Lending and taking security in Israel: overview

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OVERVIEW OF THE LENDING MARKET

1. What have been the main trends and important developments in the lending market in your jurisdiction in the last 12 months?

The main trends and important developments in the lending market over the last 12 months are as follows:

- There has been an increase in the scope of participation by Israeli institutional investors in credit transactions as well as diversification of deals in which these investors participate. The main reason behind this seems to be the lack of investment alternatives yielding high rates of return.
- More transactions have been carried out by large-scale international lending syndicates, particularly in the offshore natural gas projects. These types of transactions are typically governed by foreign law.
- Israeli companies were successful in raising funds through 144A bond offerings, thereby being able to circumvent the need to undergo a public offering in Israel.
- As in other parts of the world, crowd-funding lending initiatives are gaining popularity in Israel, for both businesses and consumers.

FORMS OF SECURITY OVER ASSETS

Real estate

2. What is considered real estate in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected (that is, made valid and enforceable)?

Real estate

In Israel, real estate is considered immovable property, such as land and anything that is built, planted or permanently fixed to the land, except for objects which can be dismantled. Under the Lands Law 1969 (Land Law), ownership rights in land include ownership of:

- Surface-level land.
- Subsurface land.
- Aerial space which extends above the land.

It should be noted that 93% of the land in Israel is property that is owned either by the State or related entities, and is managed by the Israel Land Administration. Accordingly, "ownership" with regard to such land means leasing rights from the Israel Land Administration for 49 or 98 years, and a "mortgage" over such land implies a security interest created over such leasing rights.

Common forms of security

The most common form of security interest granted over real estate is a mortgage (*mashkanta*). A mortgage can be granted over real estate property that is registered with the Israeli Land Registry. If the real estate property is not yet registered, a security interest can be granted over it by way of a pledge. A mortgage and a pledge are similar in most of their legal characteristics, while the main difference between them relates to their registration procedures (*see Question 3*).

Under the Land Law, the registration of a mortgage with the Land Registry has strong binding power and is very difficult to challenge. Therefore, a registered mortgage is considered a valuable and trustworthy security. However, under the Enforcement Law 1967, enforcement of a mortgage registered on a residence in which the pledgor resides, requires evidencing that the pledgor and his family have an alternative reasonable residence or that they have sufficient means to finance such an alternative reasonable residence.

This requirement can complicate the realisation process of a mortgage registered on a residence (*see Question 8*).

Companies can also create a floating charge on all or part of their assets (*see Question 3*). If a floating charge also includes real estate property owned by the company, then registering the floating charge only with the Companies Registrar is sufficient and there is no need to also register the floating charge with the Land Registry.

Formalities

A charge is created by an agreement between the debtor and the creditor. If the asset is immovable property, the agreement must be in writing. A charge over an asset of a company must also be evidenced in writing. This also applies to a floating charge.

Perfection of a security interest refers to making the security interest effective against third parties. A security interest that is not duly perfected is not effective against other creditors of the pledgor, unless the creditor knew or should have known about the creation of the security interest. In particular, a security interest which was not duly perfected is ineffective and will be deemed invalid by a liquidator or insolvency administrator of the pledgor.

The primary perfection method requires registering the security interest with the relevant registrar, in accordance with the following regulations:

- Security interests over the assets of companies must be registered with the Registrar of Companies under the Companies Ordinance [New Version] 1983 (Companies Ordinance). The documents governing the security interest must be filed with the Registrar of Companies within 21 days of execution of the charge agreement. If filed within this period, the security interest is retrospectively valid against third parties from the date it is created. This also applies to floating charges. In addition, perfection of security interests over certain types of assets owned by companies might require additional registration, such as, for example, a mortgage over real estate

property must be registered with the Land Registry, in addition to its registration with the Registrar of Companies.

- Security interests over the assets of individuals, partnerships and companies incorporated outside Israel must be registered with the Registrar of Pledges, at any time following creation of the security interest, and are valid against third parties from the date of registration.
- Security interests over real estate must be registered with the Land Registry. It is advisable to register a mortgage made by a company with both the:
  - Land Registry;
  - Registrar of Companies.

Tangible movable property

3. What is considered tangible movable property in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected?

Tangible movable property

In Israel, tangible movable property is considered any tangible asset which is not deemed immovable property (*see Question 2*). Such assets may include machinery, furniture and trading stock. Although tangible movable property differs from non-tangible rights (such as, financial instruments), the Tangible Assets Law 1971 also applies to non-tangible rights where applicable.

Common forms of security

The most common form of security interest over tangible movable property is a charge (*mashkon*). In Israel, a charge is also referred to as a fixed charge (*shiabud*). Charges are mainly governed by the Pledge Law 1967 (Pledge Law), which defines a charge as a lien over an asset created to secure repayment of a debt. A charge entitles the lender to be repaid out of the proceeds of the sale of the asset if the debt is not repaid.

Companies can also grant a floating charge over all or part of their assets. However, floating charges can only be created by companies, and individuals cannot create floating charges over their assets, even if such assets are business-related. A floating charge is governed by the Companies Ordinance [New Version] 1983 (Companies Ordinance). A company whose assets are subject to a floating charge can sell and buy assets and enter into transactions in the ordinary course of business. If certain events occur (as specified in the debenture or other instrument creating the floating charge), the floating charge crystallises and becomes a fixed charge.

A floating charge ranks lower in priority to a fixed charge (*see Question 24*). The instrument creating the floating charge often includes negative charges or covenants which, if properly registered, are enforceable against third party creditors. Therefore, if another creditor is subsequently granted a charge over an asset of the company, the floating charge creditor will have priority over the subsequent creditor. However, if a company charges a new asset in favour of the creditor who lends the money used to acquire that asset, such subsequent charge has priority over the existing floating charge, despite negative charge covenants in the floating charge debenture.

