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Alternative Mutual Funds: Hedge Funds in Trust and Fund of Hedge Funds Specification of Core Features

Revised November 2020

The ISA continues to promote its initiative to increase public capital market efficiency by launching two new investment vehicles to be offered to the public under the Joint Investments in Trust Law:¹ hedge funds in trust (“HFIT”) and funds of hedge funds (“FOHF”). These hybrid products will combine features of (supervised) mutual funds and features of (unsupervised) hedge funds, allowing the public to benefit from both worlds. This initiative will, on the one hand, give the general public access to investments in unsupervised hedge funds, yet at the same time, these products will be mutual funds for all intents and purposes. These products will be subject to the same regulation that is relevant to mutual funds, after adjustments, and they will be under ISA supervision.

To involve the public in the development process of these new products, the ISA published a request for public suggestions and comments, which was followed by the publication of draft specifications of the key proposed features of the new funds.²

The ISA carefully considered the public comments. ISA Staff also approached various entities, including market players, in the alternative fund sector for further explanations and to learn further about the industry and its challenges. Discussions with these entities were based on the shared interest in defining a regulatory regime that will allow relevant market players to offer the new products to the public, yet protects the interests of the investing public.

This document, which constitutes another step in this process, presents a revised version of the **key features of the proposed products**. This revised version includes the ISA’s

¹ Joint Investments in Trust 5754-1994 (hereinafter, "the Funds Law" or "the Law").

² Alternative Mutual Funds such as Hedge Funds in Trust and Funds of Hedge Funds – Specifications of Core Features [LINK](#).

position on the public comments it received, and also addresses regulatory relief and the relevant adjustments to the provision of law that currently apply to mutual funds. The ISA clarifies that other provisions of law that are not mentioned in these specifications will apply to the new funds as they stand.

To continue to promote this initiative, The ISA is currently examining all the implications of implementing the unique features of these new products, and specifically the implications of the settlement process of creations and redemptions of hedge fund units.

ISA Staff clarifies that the ISA intends to introduce the necessary legislative adjustments into law. In line with the ISA's Procedure for Initiating Regulation,³ legislative amendment files will be published for public comments in the future.

ISA Staff further clarifies that the ISA is not obligated to take steps to implement these revised specifications exactly as they appear here. The adopted changes will be reflected in relevant legislative documents.

Specifications of Hedge Funds in Trust

1. Fixed-Date Funds

- 1) Hedge funds in trust (HFIT) will be open fixed-date funds.⁴
- 2) The interval between consecutive fixed dates will be no less than three months (and no more than six months, pursuant to the relevant provisions of law).

2. Advance notice on creation and redemption orders

The fund manager will publish, in the fund's prospectus, the final advance notice date for creations or redemption orders ("Final Advance Notice Date"). The Final Advance Notice Date will occur at the cut-off time on a price calculation date that is no later than 10 price calculation dates prior to any fixed date.

All orders received by the distributor after the cut-off time on the Final Advance Notice Date will be transferred to the fund manager for execution on the following fixed date.

3. Calculation and publication of unit prices and redemption

³ Internal ISA procedure on initiating regulation. [LINK](#)

⁴ Section 47 of the Law

- 1) The fund manager will calculate the unit price and redemption prices on each price calculation day.⁵
- 2) On each price calculation day, the fund manager will submit to the ISA a report that includes the unit and redemption prices that the fund manager calculated as set forth in (a).
- 3) The fund manager will publish the unit and redemption prices on the following dates:
 - 1) On the three price calculation days prior to the Final Advance Notice Date (as set forth in Section 2 above), for the price calculation date preceding the publication date.
 - 2) No later than the third price calculation date in each month, for the final price calculation date of the preceding month.

