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Israel: Feeling the heat of technology

Israeli lawyers are operating in a vibrant economy but innovation is so rapid, regulators are finding it hard to keep up

In which areas of the legal market do you expect to see most growth and activity over the next year or two, and why?

Alan Sacks, head of the international practice, Herzog Fox & Neeman:

For many years now, the main driver of the Israeli economy has been technology. There is no sign that the level of activity in the tech sector will slow down. Recent transactions such as PepsiCo's acquisition of SodaStream for \$3bn (£2.3bn), Nvidia's acquisition of Mellanox (near \$7bn), and the more modest, yet significant, acquisition of Dynamic Yield by McDonald's (\$350m, McDonald's first corporate acquisition for a decade) show that the opposite is true.



There are numerous sectors where Israel is a world-leader – self-driving vehicles, fintech, cybersecurity, biotechnology, for example – and we expect to see much activity in these areas in the coming years.

The real challenge to the financial establishment, and the real driver of competition in the financial sector, is technological innovation. Alternative payment methods, peer-to-peer lending, cryptocurrencies and other 'disruptors' will generate significant activity in the legal market, not only on regulatory issues, but also in the M&A space.

Simon Jaffa, founding partner, Barnea Jaffa Lande & Co: Israel has become a shop window for tech and innovation. As a consequence, M&A remains strong, as do both private equity and venture capital investments. More and more leading companies have identified acquiring Israeli technology as a key component in their strategy to remain innovative in their respective businesses.

In addition, the state of Israel is making huge efforts to develop modern infrastructure. There are numerous transportation and energy projects in the pipeline that will attract companies from across the globe. Added to this, you have offshore gas, which also attracts new players to the Israeli landscape.

Adrian Daniels, partner, Yigal Arnon & Co: Our increasingly digital world will have an exponentially increasing effect on our lives and consequently on the laws that govern our lives. Consequently, the parts of the legal market that overlap with these areas are the leading candidates for growth in future.



Over the next year or two specifically, I believe that we will see particularly significant growth in practice areas related to privacy and money laundering. We are already seeing the results of Europe's GDPR across the globe. In the field of hi-tech in particular, where data rules, most companies are having to assess their levels of compliance, register databases where required and institute procedures which ensure compliance.

As the laws are tested and case law develops over the near future, and with the US soon to follow suit with its privacy regulations, we are going to see additional elements which will need to be incorporated into the DNA of our clients.

With the rise of internet money transfers, and cryptocurrencies, has come the rise of anti-money laundering legislation at local and international levels. In Israel, we have seen the Supervision of Financial Services (Regulated

Financial Services) Law 2016, which created the office of the financial regulator, and in October we had the portion of the law relating to those non-institutional players involved in the custody, conversion, transmission and management of financial assets – including virtual currencies – requiring them to take various steps in ascertaining the provenance of funds being handled by them.

There has been a notable increase in new regulations in several areas in recent years, such as the Insolvency and Rehabilitation Law 2018 and in financial services more generally. What impact is this having on the legal market and how is your firm responding?

Daniels: Most large firms in Israel have already significantly grown their departments which deal with financial services in general and cryptocurrencies in particular, and whether by accident or design have seen their data protection groups expand to deal with the increase in volume of work from clients looking to be compliant.

In the realm of cryptocurrencies and blockchain, lawyers who previously may have specialised in financial service regulations relating to fintech have had to up their game to include some understanding of securities laws, elements of the workings of capital markets and a deep knowledge of the current trends in the world of cryptocurrency offerings, to compete in the expanded world of fintech.

To some degree, the growth of this new sector has allowed a number of much smaller firms to compete in an area which has always been dominated by the larger players.

Jaffa: The Insolvency and Rehabilitation Law 2018, which comes into force in September 2019, includes a number of provisions with the potential to affect the rights of creditors in cases of insolvency. The law provides codification of the various insolvency proceedings scattered around a number of legislative acts. It further offers a unified approach to individual bankruptcy and corporate insolvency.



When dealing with corporate insolvency, there are two notable goals the law aims to achieve. The first is to leave more to inferior and unsecured creditors and the second is to give preference to rehabilitation over liquidation.

While many of the apparent changes in the law will become relevant for companies and creditors only in the wake of insolvency, certain changes must be taken into account by creditors now in the structuring of securities. The main change relates to those creditors holding floating charges. In accordance with the new law, creditors' ability to recover from the proceeds of the assets caught by the floating charge will be limited to 75 per cent of the value recovered. In addition, the floating charge will be limited to assets existing at the time of initiation of the insolvency proceeding and will not extend to future assets.

Therefore, when considering the security package, creditors must reconsider the balance between the fixed pledges, the floating charges, and other securities.

Another point to consider is the interim provisions of the law. Generally, the charges made and duly perfected prior to entry of the new law into force will not be affected by the new provisions in case of insolvency of the debtor. However, if certain amendments to the terms were made after the law's entry into force, the enforcement of the charge in case of insolvency will be subject to the new law.

The law also introduces new provisions related to international insolvency, allowing for global cooperation in insolvency proceedings. This is a material addition as the Israeli market becomes more and more global. In this respect, it should also be noted that, pursuant to the law, insolvency in Israel can be initiated against non-Israeli companies with economic activities in Israel (subject to general claims of forum non conveniens). This codifies recent case law decisions.

As Israeli courts begin to implement the Insolvency and Rehabilitation Law, more developments are expected in this field.