Formalities

The primary perfection method of charges created over tangible movable property includes registering the charge with the relevant registrar (*see Question 2, Formalities*).

In addition, perfection of charges created over particular types of tangible movable property might include special registration requirement (for example, a charge created over shipping vessels must be registered with the Registrar of Vessels).

An alternative perfection method is to physically deposit those assets with the secured creditor or a custodian on its behalf.

Financial instruments

4. What are the most common types of financial instrument over which security is granted in your jurisdiction? What are the most common forms of security granted over those instruments? How are they created and perfected?

Financial instruments

A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Security interest can be granted over a wide range of financial instruments, including:

- Cash.
- Shares of capital stock of a company and other securities.
- Bonds.
- Capital notes and other forms of incurred debt.
- Loans.
- Lease agreements.

In a recent case of the Israeli Supreme Court (ISC), in an *obiter dictum*, the ISC discussed whether it is possible to create a fixed charge on a portfolio of securities, as a whole, rather than creating a fixed charge on each type of securities individually. The ISC expressed the opinion that, since it is virtually impossible to create a fixed charge on each type of security that enters the portfolio, and in order to preserve the liquidity of the securities in the portfolio, creating a fixed charge on the portfolio as a whole is likely to be considered a valid and effective security interest. However, this opinion was an expressed *obiter dictum* and is therefore not a binding ruling.

Common forms of security

Security interests over financial instruments are most commonly created by way of a fixed charge, and for companies also by way of a floating charge. For the perfection methods of a fixed charge and a floating charge, see *Questions 2* and *3*. It is also possible to register a security interest over contractual rights using an assignment by lien (*see Question 8*).

Claims and receivables

5. What are the most common types of claims and receivables over which security is granted in your jurisdiction? What are the most common forms of security granted over claims and receivables? How are they created and perfected?

Claims and receivables

The most common types of claims and receivables over which security is granted in Israel include debts and rights incurred under contractual frameworks (which in most cases relate to seller-buyer relationships and lessor-lessee relationships).

Common forms of security

Security interests over claims and receivables are most commonly created by way of a charge, and with respect to companies, also by way of a floating charge. For information on the perfection methods for claims and receivables, see *Questions 2* and *3*.

Cash deposits

6. What are the most common forms of security over cash deposits? How are they created and perfected?

Common forms of security

Cash deposited in a bank account can be secured by way of a charge, and, with respect to companies, also by a floating charge.

Given the dynamic characteristics of bank cash deposits, there is a risk that a fixed charge created over such deposits might be reclassified by a court as a floating charge. This can be crucial, since a floating charge ranks lower in priority to a fixed charge (*see Question 24*).

A bank account is considered a fungible asset. According to scholars, a fixed charge created over fungible assets is valid and should not be reclassified as a floating charge provided that:

- The pool of assets is properly identified.
- The creditor has a high degree of control over the movement of assets from and the pool of assets (which can be established through a well-drafted accounts agreement).

Formalities

For information regarding perfection methods of a fixed and floating charge, see *Questions 2* and *3*.

Intellectual property

7. What are the most common types of intellectual property over which security is granted in your jurisdiction? What are the most common forms of security granted over intellectual property? How are they created and perfected?

Intellectual property

The types of intellectual property (IP) over which securities can be granted are diverse and include both:

- Registered intellectual property, such as patents and trade marks.
- Non-registered intellectual property, such as trade secrets, license rights and goodwill.

Common forms of security

IP can be secured by way of a fixed charge, and with respect to companies, also by way of a floating charge.

For unregistered IP owned by companies, it is advisable to register a floating charge in addition to any fixed charge. This is because any developments or improvements made to the secured IP after the perfection date of the fixed charge security interest could be excluded from the scope of the fixed charge, as the developments or the improvements did not exist at the date on which the fixed charge was perfected.

For additional information regarding charges created on future assets, see *Question 8*.

Formalities

For information regarding perfection methods of a fixed and floating charge, see *Questions 2* and *3*.

The perfection methods of security interests created over patents require special registration procedures, as follows:

- The documents governing the creation of the security interest must be made in writing.
- The security interest must be registered with the Registrar of Patents within 21 days of the execution of the security interest agreement.
- If the grantor is a company, the charge must also be registered with the Registrar of Companies in addition to its registration with the Registrar of Patents (however, if the patent is secured under a floating charge created by a company, then the registration of the floating charge with the Registrar of Companies is sufficient and there is no need to also register with the Registrar of Patents).

8. Are there types of assets over which security cannot be granted or can only be granted with difficulty? Which assets are difficult or problematic when security is granted over them?

Generally, there are no types of assets over which security interests cannot be granted or which can only be granted with difficulty.

Future assets

The Pledge Law does not specifically regulate the legal aspects for the creation of security interests over future assets. However, other Israeli laws indicate that the creation of security interests over future assets is possible, for example:

- The Assignment of Obligations Law 1969 (Assignment Law) provides that a right of a creditor, including a conditional or future right, can be assigned to a third party, including by way of a lien.
- For companies, the Companies Ordinance stipulates that a company can create a charge on its assets, including any present or future asset.

