
The Committee for Promotion of Investments in Publicly Traded Research and Development Companies

Final Report

January 2014

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Summary

1. The Committee for Promotion of Investments in Publicly Traded Research & Development Companies (hereinafter – the "**Committee**") was established on September 6, 2012 by Prof. Shmuel Hauser, Chairman of the Israel Securities Authority. Its members include representatives of the Capital Markets Division, Accountant General's Division and Budget Division at the Ministry of Finance, Tax Authority, National Economic Council, Ministry of Justice, Tel Aviv Stock Exchange Ltd. (hereinafter – the "**Stock Exchange**") and the Israel Securities Authority.

The Committee's letter of appointment is attached to this report as Appendix A.

2. Recognizing that the Hi Tech industry – in its various aspects – is the industry of the future and growth driver of the Israeli economy, the State of Israel has decided to promote it.
3. Throughout the years, a number of committees have been established with the goal of promoting this industry by finding solutions for companies' various development stages, so as to increase the likelihood that these companies continue to grow in Israel rather than be sold. As a result, the State has helped and continues to help develop and promote this industry in a number of ways, *inter alia* by:

- Training programs intended to produce skilled manpower.
- Financial assistance to companies granted by the Ministry of Economic Affairs' Chief Scientist.
- The Program for Encouraging Israeli Institutional Investments in Hi Tech Companies, which granted Israeli institutionals investing in venture capital funds (which invest in Israeli hi tech companies) risk participation by the State.
- The "Angels Law", which grants tax benefits to individuals investing in start up companies.

4. In this context, it seems appropriate to cite the explanatory notes to the 2011 and 2012 Proposed Bill of Economic Policy (Amendment) of 2010.

Large-size hi tech companies are highly important to the Israeli economy, since their positive external impact on other economic sectors is more obvious than that of smaller companies. Such impact includes creating more employment opportunities so as to include a greater variety of jobs for employees of various education levels, preserving a larger portion of the value chain in Israel, as well as contributing to the improvement of competitiveness and to a positive spillover of employees and executives to other industries. In addition, larger companies are relatively stable, which leads to a higher return for the economy over the years."

5. A review of the hi tech companies listed on the Tel Aviv Stock Exchange reveals that, excluding biomed companies, the Stock Exchange has not served as an

effective financing alternative for such companies, especially for relatively large ones.

6. The Israeli capital market is expected, *inter alia*, to finance and enable companies' growth as well as serve social causes (such as economic and social mobility). In addition, it is expected to offer savers a variety of securities, enable them to build effective savings portfolios and encourage private savings. The Israel hi tech industry undoubtedly contributes to economic and social mobility and can offer savers a variety of securities embodying various risk levels.
7. In light of the above, the Committee was established so as to examine and recommend various means and initiatives which may encourage investments in hi tech companies through the Stock Exchange, without compromising the interests of the investing public or orderly trading.
8. The Committee conducted numerous discussions with entities active in the technology and biomed industries, including venture capital funds, institutional entities, private and public companies, attorneys, accountants and the representatives from the Chief Scientist at the Ministry of Economic Affairs. The list of entities which appeared before the Committee is attached to this report as Appendix B.
9. The Committee examined, *inter alia*, the following issues: the suitability of prospectus disclosure provisions and current reporting provisions; establishing dedicated trading rules and examining whether a separate index is justified; encouraging reviews of hi tech companies by analysts; making the Securities Exchange more accessible to foreign investors and foreign companies; encouraging investments by institutionals; incorporation structure; tax benefits for investors.
10. On June 4, 2013, the Committee published an interim report, which included most of its recommendations, intended to encourage investment in research and development companies through the Stock Exchange, and make this financing track more attractive to these companies.
11. After examining the public's comments, the Committee decided to uphold the main recommendations of its interim report, subject to several adjustments, most of which will be described hereunder:
 - **Defining the target companies** – the minimum requirement for a (post-IPO) market capitalization was reduced from NIS 250 million to NIS 200 million, following public comments regarding capital requirements for biomed companies;
 - **Encouraging independent analyst reviews of hi tech companies** – in order to improve the local capital market, the Committee recommends that the Ministry of Finance and the Ministry of Economic Affairs' Chief Scientist examine, in cooperation with the Israel Securities Authority, the possibility of establishing a support track for small hi tech companies, so that the government take part in financing the analyst reviews.
 - **Taxing of individuals who are controlling shareholders** – the interim report recommended that individuals who are controlling shareholders in research and development companies first listed on the Stock Exchange

