

CUSTOMERS' INVESTMENTS IN FINANCIAL ASSETS
VIA PORTFOLIO MANAGERS

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CHAPTER 1: INTRODUCTION AND DEFINITIONS

Introduction

1. This directive determines the procedures which a banking corporation (including an auxiliary corporation) must follow regarding investment in financial assets on customers' behalf via portfolio managers (henceforth, investment via portfolio managers).

Definitions (6/98) (12/98)

2. **"Family Member"** - As defined in section 1 of the Securities Law, 5728–1968;
- "Counselling Law"** - The Regulation of Investment Counselling, Investment Marketing, and Portfolio Management Law, 5755–1995;
- "Qualified customer"** - As defined in section 1 of the Counseling Law;
- "Portfolio manager"** - Someone who engages for payment in the management of investment portfolios, and someone who manages investment portfolios for more than five people excluding his family members.
- "Management of investment portfolios"** - Conducting transactions in financial assets, on the basis of judgement, to other people's accounts, except for the management of investment portfolios as stated in Section 3, Paragraphs (6), (9), and (10) of the Counselling Law.
- "Financial asset"** - Securities and financial assets as defined in the Counselling Law, deposits for a fixed period, and foreign-currency deposits.

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CHAPTER 2: DETERMINING POLICY AND INTERNAL PROCEDURES FOR PORTFOLIO MANAGERS

General (6/98)

3. (a) The management of the banking corporation shall determine internal procedures for the branches and departments dealing with investment in financial assets via portfolio managers at least for all the subjects specified in this directive and in subjects covered by the Counselling Law.
- (b) The internal procedure shall also state whether office holders, and which ones, are permitted to refer the banking corporation's customers, and to whom. If a customer has been referred to a portfolio manager this shall be reported to the management of the banking corporation.
- (c) The aforesaid volume of internal procedures shall also include sample forms granting power of attorney, including samples of such in the English language.
- (d) The banking corporation shall not share in the portfolio managers' income from the management of its customers' investment portfolios.

The customer (6/98)

4. The internal procedures shall include guidelines on the following subjects:
 - (a) Recording the customer's identifying details in full;
 - (b) A list of the documents that the customer must sign in order to invest in various types of financial assets; and with regard to investments executed in foreign currency, a list of the documents and consent forms required;
 - (c) An affirmation regarding when and under what conditions, at the initiative of the banking corporation, the implementation of the customer's transactions is to be terminated, including the procedures for closure;
 - (d) A determination regarding the way the customer should inform the banking corporation of the termination of his consent that the portfolio manager acts on his behalf.

The portfolio manager (6/98)

5. The internal procedures shall include guidelines on the following subjects:
 - (a) Recording in full the identifying details of the portfolio manager and those of his employees who are permitted to instruct the banking corporation on behalf of their customers, with reference to instructions given over the telephone, computerized media, etc.
 - (b) Criteria for appointing portfolio managers who operate by means of the banking corporation.

Power of attorney and agreements

6. The activity of the banking corporations via portfolio managers shall be regulated by a power of attorney and agreements (henceforth, agreements), as specified in Chapters 3 and 4 below. The banking corporation shall not permit a portfolio manager to manage a customer's account until it has verified that all the relevant agreements have been duly signed.
If the customer is a corporation, the banking corporation shall request a copy of the minutes of the meeting of the corporation's board of directors/management, or a statement regarding the decision from a person authorized to do so, regarding its activity via a portfolio manager.

Special accounts (6/98) (12/98)

7. The banking corporation shall administer special accounts for the purpose of managing a portfolio on behalf of a customer, in which only the customer and the portfolio manager shall be authorized to act; these shall be of the following types:
 - (a) Special financial accounts: only the financial proceeds on transactions executed by the portfolio manager, the customer's deposits and withdrawals, the income derived from the investments executed by the portfolio manager, and the commissions and management fees on the special accounts, as well as the commissions and management fees charged on behalf of the portfolio managers, shall be recorded in these accounts.
Management fees charged by the bank on behalf of a portfolio manager shall be charged separately from the bank's other fees.

- (b) Special custody deposit accounts (including another account in which investment in a financial asset is recorded): the movements in the customer's financial assets shall be recorded in these accounts.

Transaction Account (6/98)

- 8. (a) If the portfolio manager seeks to execute transactions on behalf of his customers via a transaction account (or via one central instruction), the banking corporation shall establish procedures for the implementation of such transactions. The procedures shall specify *inter alia* that:
 - (1) The transfer of the financial assets between the transaction account and the customers' accounts, in the amounts according to which the actual transactions were executed, shall be done to the extent possible on the day the transaction was executed, but not later than the beginning of the next day of trading in that financial asset.
 - (2) The portfolio manager shall submit a declaration to the bank to the effect that permitted transactions under the Counselling Law in financial assets via a transaction account for himself or his first degree relatives, and if the portfolio manager is a company, the aforesaid transactions via a transaction account on behalf of the company, its employees, its owners and their first degree relatives, or for its affiliated companies, shall be executed only via a separate and special transaction account for the persons mentioned in this paragraph.
 - (3) Offsetting of one transaction account against another transaction account is not permitted.
- (b) Despite the aforesaid in this section, futures transactions, options, etc. may not be executed via a transaction account.