The question of what constitutes a "future asset" has been met with two interpretations from scholars:

- On one hand, a future asset could constitute a legal right underlined by an executed, binding contact, that will only take place on its realisation date in the future (for example, a loan contract with a future repayment date). There is no doubt that such a right could be charged by a creditor, despite the fact that its realisation date takes place only in the future.
- On the other hand, an additional type is a right that has yet to legally materialise (for example, a right underlined by a contract that has not been executed). For such assets, the charge agreement between the debtor and the creditor is executed before the execution of the contract which creates the right that has been charged. Therefore, the pledged asset is not a bona-fide legal right, secured under law or contract, but rather an expectation to receive a particular legal right (at a future time when the right will materialise legally).

Scholars have adopted a liberal position as to what constitutes a "future asset" to also include an expectation in connection with a right that is not underlined by a binding contract. However, Israeli case law presents difficulty with this understanding based on the premise that title to a property has been charged or assigned before the actual property has come into existence. Nevertheless, recent trends in Israeli case law have shown Israeli courts to be adopting a more liberal position in relation to the legal boundaries of "future assets", and specifically, regarding legal rights that have yet to materialise.

Fungible assets

Security interests over fungible assets are common in Israel. A typical example is a charge over cash or securities (*see Question 6*).

Residential dwellings

The enforcement of a mortgage registered on a residential dwelling used by the pledgor as his own residence requires finding an alternative reasonable residence for the pledgor and his family (an alternative residence can include a smaller residence located in a cheaper location). This protection decreases the realisation value of the mortgage and prolongs the realisation process (*see also Question 2, Common forms of security*).

However, the lender can stipulate under the mortgage agreement that, in enforcing the mortgage, the lender will not be required to provide the pledgor and his family with permanent residence, but will only be required to provide them with temporary residence for 18 months and only in their current residence location. This condition must be clearly stated in the mortgage agreement and properly explained to the pledgor.

RELEASE OF SECURITY OVER ASSETS

9. How are common forms of security released? Are any formalities required?

A security interest is released when the obligation underlying the security interest has expired (*Pledge Law*). On the release of the security interest:

- If the secured asset was deposited with the creditor or a representative on his behalf, the debtor can demand that the creditor returns the secured asset to him.
- If the security interest was registered, the debtor can demand that the creditor removes the registration.

The procedures governing the removal of a security interest registered by a company with the Companies Registrar are set out in the Companies Ordinance. Accordingly, the Companies Registrar will remove the registration of a security interest, when it is presented with sufficient evidence that the debt underlying the security interest was removed. In practice, a written notice to that effect signed by the creditor serves as sufficient evidence. Similarly, security interests registered by an individual or a partnership with the Registrar of Pledges can be cancelled by presenting the Registrar of Pledges with a notice signed by the creditor requesting that the registration be cancelled.

Removal of a mortgage registered with the Land Registry requires a signed deed of cancellation or an application signed by the beneficiary of such mortgage. Removal of a mortgage registered by a registered bank involves a more simple procedure.

SPECIAL PURPOSE VEHICLES (SPVS) IN SECURED LENDING

10. Is it common in your jurisdiction to take security over the shares of an SPV set up to hold certain of the borrower's assets, rather than to take direct security over those assets?

It is common for lenders to require that a security interest be created over the shares of a special purpose vehicle (SPV) borrower. However, it is common for lenders to also require that a security interest be created over the SPV's assets.

In Israel, an SPV is commonly used in project finance transactions. In such transactions, the SPV is usually required to operate in accordance with authorities mandated under a concession or a license granted to it by a regulatory body. Such concession or license often includes:

- Restrictions on the transfer of ownership interests in the SPV.
- Restrictions on the creation of liens on the SPV's shares.

Common restrictions include:

- A requirement to procure the consent of the relevant regulatory body for transferring ownership interests in the SPV.
- A requirement to procure the consent of the relevant regulatory body for the creation of a lien on the SPV's shares or assets.

QUASI-SECURITY

11. What types of quasi-security structures are common in your jurisdiction? Is there a risk of such structures being recharacterised as a security interest?

According to section 2(b) of the Pledge Law, the Pledge Law will apply to any transaction proposing to create a security interest over an asset in order to secure the repayment of a debt, regardless of the transaction's formal characterisation.

Historically, section 2(b) has been broadly interpreted by the Israeli courts. This has resulted in many transactions being recharacterised as financing and security interest transactions (for example, a sale transaction using a retention of title clause (*see below, Retention of Title*)).

Sale and leaseback

Sale and leaseback transactions are widespread in Israel, and are mostly common in real estate transactions. In a sale and leaseback transaction, an asset is sold to a third party and is concurrently leased back to the seller of the asset. In these transactions, the original owner of the asset is able to raise capital through the sale of the asset while still being able to use asset (albeit no longer owning it), through its lease-back.

In relation to the risk that a sale and leaseback transaction might be recharacterised as a security interest transaction, the common view among legal practitioners is that the risk of recharacterisation is not substantial in this context.

Factoring

Factoring transactions are typically made by an outright assignment of the receivables (true sale) to a third-party financing institution at a discount price, and providing notice of the assignment to the debtors of the underlying receivables. In this manner, the seller receives an advancement payment on the assigned receivables while also having the risk associated with the potential default of those receivable transferred to the purchasing financing institution.

Factoring transactions are relatively new in Israel and are increasing in popularity.

In relation to the risk that a factoring transaction might be recharacterised as a security interest transaction, the common view among legal practitioners is that the risk of recharacterisation is minimal in this context.

Hire purchase

Hire purchase transactions are sale transactions where the payment for the goods purchased is made over time in instalments. Hire purchase transactions are common in Israel.

Under Israeli case law, in hire purchase transactions that allow the seller to repossess ownership of the goods sold where the purchaser has defaulted on payment, the goods sold might be viewed as collateral for the payment, and, accordingly, might be recharacterised as a security interest transaction.

