Israel Securities Authority

Legal Department

Staff Position Paper 199-8

The ISA Staff Position presented below is a professional position that reflects the Staff's decisions and positions on issues related to the application of securities laws. The published position papers guide the ISA and its Staff in exercising their authority, and the public may use and apply these positions in similar circumstances.

(This Position Paper includes revisions dated February 2021 marked in shaded text)

July 26, 2010

Legal Position No. 199-8: Safe Harbor Protection for a Securities Repurchase by a Corporation

Background

The ISA has recently received requests from various companies for the ISA's position on safe harbor protection against liability for violations of insider trading provisions during the execution of securities repurchase plans. In response to these requests, ISA Staff defined the features of corporate repurchase plans under which corporations will be protected from liability for insider trading violations.

The revised version dated February 2021 includes clarifications that were added in response to questions that emerged since the publication of the original Staff Position.

The Normative Framework

Chapter Eight "A" of the Securities Law 5728-1968 ("**the Securities Law**" or "**the Law**") determines the scope of and limits to the prohibition on the use of inside information. Section 52B(a) of the Law determines that the a transaction involving a company's securities is deemed use of inside information if the party that performs the transaction possesses inside information about the company. Sections 52C and 52D of the Law determine that the use of inside information by an "insider" or by any party who received such information from an "insider," respectively, constitutes a criminal offense.

According to the Maharshak ruling,[1] a conviction for an inside information violation does not require proof of a causal association between the inside information and the use thereof. It is sufficient to prove the three elements of the offense listed in Section 52C of the Law for the offense to be considered complete. However, to be acquitted, a defendant may prove one of the defenses listed in Section 52G of the Law.

[1] *Leave to Appeal - Criminal 8472/01 Maharshak and others v. State of Israel*.

Section 52G(b) of the Law defines the following defense, that applies to corporations that perform transactions involving its securities:

> ***A body corporate shall not bear criminal liability under this Chapter*** *and shall not be held liable under Section 52C(a), 52D or 52H,* ***even though a director or employee thereof has access to or is in possession of inside information about the body corporate,*** *the security of which or another security for which the company's security is an underlying asset is the subject of the transaction or of the opinion,* ***if it proves that the decision to enter into the transaction or to give the opinion was not made by the director or the employee who had the information and that there is a reasonable explanation for the transaction having been carried out*** *or the opinion having been given.*

It is ISA Staff's position that safe harbor protection is granted under the conditions specified in this Position Paper, which explicates the legal conditions of the defense stated in Section 52G(b), such that meeting these conditions:

(a) removes the obligation to prove that "the decision to enter into the transaction or to give the opinion was not made by the director or the employee who had the information" due to the combined mechanism of a decision issued in advance by the board of directors to execute a repurchase program, the plan's irrevocability, and the blackout period specified below.
(b) constitutes a "reasonable explanation for the transaction having been carried out."

It is stressed that **this Staff Opinion does not modify or detract from any judicial rulings in Israel on inside information violations**.

Discussion

As a rule, a corporation may purchase securities that it previously offered to the public. Furthermore, since the Companies Law 5759-1999 came into effect, a corporation may repurchase the securities that it issued without court approval (subject to the distribution rules), either by itself or by companies that it controls. The repurchase may be executed under a repurchase plan ("**Repurchase Plan**") that the corporation developed or following an ad-hoc resolution.

The repurchase of securities that, in itself, may be performed for legitimate economic considerations, may be suspected of constituting a violation of the provisions of the Securities Law related to securities fraud and the prohibition on the use of inside information.

ISA Staff has decided to adopt the conditions specified in this Position Paper in connection to the operations of corporations that wish to repurchase their securities. Satisfaction of the conditions of a safe harbor defense is subject to the discretion of the corporation. Satisfaction of these conditions constitutes a safe harbor defense exclusively for the use of inside information. That is to say, in the event of a repurchase where the company possesses inside information, the ISA will not take enforcement action against a company that proves that it executed "an auto-pilot" repurchase plan (i.e., the plan was defined in detail in advance of the repurchase transactions) that meets the conditions of this Staff Position.

The conditions of a safe harbor defense set forth in this Staff Position are based on US regulation of this issue (Rule 10b5-1), which was adapted to the conditions and nature of Israel's capital market. The general principles that form the basis of the US arrangement are, first and foremost, that the commitment to execute the transaction (either in an agreement, a directive, or a plan) preceded the date on which the information came into the possession of the party that used inside information. Second, the agreement, directive, or plan explicitly states the quantities, prices, and dates of the transactions or a formula for calculating them; and third, the provisions or plan are irrevocable.

