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Credit and financial services

BRIEFING:
Israel

Opportunity blows in on the wind of change

Investors take note, as credit card companies are sold off and regulation is relaxed in an attempt to diversify the sources of credit open to SMEs

By Elite Elkon, partner

Israeli financial regulation is undergoing a revolution aimed primarily at increasing and diversifying the sources of credit for retail and small business clients. This is to be achieved by a two-pronged approach: first, promoting competition on the supply side of credit to households and small businesses and second, increasing awareness on the demand side.

On the supply side the plan is to add credit providers, ease the regulatory regime on payment card companies (as competitors of the Israeli banks in providing credit to households and small businesses), increase sources of funding available to non-bank credit providers and develop a database with extended consumer credit information. On the demand side, proposals include enhancing customer awareness of new sources of credit and regulating non-bank credit providers as a trust-building measure.

This article focuses mainly on the supply side and the concrete opportunities these changes present, namely the contemplated sale of the major Israeli credit card companies by the country's leading banks.

Forcing banks to divest their credit card businesses

Three companies, Isracard, Leumi Card and Cal, dominate the credit card market in Israel, holding 45 per cent, 28 per cent and 27 per cent of the market, respectively. The companies issue cards (debit and credit), provide clearing services (merchant acquirer activity, which is their main revenue stream) and grant loans to retail consumers and small businesses. To increase competition the Bank of Israel (the regulator of banks) and the Ministry of Finance have appointed a Committee for Increasing Competition in Banking and Financial Services, which released its interim recommendations on 14 December. The committee advises, among other things, separating control and ownership of Isracard and Leumi Card from Israel's leading banks Bank Hapoalim and Bank Leumi within two years, while preventing the selling banks from issuing their own credit cards for several years. Issuing debit cards would be permitted. In addition, the committee recommends considering forcing the sale of Cal, which is held by two medium-sized banks.

It should be noted that the major Israeli financial institutions such as banks, insurance companies and large investment houses will be prevented from acquiring the aforementioned credit card companies. The market believes – as does the Bank of Israel – that foreign private equity funds and foreign credit card companies are the most likely potential candidates for acquiring these companies.

Encouraging payment card companies to compete with banks

As one of the steps to encourage payment card companies to compete with banks, the Bank of Israel plans to supervise payment card companies more leniently than banks. The aim is to allow them to diversify their sources of funding to include lines of credit from banks, capital-raisings from financial institutions, public bond issuances and possibly by taking deposits from the public – a function that in effect brings them close to becoming banks.

Easing regulation on merchant acquirers (clearing activities)

The payment card companies dominate merchant acquiring activities. Merchant acquiring activities require card companies to comply with Bank of Israel requirements, including with respect to capital. Recently, the Bank took a big step towards easing the regulatory regime governing the merchant acquirer segment by reducing requirements for obtaining a permit to hold a controlling interest in an acquirer. Under new requirements, a control holder of a payment card company will be able to take the company public while keeping a stake of between 20 and 25 per cent.

Another easing is a reduction of the Tier 1 capital requirement of merchant acquirers. This should enable them to provide more credit on the back of the same capital, or increase dividend distributions.

Increasing sources of funding for non-banks

In an effort to enhance the ability of non-bank credit providers (payment card companies and merchant acquirers included) to provide credit, another regulatory relaxation allows non-banks to issue bonds of up to ILS2.5bn (£446m). This was previously a privilege of banks alone, but will now provide non-bank credit providers with an additional source of funding without the need to resort to banks.

Conclusion

The winds of change are blowing in interesting opportunities for foreign investors. It remains to be seen whether efforts to increase competition will prove fruitful.

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