

# New Israeli Lending Legislation

## Conditions for providing financial services including loans and currency exchange

New Israeli legislation regulating the non-institutional financial services sector in Israel (the Financial Services Supervision (Regulated Financial Services), 5776 – 2016 Law, the “**Law**”) was adopted by the Israeli legislature in July 2016. The law imposes a new licensing regime, by authorising the Ministry of Finance (principally through the Capital Market, Insurance, and Savings Commissioner) to issue licences to individuals or companies that wish to provide either (i) financial asset services (including currency exchange and certain virtual or pre-paid currencies commonly used in the Fin Tech sector) or (ii) provision of credit, defined in a broad manner, as “*providing credit by way of occupation*”. In this bulletin, we examine to whom the law applies and what types of lending it will affect.

### Who is exempt?

The Law includes a list of exempted entities, which are not required to obtain a licence in order to engage in the above services. This list includes mainly Israeli financial institutions and other entities that are already regulated within the scope of other legislation (e.g. Israeli banks, insurance companies and pension funds). The Law however does not exempt banks or institutional investors which are regulated outside of Israel. Other institutions may apply for specific exemption and we will be happy to provide further information in relation to this.

### What are the criteria for obtaining a licence?

In order to obtain a licence for the provision of credit, the applicant has to meet a set of criteria that includes, inter alia: (i) a minimum capital requirement that varies between NIS 0.5m – 4m, depending on the type of services and the scope of the licence; (ii) good standing; (iii) solvency; (iv) **being an Israeli citizen or an Israeli incorporated company, with at least one Israeli officer (citizen or resident)**; and (v) complying with certain corporate governance requirements.

### Regulations that apply to licencees

Once a licence is granted, the licencee has to comply with specific regulations, including corporate governance, limitation on disposition of equity and reporting obligations. These regulations include, for example, reporting any deviation from the information initially provided in the licence application, provision of sixty (60) days prior written notice with respect to the appointment of any officer (provided that the commissioner may contest such appointment), a prohibition on the assignment of any voting right, any right to appoint a board member, or any right to participate in any distribution of profits or assets unless the assignee has a licence or is otherwise exempted as well as various other filing requirements. A breach of some of the provisions of the Law would constitute a criminal offence, bearing a maximum penalty of eighteen (18) months of imprisonment or an up to NIS 452,000 fine, which fine cannot be insured or indemnified by third parties.

### Applicability to foreign entities

As the Law is of territorial nature, it is yet to be clarified whether it is applicable to any loan between a non-Israeli entity/person and an Israeli entity/person, or whether such loan can be excluded from the applicability of the Law (e.g. if such loan is governed by a foreign law or executed through a bank account outside Israel). Although it seems that the legislator was not aiming to prevent *bona fide* loans provided by international lenders to Israeli entities, the language of the Law is vague and very broad.

Should the Law apply to loans granted by non-Israeli lenders it would require non-Israeli entities wishing to grant loans in Israel to incorporate an Israeli company and become licensed.

## Convertible loans

The Law regulates “facilitating credit”, without specifically addressing convertible loans. A convertible loan structured to avoid this (i.e. that does not include essential “loan” characteristics such as repayment and interest) may be an advantage to the company receiving the funds (as it has to pay no interest, it is not subject to repayment, and does not have to deal with Israeli withholding tax) however such structure may result in adverse tax implications to the provider of the funds, *inter alia*, as the money provided may be deemed to be an investment rather than a loan.

As convertible loans are “market practice” in the Hi-Tech industry, we anticipate a significant pressure expressly to exclude convertible loans from the Law; however, at this stage there is no specific carve out in this respect.

## Online, Peer-to-peer Lending

At this stage, the Law specifically exempts individuals from the licensing requirements with respect to the provision of loans through P2P online platforms; however, the committee which proposed the Law also recommended the regulation of the operation of online platforms in the future, by separate legislation.

The Law will come into effect on 1 June 2017, however certain provisions (including with respect to the provision of financial assets services) will only come into effect on 1 June 2018.

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