Credits and collateral (6/98)

- 9. (a) A banking corporation shall not permit a portfolio manager to take credit in a customer's account unless a signed agreement has been made between the banking corporation and the customer to extend credit for the purpose of transactions executed by the portfolio

manager. The agreement shall specify the credit frameworks and collateral for the various kinds of transactions, and the procedures for monitoring them.

- (b) If no such agreement has been signed, but incidentally the account is temporarily overdrawn, or if an agreement has been made but the overdraft exceeds the permitted amount, the banking corporation must do all it can as soon as possible, and in any event not later than within the next four trading days, in order to cover the overdraft created. The banking corporation shall act to guarantee incidental overdrafts created as aforesaid.
- (c) The banking corporation shall make a distinction between a person who authorizes credit to a customer and persons implementing investments in financial assets in accordance with the instructions of the portfolio managers.
- (d) The contents of this section do not contradict the prohibition in Section 4(d) of [Directive no. 322](#).

Definition of authority and responsibility

10. The banking corporation shall examine the conformity between the procedures concerning transactions in financial assets and the transactions executed by means of portfolio managers, and especially when these transactions are connected with several elements within the banking corporation, such as foreign-currency transactions, with reference to the following aspects:
- (a) Details of the work processes and task of each element within the banking corporation, as well as a definition of the authority and responsibility of each of them separately;
 - (b) Appointing someone within the banking corporation who is responsible for monitoring and internal reporting on the state of the banking corporation's credit or exposure vis-à-vis the customer as a result of the transactions executed by the portfolio managers, with regard to both customers and portfolio managers;
 - (c) Determining the right of the customer or the portfolio manager—if any—to directly approach the central implementation unit, e.g., the trading room of the banking corporation or of its overseas branch, or a broker abroad.

Reporting procedures

11. (a) The banking corporation shall notify the portfolio manager of every transaction executed for him at his instruction. A copy of the notice shall also be sent to the customer unless an arrangement of a blind trust exists.
- (b) The banking corporation shall send directly to a customer whose account is administered by means of a portfolio manager, a copy of the special financial account bank statements and details of the balances in the special custody deposit accounts, in accordance with the provisions of the Banking (Service to Customer)(Proper Disclosure and Submission of Documents) Regulations, 5752–1992, or as requested by the customer. A banking corporation that transfers to the portfolio manager a fee that it charges the customer, whether in full or in part, shall note it in the aforesaid bank statements or in the accompanying notice.
- (c) The banking corporation shall submit to the portfolio manager, at his request, the daily balance in the special financial accounts and the special custody deposit accounts that are administered by the portfolio manager.
- (d) Immediate reporting procedures to internal elements and to the customer shall be determined for the following instances:
- (1) When the extent of the customer's credit or exposure exceeds the pre-set framework;
 - (2) When there is an imbalance between the collateral received and the customer's credit or exposure.

CHAPTER 3: POWER OF ATTORNEY GRANTED BY THE CUSTOMER TO THE PORTFOLIO MANAGER

Content of power of attorney (6/98)

12. Without detracting from the requirements specified in Section 13 of the Counselling Law, the power of attorney given by a customer to a portfolio manager shall also include the following:
- (a) The customer's full name and address;
 - (b) The name of the banking corporation by means of which the customer's accounts are administered;

- (c) Details of the special accounts, including their numbers, in which the portfolio manager is authorized to act;
- (d) The customer's declaration that he grants the portfolio manager the power of attorney to execute transactions in securities or deposits with the banking corporation, specifying the types of transactions that the portfolio manager is authorized to execute; if the customer wishes to grant the portfolio manager the power of attorney to execute transactions in other financial instruments, the kinds of financial instruments shall be specified separately in the power of attorney;
- (e) The customer's declaration that he will not knowingly act contrary to the instructions given by the portfolio manager.

Subjects not to be included in power of attorney (6/98)

13. The power of attorney granted by the customer to the portfolio manager should not include the following:
- (a) Sections releasing the portfolio manager from responsibility for negligence in administering the customer's portfolio, or for a breach of confidentiality;
 - (b) Permission for the portfolio manager to pledge any financial asset from the special deposit account, or to pledge money from the special deposit accounts;
 - (c) Permission for the portfolio manager to take credit for the customer's account or to act in the customer's financial account in such a way as to create an overdraft, unless an agreement has been made between the banking corporation and the customer;
 - (d) Permission for the portfolio manager to transfer the customer's accounts to be managed by means of another banking corporation.

