



## Bank Leumi: Family battles for control of Israel's biggest bank

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Wednesday, December 01, 2010

**Bank Leumi might soon have a new owner. But as the government sells its controlling stake in Israel's biggest bank, Leumi might instead be left without any controlling shareholder. Dominic O'Neill questions the finance minister and central bank over the role of Israel's banking tycoons.**

ISRAEL ELIAHU IS hoping to enhance his company's position in Israel's banking market. "The sale of the government's share will pave the way [for us] to put together a controlling-interest group [in Leumi]," the chief executive of Shlomo Eliahu Holdings says, during a lunch with *Euromoney*. Shlomo Eliahu Holdings, whose chairman, Shlomo Eliahu, is Israel Eliahu's father, is already the largest private shareholder in Leumi, Israel's biggest and oldest bank, with a 9.59% stake.

The government retains a controlling stake of 11.5% in Leumi – the legacy of a banking crisis in the 1980s – but in November finance minister Yuval Steinitz told *Euromoney* that the remaining shares "will be sold in the next few months".

"My goal is to sell as soon as possible with a good price," says Steinitz. "There is no preference for this or that group." However, he says the shares will probably be sold to an investment bank for widespread distribution – rather than in a block to a group aiming to gain the 20% needed for a privately held controlling stake. Steinitz says this method of market distribution worked well in the staggered sales between January and October this year of the government's remaining 25% holding in Discount Bank, Israel's third-biggest lender.

Deutsche Bank, UBS and Citi bought and distributed stakes in Discount, respectively of 5%, 8.33%, and 11.69%, in January, July and October. Steinitz says no bank has yet been mandated for the Leumi sale. But a senior Tel Aviv-based investment banker at a global firm says pitching has already begun for the deal.

The difference between the Discount disposal and the sale of the government's last shares in Leumi, however, is that Discount already had a private controlling shareholder. The Bronfman-Schron group, led by US businessman Matthew Bronfman, bought 26% of Discount from the government five years ago.

Israel Eliahu shows *Euromoney* a document arguing why Leumi should become, under its new controlling owners, "an essential channel for the export of financial services to foreign markets", helping further Israel's already strong technology export industry into financial technology and structuring. He says that although foreign acquisitions would not be a goal in the short term, "Leumi's market share in Israel is 30%. It can only achieve growth abroad, and the main edge we have is in technology."

Eliahu says his family is in advanced discussions with potential members of a controlling group for Leumi. He says the family is still looking for partners, as it would prefer a group able to buy more than the 20% minimum. Eliahu hopes to find foreign groups that could contribute to Leumi's future as an international provider of financial technology. "We hope to ask for Bank of Israel's permission to take control of Leumi at the beginning of next year," he says.

However, it is widely rumoured in Tel Aviv's financial community that Bank of Israel opposes the approval of any potential Eliahu-led request for regulatory permission to gain control.

A common view is that this has a lot to do with Shlomo Eliahu's combative reputation. A January article in Israeli newspaper Ha'aretz, for example, tells of a court dispute between the Eliahu group and fellow members of the controlling group of Bank Igud, Israel's sixth-biggest lender, over the appointment of the bank's chief executive. Israel Eliahu does not deny bad relations within Bank Igud's control group.

"My father is a self-made man, so he's very dominant," says the chief executive. But he adds: "He's very cooperative." He describes the Eliahus as being far from wealthy when they arrived from Iraq, to an Israeli transit camp, shortly after the post-war creation of Israel. He says his father worked first as a messenger at Migdal, one of Israel's oldest insurance groups.

Jews of European, not Middle Eastern or North African, descent have long tended to dominate Israel's elite. Israel Eliahu, whose mother emigrated from France, describes how his father went on to win a place at the top of Israeli society, earning millions with Eliahu Insurance, which he set up in 1966.

But one bank analyst still describes Shlomo Eliahu as something of an outsider to the Israeli financial establishment – someone who is impatient with the requisite politicking. Indeed, earlier this year, according to Ha'aretz, Eliahu took the finance ministry to court in an attempt to force the sale of the government's remaining shares in Leumi (Israel's high court turned down the petition in September).

Eliahu also lost a battle to have former Bank of Israel governor David Klein appointed as Leumi's chairman this year after Eitan Raff came to the end of his 15-year stint. (Leumi chief executive Galia Maor also bid for the position and had to back down because of rules against bank executives becoming directors without a two-year break.)

