

Banking and Finance

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The Banking and Finance Sector Presents: Wind of Change

The financial sector in Israel includes a wide variety of participants, dominated by the Israeli banks. The Israeli banking sector is highly concentrated, comprising five banking groups controlling approximately 94% of the entire Israeli banking credit, with the two largest banking groups holding approximately 60% of the entire banking sector's assets.

Alongside the banks, the financial sector also includes "institutional investors," mainly, insurance groups, provident and pension funds and also – principally with respect to traded credit instruments - mutual funds. Over the last decade, the volume of credit provided by institutional investors has been constantly increasing, the result of major governmental led structural reforms in the financial sector.

The growing impact and larger market share of institutional investors led to a strengthened regulatory framework applicable to those entities. In the past few years, several committees have been appointed by the regulators, with laws and regulations enacted to create an extensive regulatory framework relating to institutional investors' investment in non-governmental bonds, tailor made credit facilities, actions in case of debt restructuring and providing credit to entities previously subject to such proceedings.

Over the last decade, the volume of credit provided by institutional investors has been constantly increasing, the result of major governmental led structural reforms in the financial sector.

This regulatory framework addresses different aspects of the credit process - from limitations on the types of credit in which the institutional investors are entitled to engage, through to the content of the agreements between the parties in credit transactions, to structural matters relating to the day-to-day management of credit by the institutional investors.

However, the contribution of the institutional investors to the financial market is reflected in the growing competitiveness of the credit market for the large businesses sector, while in the small and medium-sized enterprises (SMEs) and consumer loans' sectors the banks remain dominant, with a market share of approximately 90%. Other participants in those markets are non-bank lending entities, specializing in certain types of credit (such as factoring and discount services, short terms loan facilities (provided also by credit card issuers and P2P platforms), some apply to SMEs and some (mostly those using virtual platforms) apply to consumers. During the past year, regulatory

efforts were invested mainly in setting the framework for entering the market and the activity of such credit providers.

Trends in the Large Businesses Credit Sector

Alongside raising debt in the capital markets, the main participants in the credit market for large businesses are the banks and institutional investors. This market segment is relatively competitive, entailing lower margins.

The banking sector experienced changes over the past year as it continued its preparations for the higher capital requirements stemming from the adoption of the Basel III regulations. These changes include:

- An expansion of the variety and volume of risk transfer transactions, including a major increase in the volume of secondary market transactions, banks selling loans and expanded syndication activity. We have also seen the introduction of innovative transactions into the Israeli market, including derivatives such as CDOs, CLNs and different types of insurance transactions, including the sale of mortgage portfolios to institutional investors.
- A suspected credit crunch in the banking sector, mainly with respect to larger borrowers and revolving facilities. Borrowers face tougher barriers when seeking short term loans or revolving facilities and other types of credit. This trend is already changing gradually and is expected to change further during 2017.
- The shrinking credit portfolios in segments of the banking sector provide an opportunity for the institutional investors' private loans market. The volume and variety of such loans have increased in the past year. However, many large Israeli borrowers are accustomed to using revolving facilities as a long term financing tool, and since the institutional investors are not typically participating in providing such short terms facilities, borrowers in need of constant revolving financing either vary their finance structure to include longer term loans or seek other alternatives.

Such changes may lead to a more balanced finance market for large businesses, where the banks focus on shorter term credit, as well as organizing and managing syndications, and institutional investors will further expand their traditional role as providers of longer term credit and further expand their participation in bank managed syndications.

Trends in the Consumer and SME's Credit Sector

The consumer and SME's credit sector has been changing. Firstly, the institutional investors have been slowly entering a sector previously virtually dominated by the banks. Institutional investors use two main channels: the purchase of equity stakes in non-bank lending companies (being companies that engage in lending but are not licensed banking corporations or institutional investors); and cooperation with banks, driven by governmental incentives and guarantees, to provide loan facilities to SMEs. Here, the bank provides the operational platform and the institutional investor participates in the funding.

Secondly, major regulatory efforts are being made to boost competition in the consumer and SME's credit sector. Notwithstanding the growing credit market and the increased lending by institutional investors, financing is mainly accessible to large businesses as the institutional investors have limited operational resources required to serve the consumer and SME's credit sector.

