# Israel Securities Authority

## Legal Department

## Staff Position Paper

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 law. 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.

April 13, 2014

## FINAL VERSION AFTER PUBLIC COMMENTS[1]

### Legal Position No. 101-18: Safe Harbor Defense Regarding Use of Inside Information while Performing Securities Transactions by Senior Corporate Officers,[2] Employees, and Principal Shareholders[3]

### Background

The primary function of the financial market is to divert savings into productive investments by allocating savings to the most promising productive investments. This procedure is a condition for and a key to long-term economic growth. The fundamental condition that is required to encourage investors to invest their funds in the financial market is to maintain the investor public's confidence in the financial market's reliability and the integrity of its operations. The Securities Law 1968 ("the Securities Law") and its regulations were enacted toward this end, to ensure full transparency and full due disclosure of all the information that is or may be relevant to investors.

[1] Safe Harbor Draft, public comments, and responses are published on the ISA website at www.isa.gov.il.
[2] AS defined in the Securities Law 1968, Section 37(d).
[3] As defined in the Securities Law 1968.

With the inclusion of Chapter H-1 in the Securities Law in 1981, the Securities Law has prohibited insider trading, or the use of inside information. Underlying this prohibition is the principle of fairness and the desire to prevent parties with access to a company or its information from abusing their situation in order to gain benefits at the expense of the investor public that does not have such access to inside information. The aim of the prohibition against insider trading is to prevent an unfair advantage to "insiders" who possess information on the company through the capacity of their function or position in said company, over the remaining investors who are not privy to and are unable to obtain such information before it is made public.

In Leave for Criminal Appeal 5174/97 *Keren vs State of Israel*,[4] the Court decided that "the primary aim of the prohibition against insider trading in the Securities Law is to prevent exploitation of an unfair advantage in securities trading, where such unfair advantage stems from access to information concerning a company and such access is not available to the entire investor public. The prohibition against insider trading by an insider is not against the advantage provided by possession of the information, but against the unfair use of said advantage. This prohibition does not speak to inequality of information possessed by investors in the stock exchange but the manner in which such information differential is created. Permitting unfair exploitation of information would harm the investor public's expectations of 'fair rules of the game' in the stock market, undermine confidence in the financial market, and discourage investors from investing in it."

The foundations of the insider trading offense include a behavioral element and a circumstantial element. Until administrative enforcement was added to the Securities Law, the behavioral element was the use of information, while the circumstantial, factual element determined that the user must be an insider who possesses inside information. When the administrative enforcement component was added to the Securities Law, the circumstantial element was amended such that insider trading means the performance of a transaction by an insider while the insider or the company has inside information. This also implies that the transaction constitutes a violation even if just the company, and not the insider, possesses the information. From the perspective of *mens rea*, the negligence standard of responsibility applies, where an administrative violation occurs, even in situations in which the insider presumably knew that he or the company was in possession of the inside information. It should be emphasized that no causal relation between possession of the information and execution of the transaction is required, but these two elements must coincide.

In 2010, the ISA published a Staff Position Paper (Staff Position Paper 199-8) that defined a safe harbor for corporations that wish to adopt a securities buyback plan. This

[4] Rulings 52(2) 177.

safe harbor was designed to address concerns related to insider trading when a corporation executes a buy-back plan of its securities, even where such a plan is executed for legitimate economic cause. This Staff Position Paper and the relief program published by the ISA in 2012 state that the ISA intends to consider publication of a staff position paper on safe harbors for insider trading by corporate officers and employees as well.

Staff Position Paper 199-8 and this safe harbor defense (to employees, senior corporate officers, and principal shareholders of a corporation) are based on the corresponding regulation of this issue in the United States (within the guidelines of Rule 10b5-1),[5] and have been adjusted to the elements of the offense defined by Israeli law, and to the conditions and nature of the capital market in Israel. The general principles on which the US arrangement is based are, first, that the commitment to execute the transaction (in the form of a binding agreement, plan, or instruction) precedes the date on which the information came into the possession of the user of the inside information. Second, the commitment expressly specifies amounts, prices, and dates or provides a written formula for determining amounts, prices, and dates. Third, the commitment is irrevocable.

