

The Bachar Reform

The old and the new capital market



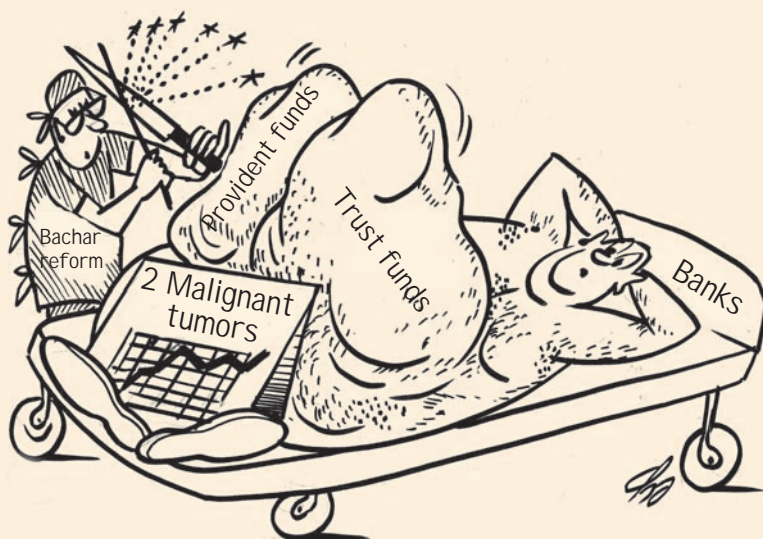
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The Israeli capital market has been, and still is, suffering from two basic fundamental problems.

The first and more important is the problem of centralized holdings, and the second - the conflict of interests.

The source of these two problems is the banking system and mainly – the two largest banks, Hapoalim and Leumi, which are a duopoly, and hence, have been holding back the Israeli capital market for years from becoming as developed and advanced a market as it could and should be.

The centralized holding problem is epitomized by the control of the banking system of the capital markets, and is reflected in the fact that banks in Israel control about 80% of the mutual fund industry (with the two largest banks controlling about 70%), more than 90% of the provident fund industry (with the two largest banks controlling about 75%), and obviously controlling the credit and loan industry, as well as a very strong presence in the underwriting and portfolio management industries. This list, which is even longer than stated here - especially since the banks advise the public and de-facto distribute their own products in this process, represents the conflict of interests the banks experience day in and day out.



The problem of potential conflict of interests is not experienced only by the banks; however, what sets them apart is the lethal combination between centralized holdings in most of the capital markets industries and the power derived from that, and the conflict of interests. Once these two factors are put to work together, there are real and actual implications not only for

specific clients, but also for the entire market. It is enough to recall the share regulation by the banks in the 80's and the credit they provided the public with in order to buy their own mutual funds in the 90's.

The power of the banks did not encourage the formation of non-banking entities, and prevented the competition that consumers deserve.

The abovementioned has been the background and basis for the formation of the Bachar Committee and its recommendations, which have undergone significant changes due to political pressures. The legislation (3 laws) has been enacted by the Israeli parliament and will be effective as of 11/05.

The Bachar Reform, despite its limitations, will fundamentally change the landscape of the Israeli capital markets, creating a new reality.

The new legislation requires that the banks sell within 3 years (the two largest banks) to 6 years (all the rest of the banks) their ownership of provident fund companies, and within 4 to 8 years respectively, their mutual fund management companies, with intermediate steps in the interim.

In addition, the legislation has set a fixed and uniform distribution fee, to be paid to the banks by every fund manager in order to prevent discrimination/preference of any of these fund managers by the banks.

Under this structure, the banks' consultants will eventually become unbiased and independent consultants once the banks no longer own mutual and provident funds.

The question remains: who will be the new owners of these mutual and provident funds? The answer: the natural candidates to purchase these assets from the banks are insurance companies, investment companies, private investment houses, foreign investment

houses, and, of course cooperations and joint ventures between some of these potential buyers for the purpose of purchasing these assets.