4. Investing rules

- 1) The provisions of Regulation 5 (Maximum Percentage of Corporate or Government Securities), 6A (Maximum Percentage of Options), 6B (Maximum Percentage of not listed commercial papers), 8 (Maximum Percentage of Nontraded Assets), 8A (Maximum Exposure to Underlying Asset Due to Unfunded Swaps), and 9 (Maximum Percentage of Units in Funds That Are Not Funds of Funds) of the Asset Regulations⁶ will not apply to hedge funds in trust.
- 2) The restriction on the percentage value of securities and foreign securities issued by a single corporation and that the fund manager sold short on behalf of the fund, of the fund's net asset value, as set forth in Regulation 5(B) of the Options Regulations,⁷ will not apply to hedge funds in trust.
- 3) The restriction on the percentage of collateral, set forth in Regulation 7 of the Options Regulations, will not apply to hedge funds in trust.⁸ Accordingly, any

⁵ As defined in the Definitions of the Law.

⁶ Joint Investment Trust Regulations (Assets that May Be Purchased and Held by a Fund and their Maximum Percentages) 5755-1994 ("the Assets Regulations").

⁷ Joint Investment Trust Regulations (Options, Future Contracts, and Short Sales) 5761-2001 ("the Options Regulations").

⁸ Accordingly, Section 2 of the Directive on Rules for Transactions in OTC Derivatives is also irrelevant for hedge funds in trust.

deviation from the fund's credit leverage restriction⁹ stemming from the fund's leverage for its operations in derivatives, will not be deemed a violation of this restriction.

- 4) Notwithstanding Regulation 9 of the Options Regulations, the lending period for securities and foreign securities, for which the fund manager does not have a contractual obligation regarding the return of the securities to the fund on demand before the end of the loan period, will not exceed the interval between fixed dates, or three months, the shorter of the two periods.

5. Expenses Payable from the Fund's Assets

Each HFIT manager may charge a success fee, subject to the following:

- (a) Success fees will be calculated on each fixed date, and will be priced into the fund's creation and redemption order prices.
- (b) Success fees will be a function of the fund's returns relative to a specific positive rate of return determined by the fund manager, or relative to a positive return of any share-based index (jointly, "the Benchmark");
- (c) A HFIT manager may charge success fees on any fixed date ("Fixed Date"), if the following three conditions cumulatively obtain:
 - 1) In the period from the Fixed Date to the preceding fixed date ("the First Calculation Period") the fund generated a positive return in excess of the return of the Benchmark defined by the fund manager for said period;
 - 2) The fund generated a positive return in excess of the Benchmark return in the 12-month period preceding the Fixed Date, or during the period from the fund's establishment date to the Fixed Date, the shorter of the two periods ("the Second Calculation Period");
 - 3) The fund's return in the First Calculation Period and in the Second Calculation Period is positive.
- (d) Success fees that are duly collected by the fund manager pursuant to the above conditions are not returned to the fund.

ISA Staff clarifies that no success fees may be collected in HFIT that charge an addition fee.

⁹ Defined in Joint Investment Trust Regulations (Use of Credit to Execute Transactions and Redemption of Units) 5761-2001.

6. Qualified participants in the fund’s investment decision making

A fund manager may, appoint an individual or company that is not a licensed portfolio manager to make investment decisions concerning the management of the hedge fund in trust’s investment portfolio, provided that said individual or company has proven experience of at least three years in managing portfolios with features similar to the features of hedge funds in trust.

7. Name of the fund

To ensure that the name of the fund is not misleading and represents the fund’s specific risk profile to the investing public, fund managers will include the words “hedge fund in trust” or “hedge in trust” in the fund’s name. HFITs will also be classified under a super-category designated for such funds. Special characters will be defined to represent the fund type in abbreviated names.

