Investors' Guide

TRADING PLATFORMS

ISRAEL SECURITIES AUTHORITY

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- All terms in the masculine are to be considered to include the feminine and vice versa.

Introduction

In Israel, there are a number of licensed trading platforms that trade with customers in complex financial instruments, mainly on Internet-based trading systems. The public is cautioned to consider the numerous risks involved in trading on trading platforms. The aim of this booklet is to help the public understand the risks and how the Israel Securities Authority (“ISA”) regulates the operations of licensed trading platforms.

First we introduce general information on the operations of trading platforms, their licensing requirement, and relevant risks, what you should do if you have concerns about a specific trading platform, and finally, we explain how to file a complaint with the ISA and how the ISA handles these complaints.

What are trading platforms?

Trading platforms are computerized trading systems that allow investors to trade in a variety of financial instruments, typically foreign currency derivatives (forex), commodity derivatives, or stocks derivatives. Trading platforms continuously quote prices for the financial instruments they offer. Generally, trading takes place on the Internet. The legal definition of “trading platform” appears in the Securities Law 5728-1968 (“the Securities Law”).[1]

Licensing requirement

In August 2014, the Knesset Finance Committee approved the Securities Regulations (Trading Platform to its Own Account) 5775-2014 (“the Regulations”), which supplement Amendment 42 to the Securities Law.

Section 44M(a) of the Securities Law determines that no person shall manage a trading platform without a license issued by the ISA, and only in conformity with the terms of the license.

In September 2016, the ISA issued the first trading platform licenses, which contained the conditions for trading in various financial instruments on the trading platforms.

1. According to Section 44L of the Securities Law: Trading platformll [is] each of the following: (1) A computerized system through which a person buys financial instruments from his customers and for his personal account, or through which the person sells financial instruments from his personal account to his customers, in an organized, regular and methodical manner - excluding a system in which all the financial instruments that are bought or sold are financial instruments the terms of which are determined through direct negotiations between the parties to the transaction; (2) A computerized system that allows a customer the opportunity to trade through a system such as is described in paragraph (1).”

Any company that operates a trading platform in Israel[1] without a license is in violation of the law, and the public should consider the risks involved in investing with unlicensed companies.[2]

Note! A trading platform license issued by the ISA does not ensure that the relevant trading platform is a safe or recommended investment vehicle.

According to an ISA decision, trading platforms are not permitted to offer trading in binary options in Israel[3].

Investors are advised to verify that the trading platform they are considering is a licensed trading platform. For a list of the companies that were issued a trading platform license, CLICK HERE.

The financial instruments offered on trading platforms

The financial instruments that are traded on licensed trading platforms in Israel are *contracts for differences*. These instruments are also known as *rolling spot contracts*. In these typically leveraged financial instruments, the value of the contract is a function of the price of its underlying asset (even though the investor does not have acquire any interest in the underlying asset), and this price is determined by the trading platform itself. Depending on the direction of the transaction, whether the transaction is long or short, and the direction of the movement in the price of the underlying asset, the client gains or loses the difference between the contract price on the position closing date and the contract price on the opening date.

In addition to the gain or loss that is calculated according to the change in the price of the underlying asset — which is determined by the trading platform — the trading platform charges clients trading commissions and other fees including rollover rates (for overnight contract holding). These fees and charges appear in each platform's by-laws or articles of association. Trading platforms settle their accounts with their client only through cash settlements.

2. Where they are located in Israel and have Israeli clients or whether they are located outside Israel and provide services to Israeli clients.

3. The ISA staff refers investors to the ISA alert on unregulated investments

The trading platform is always the client's counterparty

When a customer trades on a trading platform, he is always trading against the platform. Therefore, when a customer loses on a trade, the trading platform gains the full amount of the customer's loss. When a customer profits on a trade, the customer's entire gain is charged to the platform.

It is consequently clear that trading on trading platforms involves an inherent conflict of interests between the customer and the trading platform. For this reason, the Regulations prohibit trading platforms, or their representatives, from offering customers investment consulting services, investment marketing services, and investment portfolio management services. Furthermore, trading platform by-laws include a detailed description of the means that platforms use to reduce this integral conflict of interest. For example, some trading platforms are fully or partially covered against the positions they opened for their clients.

