BANK LEUMI LE-ISRAEL B.M. AND SUBSIDIARIES AND AFFILIATES

Annual Report 2007

Bank Leumi le-Israel B.M. Head Office: 34 Yehuda Halevi Street, Tel Aviv 65546, Israel

The Bank has received the consent of the Supervisor of Banks to the publication of the annual financial report on a consolidated basis only, with condensed statements of the Bank (not consolidated) in Note 30 to the Financial Statements.
The figures of the Bank alone are available on request from the offices of the Bank at 34 Yehuda Halevi Street, Tel Aviv or on its website: www.bankleumi.com.
This is a translation from the Hebrew and has been prepared for convenience only. In the case of any discrepancy, the Hebrew will prevail.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Annual Report 2007

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Board of Directors

Eitan Raff, Chairman

Doron Cohen

Meir Dayan

Moshe Dovrat[1]

Zipora Gal Yam

Prof. Arieh Gans

Prof. Israel Gilead

Yaacov Goldman, C.P.A. (Isr.)

Rami Avraham Guzman

Zvi Koren

Adv. Jacob Mashaal

Vered Raichman

Prof. Efraim Sadka

Nurit Segal

Moshe Vidman

[1] Elected on 20 May 2007.
Mr. S. Yanai served as a Director until 18 February 2007.

Members of Management and their Positions

Galia Maor
President and Chief Executive Officer

Zeev Nahari, C.P.A. (Isr.)
Senior Deputy Chief Executive Officer, Acting CEO in the absence of the President and CEO
Chief Financial Officer, Head of Finance, Accounting and Capital Markets
Head of Finance and Economics Division, Manager of Market Risks

Gideon Altman [1]
Acting Head of Commercial Banking Division

David Bar Lev
First Executive Vice President, Head of Human Resources

Adv. Nahum Bitterman
First Executive Vice President, Chief Legal Advisor, Head of Legal Division, Manager of Legal Risks

Zvi Itskovitch
First Executive Vice President, Head of International and Private Banking Division

Baruch Lederman[2]
First Executive Vice President, Head of Banking Division

Itzhak Malach
First Executive Vice President, Head of Operations, Information Systems and Administration, Manager of Operating Risks

Rakefet Russak-Aminoach, C.P.A. (Isr.)
First Executive Vice President, Head of Corporate Division, Manager of Credit Risks

Menachem Schwartz, C.P.A. (Isr.)
Executive Vice President, Chief Accounting Officer, Head of Accounting

Prof. Daniel Tsiddon
Executive Vice President, Head of Capital Markets Division

Joseph Horowitz
First Executive Vice President, Chief Internal Auditor, Head of Internal Audit Division

Adv. Jennifer Janes
Executive Vice President, Group Secretary

Kost Forer Gabbay & Kasierer, Certified Public Accountants (Isr.)
Somekh Chaikin, Certified Public Accountants (Isr.)
Joint Auditors of the Bank

[1] Appointed Acting Head of the Commercial Banking Division as of 1 January 2008. Until 31 December 2007, Michael Bar-Haim served as a Member of Management and Head of the Commercial Banking Division.
[2] Appointed Member of Management and Head of the Banking Division as of 1 October 2007. Until 30 September 2007, Yona Fogel served as a Member of Management and Head of the Banking Division.

Bank Leumi le-Israel B.M. and Subsidiaries and Affiliates

Directors' Report

The following is the fifty-seventh annual report of Bank Leumi le-Israel B.M. and the one hundred and sixth report of the business founded in 1902. This report will be presented to the Bank's fifty-seventh Annual General Meeting. This report is based on an analysis of the data included in the Bank's Financial Statements and Management Review, and upon additional data as required.

B. General Developments in the Group's Business

Description of the Leumi Group's Business Activities and their General Development

Bank Leumi and its subsidiary companies constitute one of the largest banking groups in Israel, continuing activities that began 106 years ago. The Bank's predecessor, The Anglo Palestine Company, was established in London in 1902 by Otsar Hityashvuth HaYehudim Jewish Colonial Trust Limited, the predecessor of Otsar Hityashvuth HaYehudim B.M.[1]

The Bank is defined as a banking corporation under the Banking (Licensing) Law, 1981, and holds a banking license under that law. As a "bank" and a "banking corporation" the Bank's activities are governed and delineated by a system of laws, orders and regulations, including *inter alia* the Banking Ordinance, the Bank of Israel Law, the Banking (Licensing) Law and the Banking (Service to Customer) Law, as well as directives, rules, instructions and position papers of the Supervisor of Banks.

The Leumi Group is involved in a variety of banking, financial and non-banking activities, in Israel and overseas. The Group's activities are carried out through the Bank, subsidiary companies and companies included on the equity basis, through 242 branches located throughout Israel, and through 86 branches, agencies and representative offices in 21 countries throughout the world.

The Group's policy, in Israel and overseas, is to provide comprehensive banking and financial solutions to its customers and a high level of professional service, to enable them to make use of varied distribution channels and to offer them a wide variety of products, adapted to their needs.

As a leading banking group, aiming to achieve high levels of long-term profitability, Leumi constantly scrutinizes the trends and changes in the business environment in which it operates and formulates strategies to deal with these changes.

To implement its strategy, the Bank is organized into five business lines, concentrating on different market segments, with each business line specializing in providing banking and financial services to a particular customer segment:
Corporate banking concentrates on servicing major and international companies, commercial banking concentrates on servicing middle market companies, international and private banking is aimed at wealthy customers requiring investment solutions at a highly sophisticated level, retail banking concentrates on providing banking services mainly to households and small businesses, the Capital Markets Division and Financial Management coordinates the activities of all the dealing rooms and the nostro within one division, with a view to improving and widening the range of services to customers active in the capital and financial markets, including institutional customers.