will be taxed on the appreciation of the options (which they held prior to the IPO) from the date on which their company went public until the exercise of the options, under the capital track in accordance with Section 102 of the Income Tax Ordinance [New Version] (hereinafter – the "**Ordinance**" or the "**Income Tax Ordinance**") in lieu of revenue tax under Section 3(i) of the Ordinance. It was also noted that the distribution of profits as of the date of the IPO and from the IPO date until the sale date shall be linear. In lieu of distributing the profit in a linear fashion, this report recommends that the profit distribution at the exercise date be made in the following manner: The portion of the value of the benefit in the amount of the value of the company's shares on the Stock Exchange after thirty days of trading on the Stock Exchange, less expenses, shall be regarded as revenue in accordance with Section 2(1) of the Ordinance, and the balance of the benefit amount shall be regarded as capital gain, taxed at 25%.

- Additional incentives for publicly traded hi tech funds – the Committee recommends that the Ministry of Finance continues to assess the need for encouraging the establishment of publicly traded hi tech funds by providing additional incentives, *inter alia*, in light of the international experience gained in this area. We propose to examine incentives for reducing the funds' finance costs, by using state guarantees with the purpose of reducing the level of risk for investors, or using state guarantees with the purpose of increasing the expected return, or a combination of the two;
 - Research and development partnerships – the interim report made an initial reference to the creation of a new finance model, such as publicly traded research and development partnerships. This issue is not included in the Committee's final report, since the members of the Committee did not reach an agreement regarding the various aspects involved in creating the model.
12. The Committee is of the opinion that the implementation of the recommendations will contribute to turning the Stock Exchange into a significant alternative for financing young hi tech companies, increasing the chance of these companies developing in Israel rather than being sold.
 13. Retaining these companies in Israel will encourage, as aforesaid, employment across various education levels; ensure the preservation of a greater part of the value chain in Israel; contribute to improving market competition and to positive spillover of employees and executives to other industries.
 14. The Committee believes that turning the Stock Exchange into a viable option for raising capital for hi tech companies will, on the one hand, vary the capital resources available to hi tech companies, increase investments in such companies and reduce dependence on other economies, and on the other hand – contribute to creating a more efficient market for the benefit of all investors.
 15. Due to the dependency of young hi tech companies on foreign funds, and the fact that over 95% of these companies are acquired by foreign corporations, the Committee recommends implementing a number of steps which will contribute, in

the aggregate, to producing an efficient and worthwhile infrastructure for raising funds through the Stock Exchange in Israel – for medium- as well as large-size companies, and for publicly traded hi tech funds which invest in earlier stage companies. Thus, the local market can become a viable option for these companies, rather than having them rely on foreign capital, resulting in a larger number of companies remaining in Israel.

16. The Committee recommends two main solutions for encouraging the funding of hi tech companies through the Stock Exchange: encouraging relatively large hi tech companies to hold IPOs in Israel and encouraging the establishment of publicly traded hi tech funds.
17. The Committee believes that the success of the proposed stock exchange-related solutions depends on three foundations: ensuring proper pricing through creating a more efficient local capital market and encouraging investments by foreign investors; adjusting regulatory provisions to the companies' and funds' characteristics and to investors' needs, while reducing the cost of their implementation; granting incentives to encourage market creation.
18. In addition to the aforesaid stock exchange-based solutions, and as a complementary step, the Committee believes that two public financing solutions for young start up companies outside the Stock Exchange should be promoted, in the form of crowdfunding, i.e., raising small amounts of money from a large number of investors from the public at large and sophisticated investor clubs – i.e., approaching sophisticated investors for fund raising).