Within the conditions of this safe harbor, we also addressed the lessons learned from the practice in the United States under Rule 10b5-1, which have proved to be inadequate in preventing their abuse by insiders who wish to use the inside information in their possession to gain profit.[6] The provisions of this safe harbor provide instructions both with regard to a plan's irrevocability (i.e., securities transactions cannot be cancelled, amended, suspended, terminated, or affected after the adoption of a plan) and with regard to a blackout period between the plan adoption date and the commencement date of its execution.

## The Need

The need for this safe harbor increased after the administrative enforcement layer was added to the Securities Law, as described above. Administrative enforcement increased concerns of capital market participants regarding their liability for a violation of the insider trading prohibition, and the ISA even received specific comments and requests to define the safe harbor for insider trading for officers, employees, and principal shareholders of a corporation (each, hereinafter, "a Trader"). The need for such a safe harbor stems, among other things, from the letter of the law that defines the transaction date as the date the transaction is executed , rather than the date on which a order is issued; and this need also stems from the Rozov decision, in which the Honorable Justice

[5] Selective Disclosure and Insider Trading. SEC Release No. 33-7881: 17 CFR 240.10b5-1.

[6] For example, a 2006 study demonstrated that plans under Rule 10b5-1 generated significantly trading yields compared to the market, and that the premature termination of plans according to Rule 10b-1 were not executed randomly. Instead they actually tended to precede drops in share price. This issue re-emerged in the US financial press in late 2012.

Heshin determined that a transaction executed according to an order issued in advance, before the inside information was in the possession of the insider, should be deemed insider trading if the inside information came into the insider's possession during the transaction execution period, because the order should be deemed as a continuous order.

**The proposed solution**

The safe harbor protects senior corporate officers, employees, and principal shareholders of a corporation who wish to trade in the corporation's securities by reducing concerns of committing an insider trading offense.

To reduce the concerns of committing an insider trading offense, and to create legal certainty when actions are performed under the defense of this safe harbor, such protection is based on the following principles:

1. **Specifying a specific written plan for trading in securities (a "Plan")** – This condition is designed to limit securities trading by senior officers, employees, and principal shareholders of a company to the plan framework, and reduce their ability to affect the course of trading based on inside information that comes into their possession in the course of executing said plan. The obligation to state the specific details of the plan (such as dates for purchase, amounts, and price) applies to the Trader, and facilitates monitoring of the plan's execution and the conformity of its elements to its pre-defined features.
2. **Irrevocability** - The irrevocability clause was defined to prevent a Trader from modifying the orders of a plan (in order to increase his profit or reduce his costs in accordance with the features of the inside information that he obtains during the execution of the plan), and to prevent the Trader from intervening, cancelling, modifying, suspending, or affecting the trades after adoption of the plan. Such irrevocability will be ensured by the Trustee, to whom the order was issued, and by the Trader's explicit affirmation that the plan is being executed, in the interests of the corporation, among other reasons.
3. **Timing of plan adoption and commencement of execution** - The Trader must not have any inside information at the plan adoption date. Furthermore, a blackout period of three months was defined, between the plan adoption date and the plan execution commencement date, during which a quarterly or periodic report is published by the company. The blackout period was determined to reduce concerns that the plan is adopted on a date at which the Trader or the company possess inside information.

4. **Execution by a TASE member or independent investment portfolio manager[7] or a trust company whose parent or sister company is a stock exchange member or a bank** – This condition is designed to create an additional Chinese wall between the entity that is executing the plan in practice and any information that might be possessed by a corporation or Trader during the execution of the plan and to ensure that plan execution is independent of the Trader.

It should be emphasized that satisfaction of the safe harbor conditions implies satisfaction of all the conditions cumulatively during the entire period from the plan adoption date to the conclusion of plan execution. If the Trader fails to satisfy any safe harbor condition, the Trader may not seek the protection of the safe harbor presented herein.

Satisfaction of the safe harbor conditions provide Traders with a defense against commission of an offense under Section 52C or 52D of the Securities Law, and against violations of items (9) or (11) of Part C of the Seventh Addendum to the Securities Law, even when the corporation (but not the Trader) possessed inside information on the plan adoption date.