According to the text of Section 52B(a) and the Maharshak ruling, in order to prove the elements of an inside information violation, there is no need to prove that the party that executed the transaction relied on the inside information; It is sufficient to prove that they possessed the inside information on the transaction date.

According to the conditions of this safe harbor defense, all inside information possessed by the corporation on the date the repurchase plan was adopted must be made public, and therefore this defense is indifferent to any new inside information that came into the corporation's possession after the date it adopted its repurchase plan.

We stress that satisfaction of the safe harbor conditions implies satisfaction of all the conditions cumulatively, during the entire period beginning from the date the plan was adopted to the conclusion of the plan's execution by the corporation. If the corporation fails to meet any of the safe harbor conditions, it will not be able to use the safe harbor defense described herein.

We further stress that satisfaction of the safe harbor conditions does not provide a defense against other violations.

The safe harbor defense applies to a corporation and its controlled companies that purchase the corporation's securities in a repurchase plan, and to any individual acting as the corporation's agent or under the corporation's direct or indirect orders to execute the plan.

Note that the safe harbor defense does not apply to securities purchases by individuals, including the corporation's interested parties and officers who purchase the corporation's securities on their own behalf. In the future, ISA Staff will consider publishing a Staff Position on a safe harbor defense in such cases.

To reduce concerns of inside information use during the adoption and execution of a repurchase plan, and to create legal certainty for actions performed under a safe harbor, the safe harbor defense is based on five principles:

1. **Detailed repurchase plan drafted in writing**: This condition is designed to firmly define the corporation's repurchase plan and limit the corporation's ability to affect the purchase process based on inside information that comes into its possession during the execution of the plan. Defining the specific features of the repurchase plan (e.g., specific dates of execution) obligates the corporation and the party that purchases the securities to closely comply with these provisions, and makes it possible to monitor the execution of the plan and assess its conformity to its pre-defined features.
2. **Irrevocability of the plan**: To prevent the corporation from modifying the provisions of the repurchase plan according to inside information that comes into its possession during the plan's execution (with the aim of increasing its profits or reducing the costs of its plan), the plan must be irrevocable, such that the corporation may not intervene in order to amend, suspend, or affect the execution of the plan after its adoption.
3. **Determining a commencement date for the repurchase plan**: The underlying assumption of this condition is that the publication of financial statements "erases" the inside information that the corporation possesses. According to this assumption, we determined that the plan cannot commence before the elapse of one trading day from the publication date of the first financial statements published after the plan's adoption, in order to allow public investors to study the information contained in the financial statements before execution of the plan commences.

Small companies, as this term is defined in Securities Regulations (Periodic and Immediate Reports) 5730-**1970 ("the Regulations**"), that adopted the relief defined in Regulation 5D(b)(5) of the Regulations concerning an exemption from the requirement to file a quarterly report and to file a semi-annual report instead, and **corporations subject to the**

provisions of Chapter E3 of the Law ("Dual-Listed Companies") will be considered compliant with the provisions of this paragraph and with respect to the requirement to publish their financial reports if they publish a pre-release of financial statements on those dates on which the corporation applied the relief and refrained from publishing a report. The format of a pre-release is described in Staff Legal Position 105-26: Pre-Release of Financial Statements.

Note that in the event that the corporation possesses, on the pre-release publication date, additional material information that was not disclosed in the pre-release publication, the corporation will not be considered eligible to use this safe harbor defense.

4. **Execution by an outside independent entity**: This condition is designed to create an additional "Chinese wall" between the information that the corporation routinely possesses during the execution of the plan, and the entity that effectively executes the plan.

5. **Maximum repurchase volume per trading day**: To prevent a situation in which the corporation adopts a repurchase plan that is completed within several days after the plan's commencement (which increases concerns that the corporation used inside information), this guidance limits the daily volume of transactions that may be executed under the repurchase plan.

Following is the ISA Staff's position on the safe harbor conditions for securities repurchases by a corporation:

Conditions of a Safe Harbor Defense

A corporation that performs a repurchase of its securities ("**the Corporation**") will be deemed protected under a safe harbor defense for an "auto-pilot" repurchase plan, if the Corporation meets the following conditions:

1) Adoption of a specific repurchase plan in writing

a) In a resolution of its board of directors, the Corporation adopted a written plan to repurchase its securities that:

i) Specifically states the quantity, price, and date of the securities to be repurchased;

- **"Quantity"** means the number of units of shares or other securities and the total repurchase cost of the securities in NIS (subject to the provision of paragraph 6C below);
- **"Price"** means a price pre-defined by a limit or a price defined in NIS;[2]
- **"Date"** means the specific dates scheduled for the repurchase.