19. The following is a summary of the Committee's key recommendations:

19.1. Recommendations regarding local IPOs for hi tech companies:

- 19.1.1. **Target companies** – the Committee believes that relatively large companies, which are usually at the growth stage and have significant capital needs, should be encouraged to go public. Thus, the main condition for target companies is a (post-IPO) market capitalization of at least NIS 200 million.
- 19.1.2. **The Tech Elite Index** – the Stock Exchange will create a new Index, which will include newly traded hi tech companies which qualify as target companies as aforesaid as well as older hi tech companies which are already traded on the Stock Exchange and have a market cap of at least NIS 400 million.
- 19.1.3. **Additional indices and index tracking products** – in order to increase the investment liquidity of the target stocks, the Stock Exchange will launch the Tech Elite Index, with the intention that issuers of index products will be able to offer ETFs tracking this index.

The Stock Exchange will consider whether or not to continue the Bluetech 50 Index. In addition, the Stock

Exchange will examine ways to cooperate with world renowned index providers in order to create indices and index tracking products which include stocks of Israeli or Israel-oriented companies listed on the Tel Aviv Stock Exchange that are included in the Tech Elite Index along with those traded solely on foreign stock exchanges.

19.1.4. Encouraging independent analyst reviews of hi tech companies –

19.1.4.1. The Exchange will promote an independent analyst program, in which the Stock Exchange will enter into an agreement with at least one research firm, which will initially review publicly traded biomed companies wishing to be included in the program.

19.1.4.2. The Committee recommends extending the analyst program (in this model or a similar model to be approved subject to amending the Regulation of Investment Advice Law,¹ – so as to include all companies classified by the Stock Exchange as technology companies (including hi tech funds and research & development partnerships as defined below).

The Committee recommends that the analyst reviews be conducted as early as the stage of submitting a prospectus for an IPO.

19.1.4.3. In order to make the local capital market more efficient, the Committee recommends that the Ministry of Finance and the Chief Scientist at the Ministry of Economic Affairs examine, with the Israel Securities Authority, the possibility of establishing a support track for small hi tech companies, so that the government participates in the costs of the analyst reviews.

19.1.5. Tax aspects –

19.1.5.1. To determine, as part of a temporary provision (three years from its effective date), that the cost of investing in stocks purchased as part of an IPO of a research and development company which has joined the Tech Elite Index immediately after its IPO, shall be recognized, on the investment date, as a capital loss eligible for set-off (in lieu of its being recognized as cost at the date of selling the stock and calculating

¹ Regulation of Investment Advice Law, Investment Marketing and Investment Portfolio Management Law of 1995 (hereinafter – the Advice Law).

capital gain), provided that: (a) The investment was made as part of a research and development company's stock issue on the Stock Exchange; (b) The company's business is mainly focused on research and development and it possesses a certificate to that effect issued by the Chief Scientist at the Ministry of Economic Affairs; (c) The company is committed to pursuing research and development for a period of three years from the date of its IPO; (d) Capital loss shall be recognized up to a maximum of NIS 5 million; (e) The company held its IPO in Israel (under the Tech Elite Index) during the time that the temporary order was in effect. If the company does not meet the conditions of the R&D activity, the issuer will incur the tax difference payment (the tax shield at the investment date) for investors who do not constitute material shareholders.

- 19.1.5.2. To determine, as part of a temporary order, that individuals who are controlling shareholders in research and development companies holding their IPOs in Israel – as part of the Tech Elite list – during the time that the temporary order is in effect, be charged a 25% capital gains tax for the appreciation of their stock options (received prior to the IPO), from the IPO date until the exercise date, under Section 102 of the Income Tax Order, capital track (25% tax rate), rather than under Section 3(i) of the Ordinance, in which the exercise of options by the controlling shareholders is taxed at a marginal tax rate.

19.1.6. Exemptions and adjustments in disclosure requirements for current reporting and prospectuses –

- 19.1.6.1. To enable target companies to prepare their financial statements, board of directors' report and description of the company's business included in the IPO prospectus for a period of two years only (rather than for three years as required for regular companies).
- 19.1.6.2. The target companies will be permitted to enjoy the exemptions listed below for a period of five years from the date of the IPO or until their market capitalization exceeds NIS 1 billion, the earlier of the two (hereinafter – the "**Exemption Period**"):

- Such companies will enjoy disclosure exemptions granted to small companies in accordance with the ISA's Roadmap² even if they do not qualify as small companies.
- These companies will be fully exempt from the iSox requirements (including the requirement to provide management statements even if it continues to apply to small companies).
- They will be allowed to prepare their financial statements in accordance with IFRS or US GAAP (see below) with no need for additional information required under applicable securities provisions.
- They will be allowed to file a quarterly report which will include only financial statements and a review of the main developments (without the need to file a board of directors' report).