Retention of title

In a precedent ruling of the Israeli Supreme Court (ISC) in 2003, the ISC acknowledged that broad interpretation of section 2(b) of the Pledge Law causes excessive recharacterisation of transactions of with retention of title clauses as security transactions and this, de

facto, causes lack of clarity and can hinder business and commercial development in Israel. Accordingly, the ISC ruled that a narrower interpretation of section 2(b) should be employed and that each case should be examined on an individual basis.

Nearly a decade later, in an ISC ruling from 2013, the ISC attempted to provide clarity as to when a transaction with a title retention clause will, in fact, be recharacterised as a security transaction. For this purpose, the ISC established the following two criteria to consider when determining whether a transaction with a title retention clause should be recharacterised:

- The court will attempt to decipher the intention of the transacting parties, to determine whether or not they intended the transaction to be a security transaction (for example, a written agreement with an explicit and clear title retention clause, which outlines the terms of the clause, will generally indicate that the parties indented to enter into a true, bona-fide sale transaction with a title retention clause and not a sale transaction with a security interest).
- If the seller retained measures for monitoring and controlling the goods sold, this can indicate that the title to the goods was not transferred to the purchaser, and such a transaction is likely not to be recharacterised as a security transaction.

Other structures

Until the enactment of the Financial Assets Agreements Law 2006 (Financial Assets Agreements Law), there was concern that collateralisation arrangements under the ISDA Master Agreement or the Global Repurchase Master Agreement (GMRA) and other master agreements which are structured as a transfer of title in the collateral, would be recharacterised as security interest transactions under section 2(b) of the Pledge Law. The Financial Assets Agreements Law eliminates the risk of re-characterisation by expressly stating that the Pledge Law does not apply in such cases, provided that certain conditions are met.

GUARANTEES

12. Are guarantees commonly used in your jurisdiction? How are they created?

Guarantees are a common form of security in many types of commercial transactions in Israel. A guarantee can be created by either:

- An agreement between the creditor and the guarantor.
- The guarantor providing an undertaking to the creditor.

If a guarantee is required pursuant to an order issued by an official authority, the guarantee will be created when it is delivered to the relevant authority.

In a guarantee arrangement, if the debtor fails to meet its obligations, the creditor can collect the unpaid amount from the guarantor in accordance with either:

- The terms of the guarantee.
- The terms set out in the Guarantee Law 1967 (Guarantee Law), if there is no agreement between the parties.

If the guarantor refuses to pay the debtor's debt, the creditor can seek recourse through the court.

From the creditor's perspective, the strongest and most advantageous guarantee is a bank guarantee or a letter of credit. This is a guarantee provided by a bank, which assumes an independent obligation to pay the creditor the amount stated in the bank guarantee, in most cases on the creditor's first demand. Since the bank's obligation is independent of the debtor's obligations, the bank guarantee is not considered a "guarantee" under Israeli law but rather as an "undertaking for indemnification", which is not subject to many of the restrictions and protective provisions set out in the Guarantee Law. However, the bank can revoke the guarantee in certain extreme and rare circumstances, such as:

- Aggravated fraud by the creditor.
- Arbitrary or otherwise unacceptable behaviour by the creditor in demanding the exercise of the guarantee.
- A demand for payment by the creditor that is driven by irrelevant considerations, compulsion or vindictiveness.

The court would not normally issue an injunction to stop a debtor insisting on a guarantee being realised, unless the guarantor can prove that extreme circumstances (*see above*), allow it to withdraw the guarantee. The court can also stop the realisation of bank guarantees within the context of a stay of proceedings for companies undergoing rescue proceedings (*see Question 21*).

A guarantee provided by an individual is subject to certain restrictions and protective provisions. These include the following requirements:

- Disclosure requirements.
- Priority provision, according to which the guarantee can only be enforced on the attempt to collect the debt from the main creditor.
- Amount of guarantee to be expressly provided.
- Establishment of several liability only (that is, where a guarantee is provided by more than one guarantor, under several liability, each guarantor is only liable for a proportionate part of the debt (as opposed to joint and several liability, in which each guarantor is liable, on his own, for the entire debt)).

Failure to comply with these requirements may invalidate the guarantee. However, the above requirements do not apply to a:

- Guarantee provided by a partner as security for the partnership's debts.
- Guarantee provided by a shareholder holding 5% or more in a company as security for the company's debts.
- Guarantee provided by a person for his/her spouse's debts.

RISK AREAS FOR LENDERS

13. Do any laws affect the validity of a loan, security or guarantee (or the terms on which they are made or agreed)?

Financial assistance

A company can purchase its own shares or provide any of its shareholders with assistance for financing the acquisition of its own shares (including by granting a security interest over a company's asset to secure financing from a third party). Such acts are deemed "distributions of dividend", and therefore the company must comply with the following two requirements according to which a company is permitted to make a distribution of dividend, pursuant to the Companies Law 1999 (Companies Law):

- The company must have sufficient profits for making a distribution of dividend.
- There must be no reasonable concern that such distribution will prevent the company from being able to repay its outstanding and anticipated payment obligations on their repayment date.

Corporate approvals

The following transactions require special corporate approval (*Companies Law*):

- Transactions between a company and its controlling shareholder(including, transactions involving the grant of a security interest from a subsidiary to its controlling shareholder - parent company).

- Transactions between a company and any of its directors (including transactions for the provision of a loan or a guarantee to director of the company).