### Tycoon on the line

"It is not true Bank of Israel doesn't want [Shlomo Eliahu] to own the bank," says Israel's banking supervisor, Rony Hizkiyahu. "We would not approve control of a bank before we had checked the nature of the group, the agreement within it, and many other factors. We have had a number of informal requests to form a control group. We explain the process, what is needed. From there they have to decide whether they can meet the criteria, whether to go through the approval process. So far no one has applied formally. They may be waiting for the government to sell before formally making a request."

However, Hizkiyahu warns potential bidders: "My recommendation is to be confidential – don't go through the media." Hizkiyahu further points out that the chances of gaining a controlling stake in Leumi have deteriorated as the government is now selling only 10.5% to outside investors (1% of the government's remaining 11.5% will be sold to Leumi employees).

In 2005 US hedge funds Cerberus and Gabriel bought 9.99% of Leumi's shares from the government, gaining an option to buy another 10.1% from the state, conditional on the funds' control of the bank being approved by Bank of Israel. In 2007 the deadline for approval expired, and the following year the funds were forced to sell their share after Gabriel lost money in the Madoff scam (5% was dispersed in the market; the rest went to Canadian-Israeli investor David Azrieli).

"A number of factors have reduced the chances that Leumi will be purchased by a control group in the coming months," says Hizkiyahu. He acknowledges, for example, that the creation of a government committee this year to address the economic power of local business conglomerates could be a sign that a controlling shareholder for Leumi will be less highly sought after.

But he says: "From our side there's no preference for a bank to be with or without a controlling stake." This seems to contrast with the previous state of affairs. For example, the Jerusalem Post quoted the finance ministry as saying in December 2007: "The finance ministry and Bank of Israel have decided to make every effort to bring about the creation of a controlling shareholder for [Leumi]."

But in 2008 Hapoalim, previously the country's biggest bank – and controlled by Israel's richest woman, Shari Arison – posted a \$235 million loss, in large part thanks to investment in US mortgage-backed securities. Hapoalim's greater exposure to risky international markets compared with the more risk-averse Leumi might have caused the Israeli authorities to rely less on the idea, for example, that entrepreneurs might have the strength to force commercial bankers to focus on longer-term returns.

Arison's highly publicized reluctance to replace former Hapoalim chairman Danny Dankner at the request of Bank of Israel in 2009 would not have helped the case for controlling stakes either. Similarly, some analysts suspect that the Bronfman-Schron group was slow to agree to a rights issue by Discount Bank for NIS400 million (\$110 million) this year. Discount Bank chairman Yossi Bachar tells *Euromoney* the control group was happy to inject capital, however. He says the only delay was in getting regulatory approval in the US (Discount has a US subsidiary).



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Holdings

#### Return of the state?

When the prospect arose that Leumi would end up without a controlling shareholder, Hizkiyahu says the Bank of Israel suggested a legal amendment to what is known as the Marani law – "to ensure the bank can function and elect board members," as he says. As before, holders of stakes above a certain percentage will be able to recommend board members to the general assembly. But the amendment – which was going through the Israeli parliament as *Euromoney* went to press – would allow for the creation of a committee, which would also be able to recommend directors.

"Without the committee, if none of the shareholders come and bring candidates, we could end up without any candidates," explains Hizkiyahu.

Hizkiyahu says various government and regulatory authorities including the central bank would probably nominate this committee. But he denies that it means that Leumi will essentially remain under state control. "The government will not be able to vote at the general assembly. The committee will have no voting rights," he says.

Nevertheless, one analyst points out that all three of Israel's biggest banks have had new chairmen over the past year and a half. And the new appointees have all been former state treasury officials. The reason, says the analyst, is that the regulatory authorities are trying to gain greater control over an already closely monitored banking sector.

Bank of Israel has to approve board members and even certain senior executives of banks. Hizkiyahu says this is because of the prevalence of controlling minority stakes, which might otherwise lead to an abuse of the system. "With a 25% stake an owner could take 100% of the risk," he says. Whether such requirements will lapse in the absence of controlling shareholders remains to be seen.

But other banks too could end up without controlling shareholders, especially if the somewhat populist post-crisis backlash against Israel's business conglomerates persists.

The Bronfman-Schron group has long been rumoured to be looking to sell its stake in Discount Bank, although just over a year ago the group denied that it intended to do so. In October Arison sold 3% of Hapoalim through Citi and local investment firm IBI, for a total of \$182 million – although again, just over a year ago, she had told *Reuters* that she planned to retain control of the bank.

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