and the emerging risks related to these factors; Its investment committee must determine rules and procedures to develop the institutional investor's internal expertise in examining these factors, risks, and aspects of practice, and the committee may contract with external service providers with expertise in ESG issues, provided that there are detailed and documented procedures for their selection, including an examination of potential conflicts of interest. The amendment of the directive came into effect on July 1, 2022.[24] Furthermore, the CMISA recently published a draft circular on the establishment of investment tracks that specialize in sustainable or environmental investments.

In December 2021, the Banking Supervision Department at the Bank of Israel ("**Supervisor of Banks**") published a circular entitled "Disclosure of ESG Factors to the Public", which clarifies that the banking corporations must include in their Directors' and management report a summary of the main ESG factors that they use, and note the significant ESG aspects that are incorporated in their business goals and strategy. In addition, given the globally accepted disclosure of banks - banking corporations are required to publish a separate annual ESG report instead of the SCR report that until now was required to be published bi-annually. Among other things, guidelines on the purpose, contents, and other report elements were also expanded and clarified. The publication date of the report was

[24] See the Supervisor's Directive on "Integrating Investment Considerations Related to Environmental, Social, and Corporate Governance Aspects."

advanced to no more than four months after the end of the reporting year, and the Supervisor's circular permits the publication of the ESG report for the year 2021 no later than June 31, 2022, and no later than May 31, 2023, for the ESG report for the year 2022.[25] In November 2022, the Supervisor of Banks published a draft update to the directive of disclosing ESG information to the public, as part of the Supervisor of Banks' efforts to reinforce the banking system's social and environmental contributions, and to reinforce long-term sustainability of the banking system and the economy, also based on of the experience accumulated in banks in Israel and worldwide regarding disclosures on these issues.[26] Among others, the draft requires the banks to disclose the involvement of the management and the board of directors in material ESG issues was extended to include the manner in which the banking corporation defines its influence strategy; examples were added of the issues that require a qualitative and quantitative disclosure of banking corporations' management of environmental and climate risks and opportunities; and added examples of disclosures of issues such as accessibility of services to the diverse or underprivileged population, and workplace diversity and inclusion. Furthermore, the document clarifies that banking corporations must, in the future, continue to assess the need to revise their disclosures to comply with current disclosure requirements and practices of banks across the world.

The Ministry of Environmental Protection decided, after consulting with the financial regulators and the members of the "Environment in Finance" Forum, including representatives of the Ministry of Justice, the Ministry of Finance, and the National Economic Council, to develop an Israeli taxonomy based on the European approach. On October 26, 2022, the "Green" Israeli Taxonomy draft to classify

[25] See Circular published on December 2, 2021 by the Supervisor of Banks on Disclosure of ESG Aspects to the Public.

[26] See circular issued on November 15, 2022 by the Supervisor of Banks on "Disclosure to the Public on Environment, Social, and Corporate Governance (ESG) Information."

economic activities based on their effect on defined environmental objectives was published.[27]

Purpose of the Directive

The extensive global interest of capital market investors in investments that take ESG factors into account and their potential impact on securities prices and risks raise the question of whether fund managers and license holders should incorporate ESG factors into their practice.[28] The operative meaning entails an assessment of the implications of such a move which includes examination and learning of the professional information related to ESG and determination what is the business approach to ESG factors and how it should be disclosed to investors.

Although implementing the Directive will generate value and benefits, given the resources that compliance may entail, it will apply only to fund managers and large license holders ("**the Relevant Entities**"). Large license holders are defined as follows: [29]

(1) a "large investment portfolio company," as this term is defined in Schedule One "A" of the Regulation of Investment Advice, Investment Marketing, and Portfolio Management Law 5755-1995 ("**the Advising Law**");

(2) a company that holds an investment marketing or investment advising license, as stated in the Advising Law, that had, on the

---

[27] The Ministry of Environmental Protection, "Draft Taxonomy to classify economic activities based on their effect on defined environmental objectives" (October 26, 2022). The draft is open for public comments till the January 31, 2023.