These rules differ for public and private companies. Furthermore, when approving such resolutions, the subsidiary's board of directors must act in good faith and for the benefit of the company (the subsidiary) in accordance with their fiduciary duty. Therefore, a resolution passed for the purpose of promoting the interests of the parent company, rather than those of the subsidiary, might constitute as a breach of the directors' fiduciary duty.

Loans to directors

Loans from a company to its directors require special corporate approvals, as set out in the Companies Law (*see above, Corporate approvals*).

Usury

The Interest Law 1957 (Interest Law) restricts the interest rates that creditors can collect on loans. Under the Interest Law, the Israeli Minister of Finance can determine the maximum interest rate that a creditor is permitted to collect on a loan. Accordingly, creditors are prohibited from demanding or receiving an interest rate that is higher than the maximum interest rate.

To date, the Israeli Minister of Finance has only limited the interest on:

- Loans made in Israeli currency which are linked to an index or the price of other assets.
- Loans secured by a mortgage of a residence.

In addition, there are no limitations on non-linked loans, except for loans secured by a mortgage, as noted above.

Furthermore, the Interest Law does not apply to loans made in foreign currency and loans linked to foreign currency, and with respect to such loans, the parties are free to set the interest rate without restriction. However, in extreme circumstances, foreign currency linked loans with extremely high interest rates could be viewed by the courts as immoral or contradicting public policy, and the courts may not enforce the payment of such interest rates.

14. Can a lender be liable under environmental laws for the actions of a borrower, security provider or guarantor?

In general, liabilities under environmental laws are imposed on the entity responsible for creating the environmental hazard. For liability to be incurred, involvement in the creation of the environmental hazard must be evidenced.

Lenders and guarantors do not usually take an active role in the management or operation of the project for which they provided financing and instead usually maintain a passive position. Liability cannot be imposed on lenders or guarantors by virtue of merely making a loan or providing a guarantee. Similarly, a holder of a security interest is not generally subject to environmental liabilities, unless it becomes the owner or holder of the secured asset as a result of its realisation.

According to scholars, lenders that maintain an active role in the projects they finance may not be viewed merely as lenders but also as decision-makers. These kinds of lenders are likely have had the ability to predict (and therefore also prevent) the environmental hazard, and therefore, there are grounds to extend liability also to such lenders. However, to date, the Israeli courts have not expanded the scope of liability under environmental laws to also apply to lenders. Nevertheless, loan agreements will often include specific undertakings of the borrower to comply with environmental laws.

STRUCTURING THE PRIORITY OF DEBTS

15. What methods of subordination are there?

Contractual subordination

Contractual subordination of debt is common. Under such transactions, two (or more) creditors can contractually agree that one creditor will be subordinated to the other creditor. The creditor ranked superior to other creditors will therefore have a higher priority for his loan to be repaid prior to the repayment of the creditors that are ranked subordinated to him.

Structural subordination

Structural subordination is possible. In these transactions, different categories of lenders (for example, senior and junior), can either receive different collateral or share the same collateral with the senior lenders receiving a first priority charge and the junior lenders receiving a subordinated charge. In such transactions there is typically an inter-creditor agreement governing the enforcement of the security interests (*see below, Inter-creditor arrangements*).

Inter-creditor arrangements

Inter-creditor arrangements are fairly common in transactions that involve several lenders or different categories of lenders. Often, inter-creditor arrangements will appoint one lender (usually the lender providing the greater part of the loan) to serve as either or both the agent (*see Question 17*) and the securities' trustee (*see Question 18*) on behalf of all lenders.

DEBT TRADING AND TRANSFER MECHANISMS

16. Is debt traded in your jurisdiction and what transfer mechanisms are used? How do buyers ensure that they obtain the benefit of the security and guarantees associated with the transferred debt?

Debt securities (debentures) are traded on the Tel Aviv Stock Exchange. Under the Securities Law 1968 (Securities Law), a trustee must be appointed in relation to all public issues of debt securities. The trustee acts on behalf of the debenture holders, and has various rights and obligations under the Securities Law. If the debenture is secured, the security interest is granted to the trustee and registered in its name. If the debtor defaults under the terms of the debenture, the trustee realises the security interest and the proceeds become payable to the debenture holders.

Further, transactions involving transfer of debt among creditors are also common. Under the Assignment of Obligations Law 1969, creditors can assign their rights relating to outstanding debt to other creditors, without having to obtain the consent of the debtor (subject to statutory limitations), while debtors can only assign their obligations relating to outstanding debt to other debtors if the consent of the creditor is obtained (subject to statutory limitations).

In most credit facilities, the creditors are contractually permitted to assign their obligations, while debtors are restricted from assigning any of their rights or obligations. Under the State Economy (Legislation Amendment for Achieving the Budget and Economic Goals for the Year 2003) Law 2002, certain restrictions were imposed on the assignment of debts secured by a mortgage to non-banking transferees.

AGENT AND TRUST CONCEPTS

17. Is the agent concept (such as a facility agent under a syndicated loan) recognised in your jurisdiction?

The agent concept is recognised in Israel.

In his capacity as agent, the appointed lender serves as representative on behalf of all lenders, and is usually responsible for:

- Maintaining on-going communication with the borrower on behalf of the other lenders.
- Monitoring the project for which the loan was provided.
- Making decisions regarding specific matters for which he was authorised.

18. Is the trust concept recognised in your jurisdiction?

The trust concept is recognised in Israel and is governed by the Trust Law 1979. Trusts created under the laws of another country will also be recognised in Israel.

In his capacity as securities' trustee, the appointed lender is often responsible for the safe-keeping of the security interests granted by the borrower, on behalf of all lenders. If the debtor defaults under the terms of the relevant security interest agreement, the trustee realises the security interest and the proceeds are payable to the lenders.