19.1.6.3. To grant the Israel Securities Authority the power to exempt companies that are listed on the Stock Exchange and qualify as biomed or technology companies from disclosure requirements for prospectuses and current reports, including the power to require such companies to meet certain conditions as a prerequisite, so that the ISA may adjust, from time to time and as necessary, local disclosure requirements for prospectuses and current reports to those applicable to hi tech companies in the United States and England.

19.1.6.4. Target companies will be allowed to state in their IPO prospectuses that adopting reporting in accordance with the provisions of Chapter E3 of the Securities Law (Dual Listing) is contingent upon the holders' approval.

19.1.7. **Financial statements prepared in accordance with US GAAP** – to allow target companies incorporated in Israel to prepare their financial statements included in prospectuses and in periodic and quarterly reports in accordance with US GAAP (and to include in them a note describing

² The main reliefs considered for small reporting corporations are revocation of the requirement to publish a report on internal control (iSox) and an independent auditor's report on internal control in small companies, as well as granting an exemption from the provisions of the second amendment to the Periodic and Immediate Reports Regulations regarding Market Risk Analysis (the "Galay Report") to small companies whose risk exposure due to holding financial instruments is low.

adjustments made to IFRS) provided they meet the following conditions prior to completing their initial public offering: (a) More than 50% of their revenues have been generated outside Israel in each of the reporting periods included in the prospectus in which the company recorded revenues; and (b) the company's controlling shareholder is not a resident of Israel; or more than 50% of the companies' shares are held by non-Israeli residents.

19.1.8. Corporate governance aspects –

19.1.8.1. **Financial statements review committee** – target companies shall not be required to establish a financial statements review committee during the exemption period.

19.1.8.2. **Term of office of a chairman of the board-CEO** – a chairman of the board who also served as a company's CEO at the IPO date (reflected by a prospectus disclosure), shall be allowed to continue serving as such for a period of five years following the IPO date, during which his/her term shall not require the approval of a general meeting under Section 121(c) of the Companies Law of 1999 (hereinafter – the "Companies Law"). In addition, if the general meeting approves the appointment of a chairman of the board as a company's CEO during the two years following the company's IPO, the approval shall be valid for a period of five years from the date of the IPO (as opposed to three years from the date of the approval under the current law).

19.1.8.3. **Management agreement with controlling shareholders** – a target company which has entered into a remuneration transaction with a controlling shareholder serving as an officerholder, which has been described in a prospectus, shall be required to submit it for reapproval only five years after its IPO date (despite the current requirement to reapprove such transactions with a controlling shareholder every three years). In addition, such companies shall be required to approve such remuneration transactions with the controlling shareholder serving as officerholder if they have been lawfully approved following the IPO on the latest of the following: three years from the date of the previous approval or five years from the IPO date.

- 19.1.8.4. **Compensation policy** – if a company has determined its compensation policy prior to becoming a public company and has lawfully described such a policy in its IPO prospectus, it shall be exempt from the requirement to approve the compensation policy in accordance with the approval procedures prescribed by Section 267a of the Companies Law. Such an approval of the policy shall only be required three years after the IPO date.
- 19.1.8.5. Remuneration of an external director – the "minimum amounts" and "fixed amounts" detailed in the Second Schedule, Third Schedule and Fourth Schedule to the Companies Law (Rules Regarding Remuneration and Expenses for an External Director) of 2000, shall be reduced by one third, as regards annual remuneration and the participation remuneration of external directors or expert external directors who serve in target companies grades A, B, C and D (with equity capital of up to NIS 1 billion), as detailed in the First Schedule to the abovesaid regulations. The abovesaid reduction shall apply for five years from the IPO date of the target company, and shall also apply, respectively, to independent directors who serve in such target companies.
- 19.1.8.6. Approval of tenure and employment terms of a CEO three years after the IPO date – the employment of a CEO under tenure and employment terms which are not materially different from those of the CEO serving at the date of the IPO and are lawfully described in the IPO prospectus, shall be exempt from approval by a general meeting, provided that the employment terms correspond to the company's compensation policy.