[28] See the significant of the process of selecting an investment policy in the Circular on the policy of the investment selection policy and its management, January 8, 2019. Also see the Directive on risk management dated June 1, 2020.

[29] The definition of a "large license holder" was determined on the basis of the threshold defined in the definition of a "large portfolio management company" in Schedule One "A" of the Regulation of Investment Advice, Investment Marketing, and Portfolio Management Law 5755-1995.

publication date of the directive, together with other companies of the same group that hold an investment marketing license, more than 1,000 customers; or an individual holder of said license who had over 1,000 customers on the publication date of the directive;

(3) the advisory functions in banks.

Whether or not investors believe that ESG information should be incorporated in the decisions made by fund managers and license holders, the issue has apparently captured a significant place in public discourse in Israel and around the world and therefore investors should be informed of fund managers and license holders' practices.

Through this Directive, the ISA is continuing a series of efforts initiated in April 2021 by publishing recommendations to the reporting corporations to publish corporate governance reports and the actions of other financial regulators in Israel as reviewed above. The Directive requires relevant entities—this time, requirements apply to entities on the demand side of the equation— to review, study, decide their point of view on this issue, and disclose it.

In other words, the Directive does not force the relevant entities to integrate ESG factors into their practices. However, the relevant entities need to conduct an in-depth assessment of the issue – **a legitimate result can lead to the decision not to integrate ESG factors**. Although some relevant entities may disqualify the integration of ESG factors and others may decide to incorporate them in their decision-making**, disclosure of their decision is required in both cases**. The relevant entities are not limited to a binary decision between adoption or rejection. Their policies may reflect various degrees of complexity, such as a policy to incorporate specific ESG considerations only or adopt such concerns to particular types of funds. Fund managers and license holders may also offer various justifications for their position.

A table summarizing the public comments and the ISA's responses and a summary of the answers to questions posed in the draft directive are published at the ISA's website.

The Directive

Definition of Terms

"**Large License Holder**" – any of the following: (a) a "large investment portfolio company," as this term is defined in Schedule One "A" of the Regulation of Investment Advice, Investment Marketing, and Portfolio Management Law 5755-1995 ("**the Advising Law**"); (b) a company that holds an investment marketing or investment advising license, as stated in the Advising Law, that had, on the publication date of the directive, together with other companies of the same group that hold an investment marketing license, more than 1,000 customers; or an individual holder of said license who had over 1,000 customers on the publication date of the directive; or (3) the advisory functions in banks.

1. **Stage One – Processing and Assimilation**

   1.1. **Large License Holders** will conduct a review whether, in their opinion, they should give weight to ESG factors in their practice, including their risk assessment process, investment decision process, assessment of the suitability process, analysis of the effects of such investments on the returns, or otherwise.

   1.2. **Fund Managers** will conduct a review whether, in their opinion, they should give weight to ESG factors in their practice, including their risk assessment process, assets allocation process, voting policy in annual general meeting ("**AGM**"), analysis of the effects of such investments on their returns, or otherwise.

2. **Stage Two - Disclosure and Implementation**

2.1. **Large license holders** will provide information in a non-public immediate report (Y11/M13) on whether its policy includes ESG considerations, and if so— in which manner, and its considerations for its policy.

2.2. **Fund managers** will provide information in a public immediate report (Event in the Fund Manager, K19) on whether its investment policy includes ESG considerations, and if so— in which manner, and its considerations for its policy.

Fund managers will also make such a disclosure in the prospectus that they publish shortly after the filing date of said immediate report, in the section of the prospectus concerning the investment selection process or the voting policy or in a special section on risk management devoted to this issue, as relevant.

Deadline for completing Stages One and Two: six months from the publication date of this Directive.

3. Fund managers and large license holders must consider how to **effectively disclose to investors** the implementation of their **policy in order to facilitate investors' access to and understanding of said policy.**

Commencement

This Directive comes into effect in the date of a notice of its inclusion in the legal records, and according to the timetables to complete the stages.