

Israel Securities Authority

Directive to Licenses Holder regarding Clarification of Customer's Needs and Instructions - Combined Version

(Time-Limited Directive)

Directive according to paragraph 28(b) of the Law for Regulation of Investment Advisors, Investment Marketers and Portfolio Managers, 5755 – 1995 (hereafter: the Law)

General

The world is currently experiencing an event with macroeconomic implications, against the background of the spread of the COVID-19 virus (the Corona virus) in many countries throughout the world. The State of Israel is taking major and unprecedented steps as a result of this event in an attempt to prevent the spread of the virus, as are many other countries.

In view of the aforementioned, and as a result of the directives of the Ministry of Health to reduce activity and movement in the public space in view of the spread of the Corona virus and in response to inquiries received from license holders, the Israel Securities Authority (ISA) has decided to amend the Directive to Licensed Professionals regarding Clarification of Customer Needs and Instructions (new version – 2014) (hereafter: the Directive), by means of a time-limited directive that will remain valid for three months.

Explanation

A license holder is required to adjust the investment advice, investment marketing and portfolio management services (hereafter: the Services) that he provides according to the needs and instructions of each customer after he has ascertained the customer's investment goals, his financial situation and the other relevant circumstances, as long as the customer agrees to provide this information (paragraph 12 of the Law). In addition, paragraph 13(d) of the Law specifies that the license holder must update himself with regard to the customer's needs in order to obtain an up-to-date picture of the customer and to give advice accordingly. The Law provides the ISA with the power to issue directives in these matters,¹ and based on that power the Directive is being issued.

The Directive applies to the clarification of needs and instructions of customers who are individuals and it establishes the details of the process for clarification of needs and their updating. This time-limited directive relates to two issues that are regulated by the Directive:

1. The process for remote initial clarification carried out with a new customer;
2. The requirement to update the customer's needs once annually and the method for carrying out that update.

Remote implementation of the initial clarification of needs

Paragraph 6 of the Directive describes the ways in which the initial clarification of customer needs is to be implemented during the initial meeting between the license holder and the customer

¹ This is according to paragraphs 3 1(d1) and paragraph 28(b) of the Law.

(hereafter: the Initial Process). The paragraph establishes that the Initial Process will involve a face-to-face meeting or a “recorded conversation” that includes a recorded telephone conversation, a recorded video conversation, correspondence or chat which is stored in a way that allows for retrieval. The Directive establishes that a telephone conversation is to be recorded and it establishes detailed conditions for the recorded conversation—whose goal is to reduce any possible gap in the implementation of the Initial Process, which is highly important for the provision of services, by means of a direct connection that is part of a face-to-face meeting—to be implemented by means of remote communication. One of the conditions established in the Directive² is that the recorded conversation be audited by a “conversation auditor” which is an officer in a licensed corporation who is responsible for the relevant area in the bank or a license holder who is at a higher level than that of the license holder who carried out the recorded conversation and has been appointed to deal with this matter. The conversation auditor must reconstruct the process as follows: listening to the telephone conversation, watching the video conversation or reading the correspondence during an Initial Process that is implemented by way of chat or email, according to the circumstances; to confirm that the Initial Process was implemented appropriately; and to confirm this in writing according to a standard text that will include a declaration that the Initial Process was implemented as required by the Law and the directives.

This time-limited directive permits the implementation of the Initial Process with a new customer by means of a telephone conversation, even one that is unrecorded, and on the condition that the conversation is documented immediately by the license holder, the documentation is sent to the customer and it is approved explicitly and with signature or any written declaration (email for example) that he has received it and agrees with its content. Additionally, the requirement in the Directive for auditing by a conversation auditor in the manner described above is cancelled and the discretion as to the way in which auditing is to be done will be that of the license holder and the banks and on the condition that the goal of the Initial Process is achieved as required by law.