It should be clarified that transactions executed in the United States involving the securities of dual-listed companies are not subject to this safe harbor, but are instead subject to the rules that apply to them under US securities law.

This safe harbor plan does not provide a defense when the Trader possesses inside information on the plan adoption date. Neither does it provide protection against other offenses.

Below is the ISA Staff Position on the conditions of safe harbor defense against insider trading in a corporation's securities by senior corporate officers, employees, and principal shareholders of the corporation.

[7] As defined in Section 1 of the Regulation of Investment advice, Investment Marketing and Investment Portfolio Management Law 1995.

**Conditions of Safe Harbor Defense Against Insider Trading Offenses When Senior Corporate Officers, Employees, or Principal Shareholders Trade in the Corporation's Securities**

Any senior corporate officer, employee, or principal shareholder of a corporation (each, hereinafter, a "Trader") who executes, either directly or indirectly, transactions involving the corporation's securities, is deemed as being protected by a safe harbor if the Trader's actions conform to the following provisions:

**1. A specific plan is adopted in writing**

A**. The Trader adopted a written plan to execute transactions involving the corporation's securities that -**

(1) specifically states the amount, price, and date of the securities transaction, where

- **Amount** – means either a specified number of units of securities or the total value of the securities in NIS.
- **Price** – means a limit price defined in NIS (Limit order).[8]
- **Date** – means the day of the year, within a pre-defined period of time in which the Limit order remains in force;

Or -

(2) includes a written formula, algorithm or computer program to determine the amounts, prices, and dates as defined in (1) hereinabove.

The elements listed in this paragraph constitute a "Plan."

B**. In this paragraph –**

- **"Corporation" –** includes a subsidiary or company controlled by a corporation;
- **"Transaction" –** as defined in Section 52A of the Securities Law, 1968.

**2. Irrevocability of the Plan**

A.

1. The Plan is irrevocable in such a manner as not to allow the Trader to cancel, modify, suspend, or affect the Plan after its adoption, with regard to the manner, timing, and execution of the transactions.

2. Irrevocability is ensured by the Trustee (defined in paragraph 4 hereunder), who is responsible for executing the plan (for example, by depositing options

[8] The price may be adjusted in the event of a distribution of dividends, bonus shares, etc.

in respect of which the Plan includes an order to exercise, or by depositing funds, in the Trustee's account, which are required to execute the future purchases, together with an irrevocable instruction to the Trustee to execute the transactions), and by the Trader's express affirmation that the plan is being performed in the corporation's interests, among other things.

3. Irrevocability is subject to the cogent restrictions defined by law or jurisdiction or in the event that a governmental or judicial authority orders the Trader or the Trustee to desist from the executing the Plan.

B.

1. The securities transactions will be executed according to the provisions of the Plan.

2. A transaction in the corporation's securities is not deemed a transaction that conforms to the provisions of the Plan if the Trader modifies any detail of the Plan (such as the amount, price, or dates of the transaction), or if he fails to follow the provisions of the Plan, or executes transactions that were designed or whose consequences were designed to reduce the Trader's exposure with regard to the Plan.

   In this paragraph:

   "**Corporation**" and "**Transaction**" – as defined in paragraph 1.B. above.

**3. Adoption Date of the Plan by the Trader and Reporting its Adoption**

A. The Trader may adopt the Plan at any time, provided that the Trader has no inside information concerning the corporation on the adoption date.

B. The adoption date of the Plan is the date on which the Plan and the resources for its execution (securities or funds) are deposited with a Trustee (as defined in paragraph 4 hereunder).

C.

1. If the Plan is adopted by an entity (officer, interested party, etc.) in respect of which the corporation has a statutory reporting obligation, the following statutory obligations apply: The Trader is obligated to notify the corporation and the corporation is obligated to report the adoption of the Plan to the public.

2. Reporting on the plan adoption date pursuant to Regulation 33 of the Securities Law Regulations (Periodic and Immediate Reports) 1970 (hereunder, "Reporting Regulations") will include the following information:

   (a) The Trader's identifying details (name and ID number);

   (b) The name of the security;

   (c) The plan adoption date;

   (d) The type of transactions that will be executed according to the Plan (selling, buying, exercising options, etc.)