Sacks: Since the Insolvency and Rehabilitation Law was published last year, the legal profession and the financial sector have been in learning mode. Our firm recruited Seffy (Yosef) Zinger from Israel's Ministry of Justice. Zinger not only wrote the law, he also negotiated its terms with the bankers'

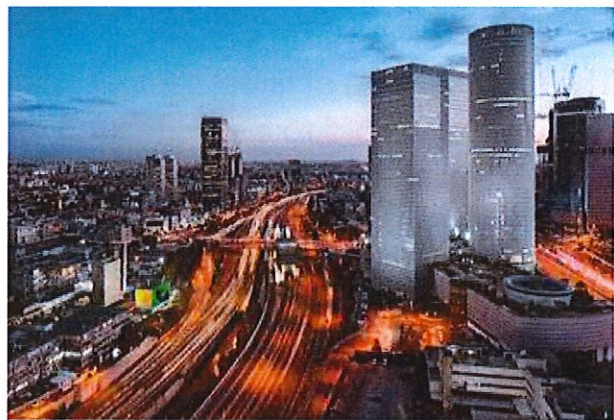
association and Knesset committees, and steered the law through to its final enactment.

The immediate consequence of the law is a thorough review of all standard bank documentation (an exercise that we are carrying out on behalf of a number of Israeli banks). The law is not yet in force so the full effects are yet to be seen in practice.

Nevertheless, we do note a tendency on the part of Israeli judges to anticipate some of the changes that will come into effect, for example with regard to cross-border insolvency issues.

Q Which other areas of regulatory change do you anticipate having an impact on the market during 2019 and beyond?

Sacks: Without doubt, it will be in the financial sector where we will see the highest level of regulatory activity. As already mentioned, efforts have been made in recent years to increase competition in this sector.



These efforts have resulted most recently in Israel's two major banks selling off the controlling interest in their credit card operations. In response, the banks have developed their own payment apps which will compete with the credit card companies that they have spun off. Laws and regulations have been introduced, or are in the process of legislation, governing payment platforms (P2P lending) and exchange and remittance services.

The new Fair Credit Law, dealing with arrangements between credit providers and consumers, will come into effect in 2019. The Bank of Israel is also introducing a credit rating system which will allow customers to move between banks and other credit providers more smoothly, so increasing competition in the marketplace. A law which will, in effect, introduce the PSD2 Directive into Israel will come into effect in 2020.

The Bank of Israel is trying, with some difficulty, to introduce EMS technology into Israel.

In March, Israel's Securities Authority published a report including recommendations regarding cryptocurrencies. The report proposes cryptocurrencies which confer rights similar to traditional securities such as shares, bonds and participation units should be deemed 'securities'.

Nevertheless, Israeli mutual funds are not allowed to invest directly in cryptographic assets, and Israeli-licensed portfolio managers may not purchase cryptocurrencies into portfolios managed by them.

The drive towards competition is not limited to the banking sector. In the insurance sector, two new digital insurance companies have been established (the first new insurance companies in Israel for many years).

The fact that one of Israel's major insurance companies (Phoenix) has recently been sold to a private equity firm and another (Clal) is held by a trustee at the direction of the head of the Capital Markets Authority indicates that there will be changes in the insurance sector in the coming years too.

Daniels: We're going to see many more changes in the world of financial regulation as the regulators chase to keep up with the technology, but I think that there will be areas outside of the digital world, which will also have a greater impact on the day-to-day operations of companies. I think that environmental regulations will have an increasing relevance to companies that until now have not fallen within the scope of such regulations, by requiring compliance with such things as energy usage and the recycling of materials.

Israel is well known for hi-tech but this is an area where the law often lags behind technological developments. How are local firms dealing with this issue?

Daniels: We can only really deal with what the law is. Where the laws are not clearly relevant, for example, with respect to the phenomenon of initial coin offerings, we rely on the application of existing laws where possible, and any new guidance published by the relevant authorities – for example, the discussion papers published by the Israel Securities Authority.

Additionally, we will often see that while the law relating to a technology is unclear, smaller companies will take greater risks in respect of non-

compliance, with the intention of cleaning matters up when they have the financial resources to examine the matters more deeply.

Jaffa: Tech lawyers are well aware of the fact that the law does not manage to follow suit with technological advancements. A law enacted in the 1970s did not envisage the effects of the internet, connectivity and globalisation.

The high road to handle any exposures is to obtain clearance from the relevant regulator, which is also minded of the dissonance between tech and law. Often the regulator is willing to 'clear' in advance any uncertainties and potential conflicts between the technology and the legal limitations.

An example of such clearance is the clarifications that the Israeli Securities Authority gave equity funding start-ups for making offerings.

However, part of being a start-up is taking calculated risks. The difference between a good law firm, and a great one, is the ability to provide risk analysis and workarounds which are tailored for the specific start-up. If Uber or Airbnb had taken only a lawyer's 'don't do' advice, they would never even have started.

The important job of the tech lawyers is not only to tell the start-up 'this you cannot do', but to understand the risk, evaluate the potential exposure and help management make a decision that is right for the firm.

Sacks: Israeli hi-tech companies usually target global markets and not simply the Israeli market. Hi-tech companies therefore look for law firms that are able to provide value added on a global scale, and not just locally focused legal input.

These companies need advisers who can assist them in understanding regulatory considerations and trends around the world, and how to apply these considerations to the specific technology of the client. Advising on these issues requires a deep understanding of both technological and regulatory trends in many areas.



Firms need practices that are focused on, and experienced in, the interplay of technology and regulation on a multi-jurisdictional basis.

By **Matt Byrne** 30 May 2019 09:00

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