

The main topics addressed by the Committee's recommendations (Appendix A to the publication)

4. Definition of custody services and custody service providers: The Committee's recommendation focuses on regulating the core services of custody. The Committee's recommendations apply, mutatis mutandis, to a direct service provider (custodian, including third-party custodian and sub-custodian) and an indirect service provider (intermediary). The recommendations clarify that when the custodian or intermediary are the counterparty to a transaction, this does not constitute custody services to which the recommendations apply.
5. Basic obligations of a custody service provider: The obligations include the ensuring of the reservation of ownership rights over the customer's assets and cash and the reservation of the rights accompanying ownership of assets, including the ability to realize them.
6. Basic principles that must be upheld by the custody service provider: The basic principles are intended to ensure the ability of the custody service provider to fulfill the basic obligations. The principles include, among other things: the existence of organizational and computerized support systems; anchoring the custody services in an agreement with the customer; asset separation, record keeping and management and reconciliation; the existence of internal procedures; not creating rights in relation to the customer's assets to benefit himself or a third party; not using the customer's assets in transactions without the advance written consent of the customer; reporting to the customer.
7. Handling customer's cash: The Committee recommends principles for handling customer's cash that is by product of custodial actions, the purpose of which is to ensure the propriety of the custody over the cash. The principles for handling cash shall not apply when the custodian or the intermediary is a banking corporation, as defined in the Banking (Licensing) Law, 5741-1981, which deposits the customer's cash in an account in the customer's name being managed at the banking corporation.

8. The appointment of a third-party custodian and on-going supervision of him: The Committee recommends a series of requirements that obligate an intermediary who contract another entity to provide custodial services to the customer (hereinafter – third-party custodian), in order to ensure the rights of the customer. The requirements apply both in relation to the stage of selecting a third-party custodian and in relation to the on-going work process with him. Among other things, the Committee recommends that an intermediary shall set out rules for the assessment and selection of a third-party custodian. The intermediary shall be obligated to relate in these rules to the third-party custodian’s ability to provide a suitable level of service, including his ability as assessed by a custody service provider rating (should any exist), to the arrangement of legal responsibility that shall apply between the intermediary and the third-party custodian, to the rules of selection and on-going supervision of the third-party custodian in relation to the sub-custodians with whom he is associated (should the custody services not be provided directly), and to its financial strength. Furthermore, the Committee defines basic principles that the intermediary must uphold as part of the work with the third-party custodian, and which are intended to ensure that the intermediary is able to fulfill the requirements pursuant to the Committee’s recommendations, and ultimately to ensure the suitable custody of the customer’s assets. The principles include, among other things, the arrangement of the legal relationship with the third-party custodian through an agreement, conducting regular periodic examinations to assess how the third-party custodian is upholding the rules set forth by the intermediary and the obligations toward him, including taking reasonable measures to ascertain that the obligations are being fulfilled, and taking measures in case the third-party custodian is not fulfilling the obligations toward the intermediary. The intermediary is required to document the examinations conducted during the selection of, and association with, the third-party custodian and as part of the on-going work with him. The Committee also imposes disclosure to the customer requirements in case of an association with a third-party custodian.

9. External audit by an accountant: The Committee recommends that an external accountant conduct an audit of the custodian or intermediary at least once a year. As part of the audit, he will assess how the requirements concerning asset separation, record keeping and reconciliations, and those regarding the handling of cash are being fulfilled, and will assess the array of internal procedures and controls intended to ensure the implementation of the recommendations.
10. Regulation, supervision and enforcement: The Committee recommends that each regulator shall ascertain the regulation, supervision and enforcement of the rules detailed in these recommendations in relation to a custodian or intermediary under his supervision.

Implementation of the recommendations by the banking corporations

11. Banking corporations that provide custody services to their customers, whether directly (custodian) or indirectly (intermediary) shall act according to the Committee's recommendations.
12. The Banking Supervision Department intends to integrate the Committee's recommendations into a Proper Conduct of Banking Business directive in the future. Until then, we will publish clarifications on how to implement the Committee's recommendations as necessary by way of "questions and answers". The first file on this matter is attached.

Implementation Date

13. The banking corporations are required to implement the Committee's recommendations as of October 1, 2013, other than the requirements detailed in Sections 14 and 15 below. Early implementation is recommended.
14. The following requirements shall apply from July 1, 2014:
 - 14.1. Providing custody services directly (custodian);
 - 14.1.1. The requirement in Section 3 of the Committee's recommendations concerning the existence of a written contract or agreement in relation to existing customers of the banking corporation at the time stated in Section

13, meaning customers to whom the banking corporation has started providing custody services prior to October 1, 2013.

14.1.2. The requirements in Sections 14 and 15 of the Committee's recommendations concerning reports to customers.

14.2. All of the requirements concerning the provision of custody services as an intermediary, including Sections 16–27 and 31–34 concerning intermediary activity.

15. An external audit by an accountant, as required pursuant to Section 35, shall be first conducted in respect of the year 2014.

16. A banking corporation that is finding it difficult to implement the above by the required date shall apply to the Banking Supervision Department to obtain specific instructions.

Sincerely,

(Signature)

David Zaken

Supervisor of Banks