We can get a first indication to how such deals may look like from the purchase of control of the Leumi Pia mutual fund

company by Harel Insurance.

This deal only emphasizes one of the greatest concerns the Bachar-Reform gave rise to - that instead of the current situation of centralized holdings, represented by the control of two big banks in the capital markets, we will find a new centralized holding landscape, this time by two-three large insurance companies, which might be even worse. In order to address this concern, legislation has set a maximum in market share any buyer can reach through acquisition of assets (versus internal growth). In any case, and despite the great concerns, the Bachar Reform is leading the Israeli capital markets to a major revolution:

- It will increase the competition in the market, which will be

based on performance, quality of service and reliability.

- It will also increase innovative competition in the sense of creating and providing new and innovative products to the market.
- It will increase the number of significant players on the capital markets, adding insurance companies, foreign investment houses and local private investment houses.
- It will increase the amount of assets managed in the mutual fund industry, bringing those closer to international standards.

All these, and more, promise a more competitive and vibrant market which will better serve the interests of the consumers.

Transport and Aviation in Israel

Public Private Partnership

Transportation is an important tier in economics. It provides the physical and logistical connection between various industries, various geographical areas and of course, between countries. The importance of transportation became clearer after WW2, when globalization and the concept of open borders began to gather momentum.

In those countries with a good infrastructure of air, sea and land transportation, we are witness to proper population distribution. In Israel, we have a good example of the opposite situation; a lack of the appropriate transportation infrastructure has caused a massive population concentration in the center of the country, while the Negev and Galilee regions are populated very sparsely. Proper transport infrastructure triggers a proper distribution of factories and companies, which results in a more balanced economy for the country.

Inter-country links reinforce the economic relations between countries as well as peaceful relationships. When Israel signed peace treaties with Egypt and Jordan, the first links that were set up were for transport – the air routes.

Quite a few examples exist where transportation infrastructure served as the basis for structural, economic and demographic change in countries. A classic example of economic development of an area is the Silicon Valley in California, USA. The Silicon Valley provided transport infrastructure (ground and air) as well as energy and communications infrastructures, all of which encouraged the area's fast development. Another example is the German Unification; the first thing that was done after the decision to unify was taken, was to connect the transport infrastructure of the two sectors – a process subsequently recognized as very successful.

As a result of Israel's geopolitical situation, sea and air transport represent a vital link in the connection with the "global village", a world without borders. In a sense, from a transportation point of view, Israel can be described as an island. This fact reinforces the importance of air transportation.

The entire region in which Israel lies is also characterized by

a lack of ground transportation. The transportation infrastructure is largely characterized by long North-South road arteries, something that is similarly true for the limited rail infrastructure, such as it is. For this reason as well, the aviation industry in Israel and the region is extremely important.

The most important product of transport is time. Transport enables consumers to move from point to point in the shortest possible time. In an examination of the domestic aviation situation, taking into consideration that Israel is a small country, we note the circumstances where competition exists between air and ground transportation. Northern Israel is a good example of the change that has come about in domestic air transport: Ever since the road system between the center and the north of the country was improved (Nahal Iron road, the Trans-Israel Highway and more recently, the substantial improvement in Israel Railways) most passengers have moved to ground transportation. This caused a major drop in the use of air transportation to Northern Israel. Under the present circumstances, Israel's domestic aviation is largely based on air services between the center of the country and Eilat; a situation that is also likely to change when the rail links between the center and the south are laid.

Contrary to the domestic aviation situation, regional air services are of fundamental importance, not to mention the absolutely vital importance of international aviation links. At a regional level, with our sparse ground transport links, we are witness to a situation where the best connections between Israel and Jordan and Egypt are by air. Internationally too, the main link between Israel and the rest of the world is by air.

Ben Gurion International Airport, Israel's primary international port of entry, is of the highest possible standards and has the appropriate infrastructure to serve the State of Israel's needs. Over 50 scheduled airlines, and a similar number of charter



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