8. Disclosure

- 1) A HFIT manager who submits a Due Disclosure Form to the ISA and the TASE concerning the assets held by the HFIT (“exposure data”) no later than by the end of seven trading day from the first day of each month may submit the monthly report only to the ISA, notwithstanding the provisions of Regulation 22(c) of the Reports Regulations.¹⁰ The monthly reports will not be open for public perusal.
- 2) The ISA intends to define the reports that HFIT managers will be required to submit to the ISA, to the TASE, and/or to the distributor, and intends to determine any additional details that must be included in existing reports, or other adjustments.

9. Management of HFITs

- 1) Each fund manager may manage only one HFIT.
- 2) A HFIT established by a fund manager, where the fund’s investment portfolio is managed by an external investment manager (“hosting”) that is not a “related party” of the fund manager, shall be deemed a HFIT managed by another fund manager. The name of the external investment manager will appear at the beginning of the name of the HFIT managed in such a hosting model.

¹⁰ Joint Investments in Trust Regulations (Reports) 5755-1994 (“the Reports Regulations”).

- 3) Any individual or company as stated in paragraph 6 above, or any licensed corporation that manages portfolios may enter into an agreement with a fund manager to manage the investment portfolio of a HFIT based on a hosting model, provided that they do not manage the investment portfolio of a HFIT on behalf of another fund manager in a hosting model.

Specifications of Funds of Hedge Funds (FOHF)

1. Fixed-date Fund

Funds of hedge funds (“FOHF”) will be open, fixed-date funds. FOHF unit creation and redemption dates will match the creation and redemption dates of the hedge funds held by the FOHF.¹¹

2. Advance Notice

In the fund’s prospectus, the fund manager will publish the final date for advance notice for creation or redemption orders (“Final Advance Notice Date”). The Final Advance Notice Date will occur at the cut-off time on a price calculation date that is not later than 10 price calculation dates prior to any fixed date.

All orders received by the distributor after the cut-off time on the Final Advance Notice Date will be transferred to the fund manager for execution on the following fixed date.

3. Calculation and publication of fund of hedge funds’ unit and redemption prices -

- 1) The FOHF manager will calculate the unit and redemption prices on every price calculation date;
- 2) The FOHF manager will publish the unit and redemption prices on the 20th day of each month, for the final price calculation date of the preceding month.

4. Assets that an FOHF may purchase and hold

The FOHF manager may purchase and hold the following types of assets in the FOHF:

¹¹ For the sake of clarification, where the terms of agreement between the FOHF manager and the hedge fund manager allow the manager of the held hedge fund to refrain from responding to a redemption request for a period of no more than 7 days, under specific circumstances, such failure to respond will not be deemed non-compliance with this condition.

- a. Units of hedge funds. For the purpose of this paragraph, a hedge fund (“Hedge Fund”) is any of the following:
 - (1) An arrangement whose purpose is the joint investment in securities, the purchase or creation of options and future contracts, or the short sale of securities, and the joint generation of earnings from holding or from transactions involving said securities, and which is not subject to the provisions of the Funds Law because it meets the conditions of Section 2(B) of the Law, and has an arrangement with the Tax Authority that is unique for tax entities that invest in financial assets;
 - (2) A corporation whose purpose is the joint investment in securities, the purchase or creation of options and future contracts, or the short sale of securities, and the joint generation of earnings from holding or from transactions involving said securities, where the manager’s domicile is a foreign country, and the corporation is not subject to the Funds Law, and said investment, purchase, creation, and short sale may be performed in such amounts and on such terms that exceed the amounts and terms permitted to mutual funds by applicable law in that country; and excludes funds of hedge funds (FOHFs).
 - b. Cash and cash substitutes pursuant to Section 1D (sub-sections 1-5) of the Directive on Investment Management in Tracker Funds;¹²
 - c. Rights and obligations under options and future contracts as stated in Regulation 2(3) of the Asset Regulations, or forward contracts as stated in Regulation 2(3C) of said Regulations, which were made to hedge against changes in the rates of foreign currency in which the assets of the FOHF or held hedge funds are traded.
5. Conditions that must obtain in the held hedge funds
- a. Hedge funds held by an FOHF must meet all the conditions that must obtain in a hedge fund that is permitted to be purchased and held by special funds.¹³ For the purpose of the condition listed in Regulation 3A(2)(a) of the Assets

¹² Directive to Mutual Fund Managers on Investment Management in Tracker Funds.