Guidelines regarding power of attorney

14. The banking corporation shall act with regard to a power of attorney in accordance with the following guidelines:
- (a) The power of attorney shall be signed before an authorized signatory, who shall by his signature attest that he has examined the particulars requiring verification in the power of attorney, and that he has given the customer all the explanations required by him with regard to the nature of the subjects to which it refers;

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- (b) When the power of attorney is signed in the presence of the authorized signatory, as stated above, the customer shall confirm in writing that he has received all the explanations as per the provisions of Subsection (a) above;
- (c) Notwithstanding the provisions of Subsections (a) and (b) above, the following customers may waive the receipt of explanations from an authorized signatory as noted in Subsection (a) above:
 - (1) A qualified customer, and provided he gave his written consent in advance
 - (2) A customer that is a corporation, and provided it signed a waiver as stated above in front of a lawyer of its choosing.
- (d) A power of attorney can also be given online, provided that in lieu of Sections (a) and (b) above, the following conditions apply:
 - (1) The banking corporation identified the customer and authenticated the customer's identity at the time the power of attorney was given by one of the ways listed in Section 19 of Proper Conduct of Banking Business Directive no. 367 on e-banking (hereinafter, "Directive 367") or via at least two authentication factors, in accordance with Section 42 of Directive 367.
 - (2) At the time of the granting of the power of attorney, the customer will confirm that he received from the banking corporation an explanation of the issues covered by the power of attorney. Prior to the customer's confirmation, the banking corporation shall give the customer an explanation of the issues covered by the power of attorney. The banking corporation shall enable the customer, pursuant to his request and during the banking corporation's working hours, to speak with an authorized signatory of the banking corporation, and to receive an answer to any question required by the customer.
 - (3) The banking corporation shall ensure via checking on the Israel Securities Authority website that the portfolio manager holds a valid "portfolio manager license" under the (4)
 - (4) The banking corporation shall clarify to the customer at the time the power of attorney is granted that it will not act in accordance with the power of attorney, should

CHAPTER 4: AGREEMENT BETWEEN THE BANKING CORPORATION

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AND THE PORTFOLIO MANAGER

Valid license (6/98)(12/98)

14a. A banking corporation may act on the subject of investments in financial assets on customers' behalf by means of a portfolio manager who must, under the Counselling Law, hold a license to engage in portfolio management, only if the said portfolio manager has a valid license as aforesaid. In this respect, the banking corporation shall be considered as meeting the requirements of this section if, prior to the start of the portfolio manager's activity, it verified by checking on the Israel Securities Authority website that the portfolio manager holds a valid "portfolio manager license" under the Counselling Law, and received a declaration from the portfolio manager that he will inform the banking corporation about any change in the validity of the license.

Portfolio manager's declaration

15. In his request to operate by means of the banking corporation, the portfolio manager shall state whether he has acted in the past by means of another banking corporation, and give his consent that the banking corporation by means of which he worked may disclose details regarding his reliability.

Content of agreement (6/98)

16. The agreement between the portfolio manager and the banking corporation shall also include the following:

- (a) Revoked.
- (b) The portfolio manager shall give his assurance that he and those of his employees who execute transactions in financial assets will give the banking corporation information and documents as to whether they meet any legal or authorities' requirements whenever they are required to do so by the banking corporation;
- (c) The portfolio manager shall give his assurance that the investment instructions that shall be given by him on behalf of a customer shall not exceed the framework of the amount deposited in that customer's financial account, unless an agreement has been signed

regarding the extension of credit between the banking corporation and the customer, except for exceptional cases in which an account is incidentally, temporarily overdrawn. The portfolio manager shall give his assurance that in such cases everything that is required shall be done as soon as possible, and in any event not later than within the next two trading days, to cover the overdraft created;

- (d) The portfolio manager shall undertake to act on behalf of his customers in accordance with the power of attorney whose format shall be attached to the agreement between him and the banking corporation, and that is the format which is signed by his customers;
- (e) An action of the portfolio manager not in accordance with the power of attorney shall be a reason to cancel the agreement between him and the banking corporation;
- (f) The portfolio manager shall undertake to act for his customers only, and not for other portfolio managers;
- (g) The portfolio manager shall undertake not to transfer financial assets from the account of one customer to that of another, except for off-the-floor transactions in securities registered on the Tel Aviv Stock Exchange (TASE) which are executed in accordance with the regulations of the TASE;
- (h) The portfolio manager shall undertake to indemnify the banking corporation in cases where it is obliged to compensate a customer on account of transactions executed by the portfolio manager;
- (i) The banking corporation shall undertake to report to the customer and the portfolio manager as specified in Section 11 above.

Stipulations in the agreement

17. A banking corporation shall be entitled to stipulate in an agreement with a portfolio manager and a customer to the effect that the receipt of instructions to execute certain financial transactions from the portfolio manager shall require prior authorization from the customer.

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Revisions

Circular 06 number	Version	Details	Date
1224		Original circular	November 19, 1985
---	1	Incorporation into Proper Conduct of Banking Business Directives	August 1991
1674	2	Update	October 17, 1993
1717	3		July 5, 1994
---	4	New version of Proper Conduct of Banking Business Directives file	December 1995
1859	5	Update—Page 462-4	March 12, 1997
1932	5	Update	June 28, 1998
1961	6	Update	December 31, 1998
2309	7	Update	September 20, 2011
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