19.1.9. Companies incorporated in Delaware –

- 19.1.9.1. Companies newly incorporated in Delaware and included in the Tech Elite list immediately after the IPO, shall be allowed to submit reports in the English language to the Securities Exchange and Israel Securities Authority.
- 19.1.9.2. The Committee recommends that the Israel Securities Authority assess the need to make further adjustments to disclosure provisions for these companies, provided they report to the US

Security Exchange Commission (SEC) as well, so as to decrease the cost of preparing the reports, provided that the quality of disclosure offered to Israeli investors remains intact as does the Israel Securities Authority's ability to supervise the company's compliance with the disclosure provisions.

19.1.9.3. The ISA shall make use of its power to grant Delaware incorporated companies joining the Tech Elite Index immediately following their IPO, corporate governance exemptions extended to Tech Elite companies incorporated in Israel, for the duration of the exemption period.

19.1.10. **Reporting language –**

19.1.10.1. To enable target companies to prepare their IPO prospectuses in English, as well as later prospectuses, and to file current reports in English as long as the company qualifies as a reporting corporation. This exemption shall not be revoked if a company is no longer included in the Tech Elite Index (unless it is no longer classified as a biomed or technology company by the Stock Exchange).

19.1.10.2. To enable companies currently listed on the Stock Exchange and included in the Tech Elite list to file all of their reports and prospectuses with the Israel Securities Authority in English, subject to obtaining approval to that effect by a general meeting of the company's securities holders through a regular majority excluding the controlling shareholders. This exemption shall be valid as long as a company qualifies as a reporting corporation and as a biomed or technology company under the Stock Exchange's rules.

19.1.10.3. To recommend that the Israel Securities Authority clarify that companies classified as biomed or technology companies (even if they are not included in the Elite Tech Index) can publish, as immediate reports, an English translation of their Hebrew reports, subject to the continuity and reliability of the translation.

19.1.10.4. The Committee supports the Ministry of Justice's proposal, according to which all companies shall be eligible to submit their articles of association and lien registration documents in the English language (in addition

to a form which would detail its main provisions in Hebrew in the said articles of association and lien documents).

- 19.1.10.5. In addition to the option of reporting in English, the Stock Exchange will create a MAYA site in English, similar to the Hebrew one, so as to provide foreign investors with convenient and user friendly access to reports of such companies, as well as of dual listed companies and other companies wishing to translate all of their reports into English.

19.2. **Recommendations regarding publicly traded hi tech funds**

- 19.2.1. **Establishing hi tech funds modeled after mutual funds** – it is proposed to enable the establishment of hi tech funds modeled after close-ended mutual funds, mutatis mutandis, due to the fact that hi tech funds are, in fact, arrangements for joint investment in securities (tradable or non-tradable), and in order to adjust regulatory provisions to the funds' characteristics, while reducing the costs of complying therewith.

- 19.2.2. **Two types of traded funds** – the Committee recommends allowing two models for publicly traded Hi Tech funds similar to closed-end mutual funds:

19.2.2.1. A limited period hi tech fund, the length of which will be prescribed in the fund agreement and will not exceed 15 years (hereinafter – "Limited Term Hi Tech Fund");

19.2.2.2. An unlimited hi tech fund, which the public may liquidate once in every period, by a special decision ("Continuous Hi Tech Fund").

Such funds shall be allowed to invest up to 30% of the amount raised from the public in securities of **non-traded** hi tech companies (either Israeli or Israel-oriented), and in case they receive government support – the rate will reach 50% of the funds raised.

- 19.2.3. **Publicly traded hi tech funds shall be established under the "exempt trust fund track"** – a publicly traded hi tech fund shall be tax exempt for its revenues, and its unit holders shall be taxable at the date of the exercise of the units or at the profit distribution date.