In Israel, a trust is not considered a separate legal entity and therefore, registering an asset held by the trust in some of the official registries (for example, the Land Registry) must be registered in the name of the trustee, rather than in the trust's name.

ENFORCEMENT OF SECURITY INTERESTS AND BORROWER INSOLVENCY

19. What are the circumstances in which a lender can enforce its loan, guarantee or security interest? What requirements must the lender comply with?

Under the Pledge Law, a lender can enforce a security interest if the loan is not repaid on time. Usually the loan agreement or the security interest agreement specifies certain events which, if they occur, will trigger the creditor's right to accelerate the loan and enforce the security. These events typically include:

- Failure to repay.
- Material breaches of the loan agreement or other specified agreements.
- Insolvency events.
- Changes of control.
- Decrease in the debtor's credit rating.
- Other material adverse changes.

Methods of enforcement

20. How are the main types of security interest usually enforced? What requirements must a lender comply with?

A fixed charge can be enforced pursuant to either (*Pledge Law*):

- A court order.
- An order of the district officer at the Enforcement and Collection Authority (that is, an administrative authority primarily authorised to execute court judgments).

A charge (both a fixed and a floating charge) is most often realised through a public sale of the secured asset. However, under the relevant circumstances the court or the Chief Execution Officer can direct that an alternative method is more efficient and/or fairer.

Under the Pledge Law, the lender and debtor are not permitted to agree on a method of realising the charge that is different from the methods set out in the Pledge Law, unless the agreement is reached after the due date of the underlying obligation.

Specific categories of lenders listed in the Pledge Law (for example, institutional lenders such as, banks and insurance companies) can realise security interests autonomously (without a judicial order), if the security interests were granted in their favour over the assets (including securities) actually deposited with them. In this case, the charge can be realised by selling the secured assets in a commercially reasonable manner on the market on which the assets are traded, to the extent applicable.

Under the Companies Ordinance [New Version] 1983, enforcement of a floating charge is subject to court approval.

Rescue, reorganisation and insolvency

21. Are company rescue or reorganisation procedures (outside of insolvency proceedings) available in your jurisdiction? How do they affect a lender's rights to enforce its loan, guarantee or security?

Company rescue proceedings are available in Israel. Rescue proceedings are set out in section 350 of the Companies Law (known as "section 350 proceedings").

At the commencement of rescue proceedings, the court issues a moratorium order, which creates an automatic stay of proceedings and restricts creditors from:

- Filing claims against the company.
- Undertaking execution/recovery actions against the company's assets.

Where a company is subject to rescue proceedings, no proceedings against the company (including proceedings by creditors seeking to realise their collateral) can be commenced or continued without the permission of the court, and any proceedings commenced will be subject to conditions set by the court.

However, the court can permit a secured creditor to realise a charge if either of the following two tests has been met:

- The court is convinced that this would not prejudice the ability to reach a recovery plan or a creditors' arrangement (test one).
- The court is convinced that the rights of the secured creditor relating to the collateral are not adequately protected (test two). The courts have interpreted this test to mean that if there is a reasonable chance that the value of the collateral will decrease if the creditor is forced to delay realisation, the creditor will be deemed not "adequately protected", and the court will allow realisation even while rescue proceedings are pending.

Once a company is under a moratorium order, the court usually appoints an appointee (Position Holder) to manage the rescue proceedings, if the court is convinced that, after hearing the creditors' arguments, the Position Holder will be able to assist in the rescue of the company without harming the creditors.

The court will define the scope of the Position Holder's authority and obligations.

With the court's permission the Position Holder can cause the sale of a secured asset, with the proceeds of the sale serving as collateral for the debt to the secured creditor. The Position Holder is legally authorised to disregard the exercise by a counterparty to an existing contract of its contractual right to terminate it due to insolvency or financial difficulties.

With the court's permission the Position Holder can also elect to continue the performance of an existing contract if maintaining the contract is necessary for the recovery of the company. Similarly, a counterparty to an existing contract that was breached by the company prior to the moratorium order cannot terminate the contract without consent of the Position Holder or the court.

The Position Holder is not permitted to maintain a credit agreement without consent of the creditor.

The Position Holder is further authorised to formulate and manage debt restructuring arrangements with the company's creditors. Such restructuring arrangements must be approved by:

- Each type of creditors of the company (secured creditors, unsecured creditors and so on).
- Each type of shareholders of the company.
- The court.

The court can also enforce an arrangement on any creditors or shareholders that are opposing to the arrangement, subject to certain conditions.

When a company has exhausted the rescue proceedings, the company either:

- Becomes solvent again and resumes operation.
- Proceeds to liquidation, where the rescue proceedings have failed (*see Question 22*).

22. How does the start of insolvency procedures affect a lender's rights to enforce its loan, guarantee or security?

In Israel, insolvency proceedings are known as "liquidation" proceedings and are conducted in accordance with the Companies Ordinance [New Version] 1983 (Companies Ordinance). An insolvent company can be liquidated through either voluntary or involuntary liquidation procedures.

Involuntary liquidation

Involuntary liquidation procedures (generally the case in an insolvency situation) are regulated by the court. The decision to liquidate the company is made by the court, and the court will do so by issuing the company a liquidation order.

When a liquidation order has been issued, no proceedings against the company (including, proceedings for the purpose of enforcing a loan, a guarantee or a security interest) can be commenced or continued without the permission of the court, and any proceedings commenced will be subject to conditions set by the court.

Moreover, any transactions involving the company's assets and any share transfer transactions made following the commencement of the company's liquidation procedure will be null and void and have no force or effect, unless the court decides otherwise.