Leverage

Leverage is one of the features of contracts for differences. Leverage allows a customer to trade without depositing the full nominal value of his trades (or his positions). According to the leverage offered by the trading platform, a customer only deposits a specific percentage of his investment as collateral.

When the price of the underlying asset fluctuates in the direction against the customer's position, the customer's position may be closed out and the customer will not be able to gain from any subsequent fluctuations, even if the price of the underlying asset moves in the direction of the client's position after the position is eliminated. If a customer is trading at a leverage of 50:1, a small 2% fluctuation against the customer's position can wipe out the customer's equity completely, and his position is closed.

Leverage involves a great risk because as leverage increases, smaller fluctuations in the price of the underlying asset that go against the customer's position cause the trading platform to close the client's trades ("forced closure"), which means that the customer loses his investment. The prices of the underlying assets typically fluctuate over the trading period.

A simple example of the effects of leverage:

A client opens a single position in the amount of 100,000 USD on a contract of differences of a pair of foreign currencies (US dollar and Israeli Shekel). The trading platform offers leverage of 100:1, which means that the minimum collateral that the client is required to deposit is 1% of the transaction (1,000 USD). If the exchange rate of the above pair of currencies (US Dollar-Israeli Shekel) is 4 Shekels to 1 Dollar, the client's trade in Shekels will be in the amount of 400,000 Shekels. He is required to deposit 4,000 Shekels as collateral.

According to trading platform by-laws, platform operators determine the amount of loss that creates a forced closure of a trade. In our example, a trade is automatically closed when the customer's loss is equal 50% of the amount of the collateral that was required to open the trade. In this case, a 0.5% change in the price of the underlying asset in the direction that is opposite to the direction of the client's trade will cause him to lose 2,000 NIS and his position will be eliminated. If the by-laws determine that a forced closure will occur when the client's cumulative losses in his account reach 100% of the amount of the collateral, then a mere 1% change in the price of the underlying asset in the undesired direction will cause a forced closure of the trade and a loss of 4,000 NIS – the entire amount of the collateral that the client deposited. If a client opens multiple positions, all the funds in his account, including his net profits from previous trades (after deducting losses and fees) serve as collateral.

The trading platform may close all of the customer's positions (including gain-making position) at the current market price when the customer's total margin level (for all her positions) drops below a certain margin level (according to the by law of the trading platform). In this case, a forced closure will eliminate all the customer's open positions, effectively wiping out all his gains from these trades. For example, if the customer has a gain of 50 NIS in one trade, and a loss of 100 NIS on another trade, his total loss is 50 NIS. If this loss is sufficient for the trading platform to close all the customer's positions, the customer will not receive the 50 NIS gain from the first trade.

Be Careful!

Every investment carries some risk of a financial loss, but there are several factors that make trading on trading platforms especially risky, such as high leverage, the fact that investors do not completely understand the risks involved in trading , and the inherent conflict of interests stemming from the fact that the platform is always the investor's counterparty. Therefore the ISA wishes to stress:

Trading on trading platforms is not for everyone. Trading on a trading platform requires skill, knowledge, and an awareness of the risks involved in this type of investment. Before you consider trading on a trading platform, please ask yourself:

- Do you have extensive experience in trading in complex financial instruments and volatile markets?
- Do you fully understand how the trading platform operates, including the costs and risks involved?
- Do you understand that leveraged trades carry a genuine risk of the loss of your entire investment in a very short time?
- Do you understand that trades on a trading platform are not executed on any stock exchange, and therefore they are subject to certain risks, such as the loss of your investment if the event that the platform becomes insolvent?
- Do you understand that the company operating the trading platform is the counterparty to your trades involving the financial instrument in each case?
- Do you understand that any position you may hold can be closed by the company, at its discretion?
- Do you understand that your money is held in a trust account, and the company is the trustee of that account?
- Can you devote the time required to manage your open positions on the platform?

