

September 23, 2019

A Call for the Public's Comments on Modifying the Rules of Corporate Governance for Companies with no Controlling Shareholder

The Ministry of Justice and the Israel Securities Authority have sent out a call to the public to receive comments on amendments to legislation in order to modify the rules of corporate governance in Israel for companies with no controlling shareholder.

Background

The Ministry of Justice, in collaboration with the Israel Securities Authority, is examining the need to amend legislation for corporate governance that applies to companies without a controlling shareholder in a changing reality.

In recent years, there have been a growing number of Israeli companies, which are traded in Israel and in other countries, that do not have a controlling shareholder. As of December 2018, companies without a controlling shareholder that are traded only in Israel constituted about 12 percent of the companies in the Israeli capital market and their aggregate market value accounted for 28 percent of the market's total value. Since the corporate governance legislation deals comprehensively with companies that do have a controlling shareholder, the question arises as to the need for modifications to the legislation for companies that do not have a controlling shareholder and primarily in view of the fact that the agency problems differ between the two. Thus, issues have recently arisen in the case of public companies without a controlling shareholder which indicate that the Companies Law may not provide a sufficiently unambiguous solution to some of the corporate governance issues that arise in these companies.

In companies with a controlling shareholder, the corporate governance mechanisms are oriented toward the agency problem that arises between the controlling shareholder and the minority shareholders (the horizontal agency problem). In general, the concern is that the controlling shareholder will exploit his dominant position in the company in a way that is optimal for him at the expense of the company or the minority shareholders.

Companies with a dispersed ownership structure generally encounter a different agency problem, known as the vertical agency problem, between the shareholding public and the company's managers. The shareholders own the company while the managers control its day-to-day management. The concern arising from this ownership structure is that the management will act to further its own personal benefit at the expense of the company and the shareholders. Since dispersed shareholders are characterized by information

asymmetry with respect to the managers as a result of their dispersion, the concern is that they will not have an incentive—and sometimes nor the ability—to effectively supervise the managers by means of the rights provided to them by the law.

The Ministry of Justice and the Israel Securities Authority are calling for the comments of the public with respect to a necessity of legislative amendments and modifications to the corporate governance rules that apply to companies without a controlling shareholder, which include the following points:

1. The quantitative threshold that defines “control”.
2. The composition of the Board of Directors and the question of whether a minimal proportion of independent directors should be stipulated for companies with no controlling shareholder.
3. The procedure for appointing and suggesting candidates to serve as directors (both dependent and independent) in companies without a controlling shareholder and including the authority to propose candidates for the Board of Directors, the ability of shareholders and position holders to participate in the selection of directors and the method for approval of an appointment, including the need to establish an appointments committee.
4. The required Board of Directors committees in companies without a controlling shareholder and their composition, including the conditions of eligibility for serving on them.
5. The term of directors (both dependent and independent) and the authority to remove them from their positions in companies without a controlling shareholder.
6. Division between the functions of Chairman of the Board and the CEO in companies without a controlling shareholder.
7. The method for approving the company’s dealings with dominant shareholders, including the definition of a shareholder with whom transactions require special approval in companies without a controlling shareholder.
8. The method of approval for transactions with directors and with other position holders and the method of approval for their terms of compensation in companies without a controlling shareholder.
9. The possibility of adopting anti-takeover mechanisms.

It should be clear that the aforementioned does not constitute an exhaustive list and that the public is invited to submit ideas and suggestions with regard to issues not listed above.

Proposals can be sent to NCScompanies@justice.gov.il until November 10, 2019.