   (e) The identifying details of the Trustee with whom the Plan is deposited;

   (f) (i) The number of securities and their share of the total securities of their class; If the securities are shares – share of the share capital and the voting rights, ex-plan, fully diluted;

   or:

   (ii) The total proceeds;

   (g) Plan period – The dates of the first and final orders according to the plan;

   (h) Transaction prices – no disclosure is required;

   (i) A statement to the effect that the plan satisfies the safe harbor conditions, and specifically states that the plan is irrevocable.

3. It should be clarified that reporting exemptions apply solely to obligations to report on the plan adoption date. Transactions executed under the plan, including the transaction prices and the proceeds, should be reported according to Regulation 33 of the Reporting Regulations.

**4. Deposit of the Plan with and its execution by a Trustee**

A. The Trader will appoint an independent TASE member or independent investment portfolio manager or a trust company whose parent company or sister company is a bank or a TASE member (hereinabove and hereinafter, "the Trustee") to execute the Plan on his behalf. The Trustee will function as an entity that is external to the Trader, and will have no material business relationship (including ownership or control or ongoing business ties, excluding holdings that do not meet the definition of an "interested party" of the corporation) with the Trader or the

Corporation, or with any senior corporate officers of the Corporation or the Trader [if the Corporation is controlled by the Trader).

B. A corporation that wishes to establish a safe harbor plan for its employees, as defined in this document, may appoint a Trustee to execute plans on behalf of its employees, senior corporate officers, or principal shareholders of the Corporation. The provisions of paragraph 4A shall apply to the Trustee, *mutatis mutandis*; However, fees paid by the Corporation to the Trustee in respect of the plans on behalf of the above entities shall not be deemed a material business relationship.

C. 1. The Trader will sign an irrevocable power of attorney[9] and assign execution of the Plan to the Trustee. The Trustee will act according to the irrevocable power of attorney, after having read and affirmed in writing, in the Trader's presence, that she will act according to the provisions of the Plan and the provisions of this safe harbor plan. The date on which the Trustee makes said affirmation is deemed the Plan Deposit Date.

2. The Trustee will retain the Plan documents in a manner that prevents any modification to the documents from the moment they are deposited with the Trustee.

D. No reporting pursuant to these safe harbor provisions derogates from the Trustee's reporting obligations by law or agreement.

## 5. Plan Commencement Date

Plan execution will not commence before the elapse of no less than three months from the Plan Adoption Date, during which period the Corporation publishes an interim financial statement or periodic report.

## 6. General Provisions

A. Untimely or incomplete reporting by the Corporation During the Execution transactions Period by the Trader - If the Corporation fails to report according to the conditions and on the dates required by law[10] (hereinafter, "**Non-Reporting Period**") and a Trader executes a transaction during the Non-Reporting Period, the Trader is not protected by this safe harbor if he is deemed to have been involved in or related to said non-reporting or untimely reporting.

[9] The power of attorney should state that the plan is being executed in the corporation's interests, among other things.

[10] It should further be clarified that the provision in this paragraph does not apply to delays in reporting permitted by law.

B. Execution of transactions during trading on the stock exchange or off-exchange transactions - Transactions in the Corporation's securities under the Plan may be executed during trading on the stock exchange or as off-exchange transactions.

C. Number of safe harbor plans – A Trader may adopt more than one plan, subject to the Trader's compliance with the conditions of this safe harbor.

D. The safe harbor plan will not apply if it is abused with the intent to circumvent its provisions or any provisions of the law.

E. Nothing in the provisions of this safe harbor prevents use of a "Blind Trustee" mechanism, pursuant to Section 52G(a)(7) of the Securities Law.

F. Nothing in the provisions of this safe harbor derogates from the provisions of disclosure; specifically, under Regulation 33 of the Reporting Regulations, reporting is required regarding changes in holdings of interested parties and senior corporate officers, both on the date they adopt the Plan and on the date of its execution. Such reports may be made pursuant to the provisions of paragraph 3(c) hereinabove.