- 19.2.4. **Exemptions regarding holding rates in provident funds** – the Committee recommends that in hi tech funds, the maximum permitted holding rates of means of control, as defined under Section 9(2) of the Income Tax Ordinance, by entities included in this section (municipalities, the

National Lottery [Mif'al Hapayis], public sector entities or provident funds) versus 50% under the current law. Such a holding rate will not be considered a violation of this section, provided that such entities are not managed by identical management firms or identical controlling shareholders.

- 19.2.5. **Additional incentives for publicly traded hi tech funds** – the Committee recommends that the Ministry of Finance continue to assess the need for encouraging the establishment of publicly traded hi tech funds by providing additional incentives, inter alia, in light of the international experience gained in this area. We propose to examine incentives for reducing the funds' finance costs, by using state guarantees whose purpose is to reduce the level of risk for investors, or using state guarantees with the purpose of increasing the expected return, or a combination of the two;

19.3. **Non-exchange-traded financing solutions** –

- 19.3.1. General – the Committee recommended promoting non-exchange financing means which would be suitable for seed stage start ups that do not qualify for trading on the Stock Exchange: raising funds through crowdfunding – using the internet to raise small amounts of money from a large number of investors from among the public; and sophisticated investor clubs. The combination of these two tools can complement other financing solutions by addressing the needs of young start up companies at the initial investment stages, as opposed to the other, capital market-related tools, which are naturally aimed at later stage companies.

- 19.3.2. **Crowdfunding** – the Committee recommends adopting a crowdfunding model for young Israeli start up companies, using the principles outlined in the Committee's report. Crowdfunding is a model for raising capital from the public via web-based platforms. The idea behind crowdfunding is to raise small amounts of money from a large number of investors. The Committee suggests that an issuer be permitted to use crowdfunding to raise, whether through a single round or a number of rounds, during a period of twelve consecutive months, a maximum of NIS 2 million. As a rule, an investor will be permitted to invest a maximum total amount of NIS 20,000 in crowdfunding ventures, with a maximum of NIS 10,000 per investment.

- 19.3.3. **Sophisticated investor clubs** – this model allows companies to raise larger amounts of money (unlike in crowdfunding) from a smaller number of sophisticated individual investors. The Committee recommends that the

Israel Securities Authority issue a clarification regarding the manner in which entities may be allowed to address the public so as to locate sophisticated individual investors without being required to issue a prospectus.

Regarding the steps which the offeror is required to take in order to ensure that the investors are indeed sophisticated, the Committee recommends setting up a pool or "club" of sophisticated investors, whose members would be addressed either directly by the start up companies or indirectly by the club manager. The advantage of addressing a well defined group of sophisticated investors rather than the public at large is that start up companies will be able to interest group members in concrete investment opportunities and would be able to rely on the club's comprehensive initial assessment and the club's periodic "eligibility assessments" rather than conduct these assessments on their own.

- 19.3.4. The Committee recommends that when such an investment is made using the crowdfunding model or investor clubs through non-public limited partnerships, revenues from passive investors investing in seed stage companies through approved partnerships shall be considered capital gains under Part E of the Income Tax Ordinance, subject to certain conditions detailed in the Committee's report.
- 19.4. **Encouraging investments by institutionals** – in order to encourage institutionals to build the expertise needed in order to invest in tradable hi tech stocks, the Committee recommends allowing them, for a limited interim period, to deduct payments arising from investments in tradable hi tech funds and index tracking products, as an expense charged to planholders in addition to management fees, provided that the fund manager is not a "related party" of the institutional. Towards the end of the period, the need for extending the interim period will be assessed, taking into account the experience gained by institutionals and the efficiency of the capital market in this area.
- 19.5. **Due to the novelty and complexity of some of the Committee's recommendations, we recommend establishing a follow up team, whose role will be to examine the implementation of the Committee's recommendations, their effectiveness and the need to make adjustments thereto. The team will comprise representatives of the entities who serve as members of the Committee, and will be headed by representatives from the Israel Securities Authority and the Stock Exchange. The team will convene at least once every six months, and will report to the Head of the Israel Securities Authority.**