Or -

ii) Includes a written formula, algorithm, or computer program to determine the quantities, prices, and dates, as defined in paragraph (i) above.

The elements set forth in this paragraph, hereinafter "the Plan."

b) **In this paragraph**:

"**the Corporation**" - including a subsidiary or company controlled by the Corporation that adopted the Plan according to the requirements of this safe harbor defense.

"**Securities**" - shares, warrants, bonds (and convertible bonds), and commercial paper issued by the Corporation.

[2] The price will be adjusted in the event of a dividend distribution, distribution of bonus shares, etc.

2) <u>Irrevocability of the Plan</u>

a) .

i) The Plan is irrevocable, such that the Corporation may not amend, suspend or affect the Plan after its adoption, with regard to the manner, timing, and execution of the purchases.

ii) Irrevocability is subject to the cogent restrictions defined by law or jurisdiction, in the event that a governmental or judicial authority orders the Corporation to desist from executing the Plan.

b) .

i) Transactions involving the Corporation's securities will be executed according to the provisions of the Plan.

ii) A purchase of the Corporation's securities is not deemed a transaction that conforms to the conditions of the Plan if the Corporation modifies any detail of the Plan (such as the quantity, price, or dates of the purchase), or if the Corporation fails to follow the provisions of the Plan, or executes transactions that were designed or whose consequences are discovered to have been designed to reduce the Corporation's exposure with regard to the Plan, provided that this provision does not prevent the Corporation from issuing or repurchasing its securities under the provisions of this guidance.

In this paragraph:

"**Transaction**" - as defined in Section 52A of the Securities Law 1968.

"**Corporation**" - including a corporation controlled by the Corporation.

3) <u>Plan Commencement Date</u>

The Corporation may adopt the Plan at any time, but the execution of the Plan will not commence before the elapse of one trading day from the publication of the first financial statements after the Plan Adoption Date.

Small corporations, as this term is defined in Securities Regulations (Periodic and Immediate Reports) 5730-1970 ("the Regulations"), that adopted the relief defined in Regulation 5D(b)(5) of the Regulations concerning an exemption from the requirement to file a quarterly report and to file a semi-annual report instead, and **corporations subject to the provisions of Chapter Five "C" of the Law ("Dual-Listed Companies")** will be considered compliant with the provisions of this paragraph and with respect to the requirement to publish their financial reports if they publish a report in the form of a pre-release of financial statements on those dates on which the corporation applied the relief and refrained from publishing financial statements. The format of a pre-release is described in Staff Legal Position 105-26: Pre-Release of Financial Statements.

Note that a Corporation that possesses any additional material information that was not disclosed in the pre-release will not be deemed eligible for this safe harbor defense.

4) <u>Number of Plans per Year</u>

A Corporation may adopt multiple concurrent securities repurchase plans, subject to the satisfaction of the conditions of this safe harbor defense.

5) <u>Execution of the Plan by an Independent Member of the Stock Exchange</u>

a) The Corporation will assign the execution of the Plan to a single stock exchange member who is an external party to the Corporation ("**the Stock Exchange Member**")

and who has no material business relationship with the Corporation (including ownership or control or ongoing business ties, excluding holdings in respect of which the Stock Exchange Member does not meet the definition of an "interested party" of the Corporation).

b) The Stock Exchange Member will act under an irrevocable power of attorney, after having read and confirm that they will do so pursuant to the provisions of the Plan and this guidance.

c) .

i) The Stock Exchange Member will report quarterly to the Corporation on their compliance with the conditions of the Plan.

Note that no report pursuant to this paragraph detracts from the Stock Exchange Member's statutory obligations to report to the Corporation.

ii) The Stock Exchange Member's report will be presented at the board of directors' meeting immediately following the date on which the report was received.

6) General Provisions

a) This guidance concerns only the case of a repurchase of securities by a corporation, and does not concern actions of individuals.

b) Late or missing report by the Corporation during the execution of the Plan - The Corporation will not be eligible for this safe harbor defense if it failed to report on such dates and conditions as required by law[3] and performed repurchases of securities under the Corporation's Plan during the period in which it failed to report and/or was late in reporting.

c) Maximum repurchase volume on any given trading day - Daily repurchases of the Corporation's securities may not exceed 5% of the total quantity of the Plan.

d) A corporation may execute its adopted Plan through transactions on the stock exchange or off-exchange transactions.

7) Reporting

The Corporation will report its securities repurchase plan and the repurchase of its securities under its plan pursuant to the ISA's guidance on "Disclosure of Repurchase Plan and of Repurchase Transactions" dated December 16, 2008.

3 Note that the presumption defined in this paragraph does not apply to the permitted delay in reporting pursuant to the law.