The court can also appoint a liquidator to the company. If appointed, the liquidator is permitted to only carry out specific authorities established under law, such as:

- Managing lawsuits for the company.
- Managing the company's assets.
- Repaying the company's debts.

The liquidator is also authorised to assemble general meetings of the company's creditors to hear their views. The liquidator is legally required to assemble such a meeting if requested by creditors representing at least 10% of the value of the company's outstanding debt.

Voluntary liquidation

Voluntary liquidation procedures are regulated by the company. The decision to liquidate the company must be made by the company's shareholders (although the liquidation process can be subject to the supervision of the court).

Once a decision to liquidate the company has been reached, the company must immediately cease to manage its operations (including, operations for the purpose of enforcing a loan, a guarantee or a security interest) except for operations required for the company's efficient liquidation.

Although a solvent company can undergo liquidation voluntarily, the specific procedures differ depending on whether the company is solvent or insolvent, for example:

- Solvent companies are usually managed by the company's shareholders, meaning the creditors enjoy less rights and authority in relation to the liquidation procedure.
- Creditors of solvent companies do not have the right to appoint a liquidator and an audit committee to oversee the liquidation process (as do creditors of insolvent companies).

Once the company's assets have been liquidated, the proceeds of sale are distributed among the company's creditors in accordance with the order of payment (*see Question 24*).

23. What transactions involving loans, guarantees, or security interests can be made void if the borrower, guarantor or security provider becomes insolvent?

Preference

Security interests granted during the three-month period prior to the commencement of insolvency proceedings can be nullified if the following conditions are met:

- At the time of granting the security interest, the debtor was insolvent (that is, not able to repay its debts).
- The security interest was granted to give priority to a certain creditor, or as a result of unlawful pressure by the creditor or anyone on its behalf.

For the second condition, it is not necessary to show evidence of criminal fraud; it is sufficient to show the intention to prefer one creditor over the others. Unlawful pressure means financial pressure or any other act constituting unacceptable business practice.

Transfer for zero consideration

A transfer of assets for zero consideration made during the two-year period prior to the commencement of insolvency proceedings can be revoked by the trustee appointed by the court. There have been attempts to challenge the validity of securities granted to creditors of an insolvent company, when there was no increase in the credit amount provided by such creditors. In such cases, the courts normally reject such claim and hold that it is sufficient for the creditor to show that he had the right to terminate, accelerate or refrain from renewing the credit.

Fraud

In the event of fraud, the trustee in insolvency proceedings can revoke transfers of securities granted up to ten years prior to commencement of insolvency proceedings. However, in these circumstances the trustee must have been a party to the fraudulent actions, or at least been aware of the fraud.

General assignment of rights

General assignments of rights (as opposed to assignments applicable to specific contracts or debtors) are not effective during insolvency proceedings, if they were not registered prior to the commencement of insolvency proceedings with the relevant registrar.

Floating charges

A floating charge created during the six months before the start of liquidation is only effective to secure amounts provided to the company after the creation of the floating charge, unless the creditor proves that the company was solvent when the floating charge was created.

24. In what order are creditors paid on the borrower's insolvency?

The priority order among creditors on the insolvency of a company is as follows:

- **Real estate tax charges.** Under relevant tax legislation, the Israeli tax authorities have first priority charges over certain assets, to secure the collection of certain real estate related taxes.
- **Possessory liens**. Certain creditors can retain possession of an asset given to them during the course of doing business until the owner-debtor of the asset has paid the debt owed to the creditor (for example, a garage can retain possession of a vehicle it has repaired until the owner of the car pays the vehicle repair fees). The Israel Supreme Court (ISC) has held that possessory liens (which secure payment of repair or other fees payable in connection with the provision of services related to the possessed assets) have priority over any charge created over that asset.
- **Charge created as security for the financing utilised for the purpose of acquiring the secured asset.** A charge created as security for the financing which made the acquisition of the charged asset possible has preference over other fixed charges.
- **Duly perfected security interests fixed charges and mortgages).**If there are two (or more) duly perfected security interests over the same asset, the security which was created first in time has higher priority, unless the relevant secured creditors specifically agree otherwise. If the required formalities to perfect the security interest are not complied with, the creditor is not considered a secured creditor and is therefore subordinated to other secure creditors.
- **Liquidation and/or receivership costs.** These are the costs involved with the liquidation and receivership process (when the liquidation and receivership costs are used for the purpose of realising the company's assets, they will be deducted first from the proceeds of the assets).
- **Statutory preference creditors.** These include:
  - employees, for unpaid wages up to a certain amount;
  - creditors who provided loans used for the purpose of paying salaries; and
  - tax authorities, for income tax deductions.
- **Mandatory payments (outstanding for one-year period prior to liquidation).** These include:
  - tax debts (other than those mentioned above); and
  - landlords, for certain rent payments.
- **Floating charge creditors.** If the floating charge crystallizes and becomes a fixed charge prior to liquidation proceedings, the creditor is considered a fixed charge creditor and is treated accordingly (*see above*).

  If there is a negative charge covenant in the floating charge debenture which prohibits the company from performing transactions with the assets charged under the floating charge, the floating charge creditor ranks superior to other pledge creditors whose securities were created in breach of the negative pledge covenant (provided the negative pledge covenant was duly registered with the Companies Registrar).

  Floating charge creditors are inferior to statutory preference creditors and mandatory payments, but not to liquidation costs (as opposed to receivership costs, which they are inferior).
- **Unsecured creditors.** All unsecured creditors rank equally. Any remaining funds are divided among these creditors on a pro rata basis according to each creditor's respective debt.
- **Deferred creditors.** Ranked last in the order of priority as deferred creditors are the company's shareholders. However, in some cases, prior to paying the company's shareholders, payments should be made to:
  - holders of capital notes; and
  - lenders of shareholders' loans.