This situation caused consumers and SMEs to be virtually dependent on the highly

concentrated banking sector. In light of this situation, the following regulatory steps have been taken during the past two years:

The Proposed Law for Promotion of Competition and Reduction of Concentration in the Banking Sector

In mid-2015, the Minister of Finance and the Governor of the Central Bank of Israel appointed a committee to examine ways to enhance competition in the banking and financial sector. The committee focused on the steps required to minimize the concentration in the consumer and SME's credit sector and to develop non-bank platforms that will enhance competition. As a result, a law is now in the process of enactment, with proposed steps including:

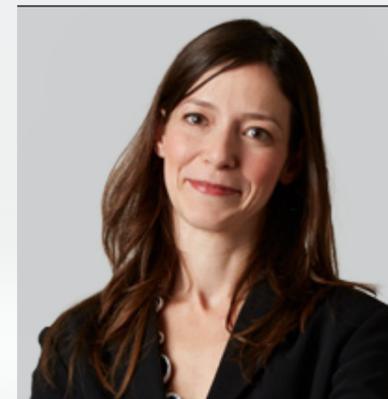
- Separation of the credit card companies from the banks: currently, all three credit card companies operating in Israel are controlled by the banks. Under the proposed law, the two largest banks will have to sell their credit card companies and not participate in the operation and issuance of credit cards.
- Regulatory exemptions for new participants in the banking sector: the establishment of new banks will face dramatically lower entry barriers, including minimal capital requirements and no capital adequacy requirement until reaching a certain capital threshold.
- Minimizing the regulatory limitations applicable to the holding of equity stakes in consumer and SME's credit providers by institutional investors' groups. Such credit providers will be regulated by the Ministry of Finance and will be permitted to raise funds in the capital market by debt issuances.

Supervision of Financial Services (Regulated Financial Services) Law and Supervision of Financial Services (Credit Services and Deposits) Draft Law

In addition to steps to boost competition in the consumer and SME's credit sector, the regulators made efforts to regulate the non-bank credit market, given that such a credit market cannot function as an effective alternative to the banks unless an effective regulatory regime is established to protect borrowers. This was the basis for two new laws:

- The Supervision of Financial Services (Regulated Financial Services) Law (entering into effect in June 2017) regulates the activities of financial service providers that are not banks or institutional investors, such as currency exchange service providers and credit providers. The law sets license requirements relating to such services, and appoints the Commissioner of Capital Markets, Insurance and Savings Department as the regulator in charge of such services. The law already raises questions, including with respect to international credit providers acting in the large businesses credit sector, requiring clarifications that will probably be provided as implementation of the law commences.
- The Supervision of Financial Services (Credit Services and Deposits) draft law - intends to regulate the micro banking sector, mainly credit unions and charity credit providers operating principally in the orthodox communities. Such service providers cannot operate under the existing banking laws since generally only licensed banks can provide credit and receive deposits at once, and the regulation of their activity will allow further credit alternative to consumers.

There are also other types of financial services providers that are expected to be subjected to certain regulatory frameworks as part of the steps take to enhance competition. Such services include, for example, P2P finance platforms and other crowdfunding platforms.



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Fischer Behar Chen Well Orion & Co (FBC), founded in 1958, is one of Israel's premier and largest full service law firms. FBC acts for prominent multinational and Israeli clients (in the practice areas noted below and in a wide spectrum of industry sectors), and offers professional excellence and personal attention across the spectrum of multidisciplinary legal services. FBC's attorneys pride themselves, first and foremost, on their business and legal acumen and ability to bring matters to closure, integrating the commercial sensitivities of attorneys experienced in handling large-scale matters with the in-depth knowledge of first-class practitioners. With over 175 lawyers, including more than 40 are partners, FBC is repeatedly ranked by international and domestic directories among Israel's leading practitioners in many areas, including by Chambers and Partners, Legal 500, IFLR 1000, Global Competition Review, World Tax, BDI, and Dun & Bradstreet.

With one of Israel's most active, involved and visible Banking & Finance practices, FBC represents many of Israel's largest creditors, including banks and insurance companies, investment houses and financial institutions, and borrowers in many of the largest and most complex secured and non-secured financing transactions in Israel. FBC regularly counsels foreign banks and financial institutions in their banking and financial regulatory matters in Israel. By virtue of its broad practice and diverse client base, FBC offers its clients a wide market perspective. It is a market leader in the areas of securitization, secured finance and intercreditor relations, and has the largest institutional lending practice in Israel. FBC's banking and finance practice is highly regarded for its ability to structure creative solutions facilitating complex transactions.

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Miri Kimhi is a partner in FBC's Corporate Department and the co-head of its Banking & Finance practice, specializing in finance, banking and financial regulation.

Miri has advised on numerous complex financing transactions, especially in secured finance and syndicated credit transactions, as well as in the structuring of innovative financial instruments for her clients. She regularly advises major Israeli and foreign clients in banking regulation and in the regulation of financial institutions.

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