The amendment is included within a series of amendments that it is the intention of the ISA staff to consider as part of a wider effort to amend the Directive. Numerous inquiries on these matters have been directed to the ISA staff, even before the Corona virus crisis, during the period since the Directive went into effect. During the current period, which is characterized by technological development and against the background of the general trend to encourage remote contact and the use of technological means and to make their use easier as long as the goal of the law is achieved, regardless of the crisis, it was decided to consider exemptions for remote contact. During the current crisis, there is an even greater and more urgent need for the amendment. On the one hand, the license holder is under extraordinary pressure due the need to answer numerous inquiries from customers who are under pressure in view of the situation in the markets (and it may be that some of the pressure is the result of the absence of some of the workers due to the Ministry of Health instructions); and on the other hand, due to the instructions of the Ministry of Health, face-to-face meetings need to be minimized as much as possible. The ISA staff has learned from the dialogue it is currently holding with the license holders that at the moment there is demand by a significant number of new customers for services. This is a

² Paragraph 6.2.5 of the Directive.

desirable phenomenon that the ISA is encouraging, but it is currently possible only remotely. The present amendment was prepared in order to enable and encourage the public to consume this service and to support the continued business activity of the license holders, while protecting the interests of the public and its health. As part of the amendment, the possibility of carrying out the Initial Process remotely is expanded and the responsibility for auditing it is now that of the license holder, who will carry this out in an efficient manner and in a way that it will be implementable also for them (and not just for the customers). These exemptions at this time will not prevent the ISA's supervision in view of the requirement to document the Initial Process in a manner that will be approved by the customer and in a way that will enable its retrieval and this documentation can also be used by the customer if necessary.

Updating of needs

Section 5 of the Directive regulates the process of updating the customer's profile and investment policy in the provision of services to customers who are individuals. According to paragraph 15 of the Directive, a license holder must update the details that were obtained during the Initial Process from a customer on an ongoing basis that is appropriate in his opinion to the character of the service and the connection with the customer. To the extent that these details are documented in an up-to-date manner and there is an up-to-date picture of the customer's situation, it is sufficient that the license holder ask the customer a general question as to whether there has been any change in these details in order for the license holder to fulfill his obligation to update the customer's details, whether this is done in a face-to-face meeting or a telephone conversation. To the extent that the details remain unchanged, the updating-of-needs process has been completed. If the license holder understands from the customer's response that there has been a change that requires an update, he must carry this out such that the details of the change relative to the present situation are clear. The license holder is to carry out the aforementioned update according to the Directive at least once during a period of 12 months and if he does not do so he has not fulfilled his obligation according to the Directive, and in addition the license holder is required to carry out a comprehensive update regarding the customer's needs and instructions according to the process specified in the Directive.

In view of the exceptional load on the license holder as mentioned above and the natural tendency to focus on providing service—which includes getting an update of customer needs—to customers that contact them, it is difficult and perhaps impossible for license holders to meet a requirement to initiate the updating of needs for customers that do not contact them and this involves numerous customers each day. Therefore, the Directive is being amended in a way that will permit the updating of needs once every 15 months, with discretion regarding the prioritization of initiated contact with customers during this period being given to the license holder according to the characteristics of the customer and the degree to which the license holder is familiar with and understand his needs and his preferences and on the condition that he fulfill the obligation placed on a license holder according to the Law to keep up to date with respect to the customer's needs and that he will in practice modify the services he provides to the customer, according to his needs and preferences.

Furthermore, the license holder has greater discretion with respect to the quality of the details that he must obtain in order to remain up to date and with respect to the manner in which the

conversation is carried out, which can—in addition to the possibility of a face-to-face meeting and a telephone conversation or by email—be carried out by chat and by means of an online internet system that has the possibility of retrieval.

Based on the extensive experience accumulated in the processes of supervision of license holders during the years since the Directive was published, the ISA staff believes that the obligation of updating at a uniform and absolute frequency should be reexamined and that it would be appropriate to provide broad discretion to license holders without compromising the goal of understanding the customer and his needs. As mentioned, a discussion of this matter will be held in the future and will be brought to the attention of the ISA plenum before a request for comments from the public is made as part of a general proposal for amending the Directive. In the meantime, and in order to provide an immediate remedy, it has been decided that during the current period and in view of the above stated a license holder will have a longer period in which to carry out an updating of needs, while having discretion to prioritize in initiating contact and in the manner that the updating conversation is carried out. Thus, for example, to the extent that a conversation was held between him and the customer against the background of the current crisis and that based on it the license holder is able to know whether there has been a change in the needs of the customer and in his preferences as updated according to law and the license holder has acted in compliance with what is required of him by law in the matter of modifying the service to the customer, then he will have no categorical obligation to initiate contact with the customer for a period of 15 months from the time of that conversation.