¹³ Regulation 3A(2) of the Asset Regulations.

Regulations,¹⁴ if the price of the hedge fund units is not published by a corporation as defined in said Regulation, the hedge fund manager is contractually obligated to report the hedge fund unit price to the FOHF manager at least once a month.

- b. The hedge fund appointed an administrator whose duty is to ensure the rights of the investors in the hedge fund by overseeing all the inflows and outflows of funds into and from the hedge fund's account (including flows for the purpose of paying management fees and success fees to the fund manager), was appointed.

6. Maximum number of units held by FOHFs

- a. The value of the units of a single hedge fund held by an FOHF will not exceed 25% of the FOHF's net asset value.
- b. The value of the units of a single hedge fund held by an FOHF will not exceed 25% of the held fund's net asset value.
- c. The total value of the hedge fund units held by an FOHF will not be less than 75% of the FOHF's net asset value.

7. Qualified participants in the fund's investment decision making

A fund manager may appoint an individual or company that is not a licensed portfolio manager to make investment decisions concerning the management of the FOHF's investment portfolio, provided that the individual or company has proven experience of at least three years in managing portfolios with features similar to the features of FOHFs or HFITs.

8. Name of the fund

To ensure that the name of the fund is not misleading and represents to the investing public that the fund has a specific risk profile, the FOHF manager will include the words "fund of hedge funds" in the fund's name. FOHFs will also be classified under a super-category designated for such funds. Special characters will be defined to represent the fund type in abbreviated names.

9. FOHF manager's fee

¹⁴ Regulation 3A(2)(a) of the Asset Regulations – "The share price is published on predetermined dates and at least once a month by a corporation that is engaged, among other things, in publishing hedge fund share prices based on information received from hedge fund managers."

The FOHF manager may charge the FOHF a fee. However, for the purpose of calculating the FOHF manager's fee, the following elements will be not included in the FOHF's asset value: Assets that are not hedge funds; that is, cash and cash substitutes held by the FOHF.

The FOHF manager may not charge a performance-based fee (success fee).

10. Holdings in "related" hedge funds

In the FOHF investment policy statement, the FOHF manager will state whether they intend to hold hedge funds that meet the conditions of a "related fund" as defined in Section 49 of the Law. If the FOHF manager holds related funds in the FOHF, the following conditions must obtain:

- a. Notwithstanding the provisions of paragraph 6b above, the value of the hedge fund units held by the FOHF does not exceed 10% of held fund's net asset value. This proportion may increase up to 25%, provided that the increase in proportion was not created as a result of an investment by the FOHF (i.e., passive non-compliance).
- b. Notwithstanding the provisions of paragraph 9 above, the fund manager's fee will not be paid from the FOHF's assets.

11. Disclosure

- 4) The ISA intends to define specific reports that managers of FOHFs will be required to submit to the ISA, the TASE, and/or to the distributor, and intends to determine any additional details that must be included in existing reports, or other adjustments.

12. Management of FOHFs

- a. Each fund manager may manage only one FOHF.
- b. An FOHF established by a fund manager, where the fund's investment portfolio is managed by an external investment manager ("hosting") that is not a related party of the fund manager, shall be deemed a fund managed by another fund manager. The name of the external investment manager will appear at the beginning of the name of the FOHF managed in such a hosting model.

- c. Any individual as stated in paragraph 7 above, or any licensed corporation that manages portfolios may enter into an agreement with a fund manager to manage the investment portfolio of an FOHF based on a hosting model, provided that they do not manage the investment portfolio of a fund of this type on behalf of another fund manager in a hosting model.