The ISA's regulatory and enforcement functions

Under the Securities Law, the ISA regulates trading platforms. In its capacity as regulator, the ISA uses various means to verify that trading platform operators are in compliance with the requirements of the Law, such as reviews of periodic reports filed by platform operators, on-site inspections, and reviewing customer complaints. To perform such oversight, the ISA has the authority to demand information on trading platform operations from the trading platforms and from others. If the ISA suspects that a licensed operator has violated the law, the ISA is authorized to demand that the operator correct the flaws in its operations. The ISA is also authorized to impose monetary fines for specific violations of the law, and has investigative authority when the ISA suspects that an administrative or criminal offense has been committed.

If, after its investigation, the ISA concludes that a criminal offense was committed, the file is referred to the State Attorney, who decides whether to file criminal charges. If the investigation reveals that an administrative violation was committed, the ISA may initiate administrative proceedings, and a panel of the administrative enforcement committee is appointed, according to the Securities Law. The panel discusses administrative violations and has the authority to revoke or suspend the offender's license and impose other penalties (monetary fines, payment to injured parties, and suspended sentences).

The ISA may initiate criminal or administrative investigations against trading platforms that operate without a license, whether or not a specific complaint has been filed.

Do you have concerns about a specific trading platform?

As a customer, you may be dissatisfied with the service you receive from a trading platform. It is important to clarify that losses in themselves are not necessarily proof of poor performance or negligence on part of the licensed trading platform. If you belief that the trading platform's conduct was improper, first discuss your concerns with the trading platform's operator and try to resolve the issue directly. Contact the trading platform operator, clarify why you are dissatisfied or concerned, and ask for an explanation. Take notes of any oral conversation that you have with the operator, including the names of the people with whom you meet, and the content of each conversation. If your communications with the operator are in writing, retain copies of all the correspondence. If you meet with the trading platform operator in person, take notes of the meeting and send him a letter with the summary of your conversation, including the things that were promised to you or agreed upon in that meeting. Make sure your notes are as accurate as possible. The explanations you receive may allay your concerns. If the answers you are given are not satisfactory, demand that the answers be given to you in writing, and retain these documents.

In general, if a trading platform operator has breached his obligations to you, you may have sufficient cause to file a complaint with the ISA or a civil lawsuit against the operator.

It is important that you convey any complaint you have to the operator or to the ISA as soon as possible after having discovered the flaw or misconduct. Do not ignore misconduct when you are making profits, and do not wait until you start losing money to file your complaint.

Filing a complaint with the ISA

If a trading platform has not conducted itself with all due professionalism, the right thing to do is to file a complaint. Filing a complaint will contribute to fairer and more orderly services, in your interests and the interests of the entire public.

- File a Complaint by electronic form - CLICK HERE. This is the quickest way to file a complaint.
- Print and complete the form manually and send it to the ISA:

  by fax to +972-2-6513646 or +972-3-5601041.

  by regular mail to the following address:
  Israel Securities Authority 22 Kanfei Nesharim
  Jerusalem 9546434

The ISA cannot refund any money you lose or give you any financial compensation for any losses or damage caused by the improper operations or misconduct of a licensed trading platform. To obtain restitution you will have to file a lawsuit (and should consult with an attorney before doing so). Under the appropriate circumstances, the ISA may initiate proceedings against a licensed trading platform that has violated its legal obligations. The actions taken by the ISA may help your civil suit against the licensed trading platform, as, according to the Evidence Ordinance, any findings or final criminal convictions against the trading platform will be admissible as evidence in any civil suit that you may initiate.

It is important to note that the ISA carefully reviews every complaint that it receives, and its decisions are made on the basis of enforcement, budgetary, and public interest considerations. There are many cases that are not pursued due to one or more of the following reasons: lack of evidence, a long time has elapsed between the violation and the complaint, lack of public interest, or the complaint concerns a trivial issue.

Summary

This booklet contains general information on the various risks involved in trading on trading platforms. Prevention is better than cure. Responsible consumer foresight and action can save you time, money, and grief. We hope this booklet helps you protect your money and your investments.