April 8, 2019

Request for Public Comment on the 2.0 Portfolio Management Service Model

Background

We are witnessing a recent development in the world of investment portfolio management: Alongside traditional portfolio management services that generally target high-wealth individuals, digital management services allow a wide range of clients to avail themselves of portfolio management services that are based on technological means.[1] At the same time, we have also witnessed an accelerated increase in the diversity of available investment products in recent years, which are considered substitutes for portfolio management services and which target broad sections of the population. In view of the unique features of portfolio management services and the benefits they embody, both for clients and for the development of the capital market, from time to time the ISA studies additional alternatives that will expand the public's access to portfolio management services and increase their attractiveness.

Within its examination, the ISA developed a proposed model of portfolio management services, which is a **universally available digital service with no minimum capital requirement, in which clients' investment portfolios will be managed through a special purpose mutual fund to be known as Portfolio Management 2.0.**

The proposed model is designed to address the following needs and achieve the following goals:

- **Access to capital market investments through portfolio management services for groups that were previously unable to receive such services**
- **Personalized tax-incentive portfolio management services at a relatively low cost**
- **Increased competition in the investment** portfolio **management market**
- **Establishing an alternative means of distribution of mutual funds.**

[1] Such services are subject to the Directive to Licensed Professionals in Connection with Services that Entail Technological Means (link).

The proposed model – Portfolio Management 2.0

General

The Portfolio Management 2.0 service is designed to be an Internet-based,[2] user-friendly and simple-to-operate service that will allow all individuals to avail themselves of personal portfolio management services with no minimum capital requirement.

In the procedure for identifying a client's needs, clients will respond to a series of questions, and will be classified into one of the following four risk profiles based on their responses:

1 – Low risk: maximum exposure to shares – 10% excluding "exclamation point"[3]

2 – Moderate risk: maximum exposure to shares – 30% excluding "exclamation point"

3 – Moderate-high risk: maximum exposure to shares – 50% excluding "exclamation point"

4 – High risk: maximum exposure to shares – 120% excluding "exclamation point"

Based on the client's risk profile, the system will identify a single special-purpose mutual fund ("Special Purpose Mutual Fund") whose investment policy matches the client's risk profile. The portfolio manager will purchase units of the Special Purpose Mutual Fund for the client's managed account, in such number as the client's investment allows, and the client's managed portfolio will contain only these units. The Clients' portfolios will be managed by portfolio managers who function as the investment managers of the Special Purpose Mutual Funds (in a hosting model).

The Special Purpose Mutual Fund's sole purpose is to create a platform for the Portfolio Management 2.0 service and therefore will not be offered to the general public otherwise (and therefore <u>the fund managers are exempt of any distribution charge in respect of the fund</u>). To ensure this purpose, the terms of these funds in their prospectus will determine that a 10% addition fee will be added to the price of the funds' units, and the funds' prospectuses will define a

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[2] This means that all stages of service provision in which the client is involved (identification of needs, execution of a service agreement, determination of risk profile class, and determination of suitable mutual fund, and ongoing services) will be performed on digital platforms.

[3] The relevant rules of mutual funds will apply in the matter of exclamation points.

corresponding 10% discount to all clients of portfolio managers whose units in the funds are purchased through the Portfolio Management 2.0 system and to them alone.

Details of the proposed model

Enrollment

Online enrollment in the service only.

Representations to clients

Representations in the client's bank account will reflect the client's holding in fund units. Clients will receive details of the securities that are held in their portfolio, through the fund, their value and their weight in the portfolio's composition. Information will be available online.

Costs and fees

Costs include <u>only</u> a management fee to the fund manager and a fee to the fund trustee. The portfolio manager will not charge the client any management fees – Portfolio managers' remuneration will come from the fund manager. Clients will not be charged any buy or sell fees as these are payed by the fund manager.

Taxation

Tax liability is deferred to the date on which clients make a withdrawal of money from their portfolio. Changes in the composition of the client's portfolio are not taxable.

Marketing the service

The Portfolio Management 2.0 service will be marketed through distribution channels that are conventionally used in the portfolio management market. Alternative modes of distribution may develop as a result of the option of comparing returns in managed portfolios (see details below) and as a result of an online-only client needs identification procedure. Today, most mutual funds are marketed through banks, but the new model may promote the development of alternative modes of distribution such as the Internet, and specific websites that compare products and services; insurance agents; and other platforms that portfolio managers consider suitable for maintaining communications with end clients. Portfolio managers will remunerate such distribution channels according to the business model they deem fit to use.

Distribution of the service will include the following information: the costs involved, the benefits, and the fact that portfolio management is performed exclusively on a mutual fund platform.

Comparing returns

The Portfolio Management 2.0 service model applies uniform standards for classifying clients, and such standards are used to determine the specific fund that matches each client's risk profile and is used as a platform for the client's portfolio management. As a result, it will be possible to compare the returns of 2.0 portfolios managed by different portfolio managers for clients with the same risk profile. To enable such comparisons by the public, the ISA intends to exempt the portfolios that are managed under the model from existing restrictions on presentation and publication of managed fund returns.[4] Removal of these barriers will facilitate informed decision making by investors. The ISA further intends to encourage the emergence of online comparison platforms that will enhance the marketing process and increase the transparency of information on the performance of the various portfolios and their management fees. This information should help investors make informed decisions about their investment portfolios.

Reporting

Portfolio managers are subject to the reporting requirements defined in the Advice Law.[5]

Fund managers are subject to disclosure requirements defined in the Mutual Funds Law.[6]

Request for Comment

The ISA is seeking public comment from the general public, portfolio managers, fund managers, and other active participants in the capital market on any aspect of the proposed Portfolio Management 2.0 service model, including the model's features (described above) and the anticipated demand for such a service, taking into account the ISA's goals and considerations related to capital market development and protection of the investor public.

Please send comments by mail to Adyl@isa.gov.il no later than May 2, 2019.

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[4] Directive to licensed professional regarding presentation and publication of managed portfolio returns to parties that are not the owners of the managed portfolio (link).

[5] Regulation of Investment Advice, Investment Marketing and Investment Portfolio Management Law 5755-1995.

[6] Joint Investments in Trust Law 5754-1994