CROSS-BORDER ISSUES ON LOANS

25. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders?

There are no restrictions imposed on foreign lenders on the making of loans to Israeli borrowers, or on granting securities or guarantees to foreign lenders.

However, under the Banking (Licensing) Law 1981 a lender must hold a particular license for concurrently lending funds and accepting deposits from 30 persons or more at the same time.

Furthermore, certain lending arrangements might be considered as offerings of securities to the public (and therefore require a permit from the Israeli Securities Authority).

26. Are there exchange controls that restrict payments to a foreign lender under a security document, guarantee or loan agreement?

There are no exchange controls.

However, payments to foreign lenders are subject to certain anti-money-laundering restrictions and tax withholding requirements. In addition, there are four countries declared by Israel as enemy countries (Iran, Syria, Lebanon and Iraq), and any business or exchange of funds is restricted with these countries.

TAXES AND FEES ON LOANS, GUARANTEES AND SECURITY INTERESTS

27. Are taxes or fees paid on the granting and enforcement of a loan, guarantee or security interest?

Income taxes, value added tax

In the absence of an exemption, interest payments paid by Israeli borrowers are subject to withholding tax at source. This is also relevant to foreign lenders to Israeli borrowers. Interest payments may also be subject to value added tax (VAT), which in Israel currently equals to a rate of 18%.

Documentary taxes

Stamp duty was cancelled in Israel and there is no similar tax or duty payable.

Registration fees

Registration of security interests are subject to nominal registration fees.

Notaries' fees

Notary services are required for certain types of filings. In addition, filings of documents in foreign languages might require a Hebrew translation authenticated by a notary.

28. Are there strategies to minimise the costs of taxes and fees on the granting and enforcement of a loan, guarantee or security interest?

Value added tax (VAT) and withholding tax issues should be considered, especially when structuring cross-border lending transactions.

REFORM

29. Are there any proposals for reform?

Three years ago, the Israeli government presented a memorandum of a bill proposing to amend the Pledge Law. The purpose of the amendment was, among other things, to:

- Facilitate the reception of credit and loans by the general public.
- Increase the range of assets that can be secured as collateral (for the purpose of decreasing risk exposure of creditors).

The amendment proposed (among other things) to unify the rules for the various types of pledges (such as, the rules relevant to pledges created by corporations or individuals and the rules relevant to pledges created on securities and cash deposits).

Although the bill was placed three years ago, there has been no public news on the progress of the legislation process of this amendment, and this initiative may significantly change before it is enacted (if enacted at all).

Further, it is believed that the Bank of Israel is currently considering amending the Banking (Licensing) Law 1981, or its applicable the regulations, to enable crowd funding initiatives.

ONLINE RESOURCES

Nevo Press website

W www.nevo.co.il

Description. Comprehensive online legal database maintained by Nevo Press Ltd. This database includes up-to-date primary and secondary legislation, published court decisions from all Israeli courts as well as full texts of books and legal journals.

Israeli Ministry of Foreign Affairs

W www.mfa.gov.il

Description. Official website of the Israeli Ministry of Foreign Affairs. This website provides access to official English translations of selected Israeli laws.

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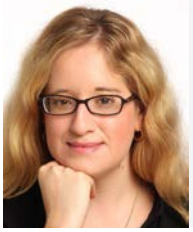
Areas of practice. Project finance; corporate finance; public tenders; high-tech; technology and transactional IP; mergers and acquisitions.

Recent transactions

- Representing consortium bidders as well as contractors, financiers and investors, in numerous projects in different fields, including, water desalination, road construction (toll based and others), military base and most recently regarding the construction of two new ports in Israel. Handled a wide variety of legal matters, covering tender compliance, corporate structuring, financing agreements, construction and operation agreements and specialised subcontractor agreements.
- Representing venture capital funds and private equity investors as well as technology companies receiving venture capital and other funding.
- Representing the founders and executives of emerging growth companies, providing strategic legal advice and general corporate representation
- Representing target companies and acquirers in M&A transactions.

Languages. English; Hebrew

Publications. Co-authored the Israeli Chapter of the International Comparative Legal Guide to Project Finance, 2012 and 2013.



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Recent transactions. Representing private and public companies in financing transactions and mergers and acquisitions.

Languages. English; Hebrew

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Areas of practice. Banking and financial services; project finance; public tenders; insolvency and creditors' rights; commercial law.

Recent transactions

- Representing banks on various matters, including matters relating to ISDA agreements and derivatives and credit transaction; assists on regulatory matters; assisted banks with the implementation of Basel II/III and the review of the legal requirements thereof; represents an Israeli bank in proceedings with various Lehman Brothers companies; represented the controlling shareholders of one of Israel's largest banks in the acquisition of the said bank.
- Representing bidders and offerors in various PFI/BOT tenders and assists concessionaires in the performance of such projects.
- Representing parties in public PFI tenders (Police Training Center, Ashalim Solar Power Plants, Governmental Centers, Ashdod Hospital, State's Archive, Hadassah Biotechnology Park and others).

Languages. English; Hebrew

Publications. Co-authored the:

- Israeli Chapter of Getting the Deal Through: Outsourcing guide, 2015 edition;
- Israeli Chapter of Global Legal Insights: Banking Regulation guide, 2013 edition.

Awards. Client Choice 2015 edition lists Yuval Shalhevet as an expert in the Corporate field.