Some of the financial services are provided by means of subsidiary companies and/or companies included on the equity basis that operate in various fields, such as: credit cards, mortgages and underwriting.

[1] Otsar Hityashvuth HaYehudim B.M. was the controlling shareholder of the Bank until the equalization of voting rights in the Bank in 1991. In 1993, most of the shares of the Bank passed to the ownership of the State, under the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993. On 3 September 2007, the company ceased to be an interested person in the Bank.

Further, the Group invests in non-banking corporations operating in the fields of insurance, infrastructure, Israeli and overseas real estate, communications and the media, energy, shipping and the chemical industry.

In August 2005, the Knesset (the Israeli parliament) passed a number of laws to implement a reform of the Israeli capital market, having a significant effect on both the banking system in general and on the activities of the Leumi Group in particular. These effects are reflected in the results of the Group commencing from 2006.

As a result of the reform, the Group was required to dispose of its holdings in its mutual fund and provident fund management companies, and to reduce its holdings in additional companies, such as insurance companies. Therefore, beginning in 2006, the Bank sold its provident funds, mutual funds and investment portfolio management activities. In addition, as a result of the reform and of other limits imposed by the Banking (Licensing) Law on the holdings of banking corporations in conglomerates, the Bank sold its holdings in Africa Israel Investments Ltd., and 10% out of its holdings in Migdal Insurance and Financial Holdings Ltd. The Bank is required to complete the sale of its remaining holdings in Migdal by 30 June 2008, as well as the sale of an additional real (non-banking) investment, as described on pages 133-134 of the Report.

In 2007, the Bank completed the sale of its remaining provident funds to Prisma Provident Funds Ltd. and the sale of the supplementary training funds to Migdal Capital Markets (1965) Ltd.

The consideration for the sales in 2007 amounted to NIS 568 million, and the net profit was some NIS 348 million. The net profit from the sales carried out in 2006 in compliance with the capital market reform provisions and due to restrictions imposed of the Banking (Licensing) Law amounted to NIS 2,078 million.

For additional details regarding the sales, see page 160 of the Report.

Following the reform, the Group's capital market activities in Israel are focused mainly on the provision of investment counseling, on the distribution of mutual funds, provident funds and supplementary training funds, on pension counseling, when the Bank receives a license to engage in such activities, and on the provision of operating services to entities active in the capital market.

Following the legislation and the reform of the capital and financial markets and against the background of the improvement in the economic situation, changes are occurring in the business paradigm of the banking system.

These changes find expression in a number of areas:

- The continuation of the movement of customers into capital market activities.
- The expansion of the financing of business customers in the economy through raising funds in the capital market and through non-banking entities.
- Increased movement between investments in Israel and abroad, following completion of the capital market tax reform.
- Increased competition following the changes in the ownership of the banks and the entry of new elements into the capital and money markets.
- The removal of the production of some capital market products from the banking system to other market players and the entry of new players into the sector, with preferential legislation in their favor.
- The gradual entry of the banks into the distribution of pension products and accompanying insurance products, as the legal situation permits.

For further details on the effect of the capital market reform and the sale of holdings by the Group, see pages 30-36 below.

On the basis of banking system data as of 30 September 2007, as published by the Bank of Israel, the Leumi Group's market share in relation to the Israeli banking system was as follows:

	30.9.2007	31.12.2006	31.12.2005	31.12.2004	31.12.2003
	In percentages				
Total assets	**30.0**	30.2	30.2	30.0	29.8
Credit to the public	**30.2**	29.9	30.3	29.9	30.0
Deposits from the public	**30.1**	30.6	30.5	30.3	30.2
Operating profit before taxes	**35.8**	27.7*	30.4	34.0	32.0
Operating profit after taxes	**36.7**	25.8*	30.7	34.1	31.7

* The decrease in the Bank's share arises mainly from exceptional salary expenses, some half of which was the result of the privatization in 2006, as detailed on page 58 of the Report.

The Leumi Group operates in a competitive market in all its activity segments. The main competitors are the other Israeli banks, although in certain segments there are additional competitors whose numbers are constantly growing, such as overseas banks, insurance companies and other institutional entities.

The market conditions and the legislation on the reform of the capital market have led to increased competition in a number of important areas:

- Private customers, with emphasis on high income customers and customers with extensive financial assets;
- Activity in the capital market, particularly in the fields of mutual funds and provident funds;
- Recruiting salary-earning household customers, accompanied by price competition both for current account management and in offering attractive terms for deposits and credit products;
- Technological developments for streamlining customers' activity through direct channels, and as the basis for expanding distribution channels;
- Development and distribution of sophisticated financial products, such as various types of structured products.
- Provision of credit to business customers, including non-bank financing.
- Competition in the mortgage market.
- Competition in recruiting professional personnel.

During 2007, and especially during the second half of the year, the American mortgage market experienced a series of shocks. This occurred especially in its weakest segment, the sub-prime sector. These loans, on the basis of which complex financial instruments were constructed, led to a revaluation of these instruments by the large banks in the United States and in additional countries throughout the world and substantial losses were consequently recorded. Given this situation, a liquidity problem developed in the European and American banking systems, which necessitated the involvement of the central banks in the United States and Europe. In the US, the central bank also reduced interest rates significantly, both in order to reduce the negative impact of the financial crisis on economic activity, and because to prevent a recession. The main impact of this crisis on Israel derives from the expected slowdown in economic activity throughout the world and primarily in the United States.
As of the publication of the Report, the impact on the Leumi Group is not material. For additional details, see Note 3 to the Financial Statement and pages 82-85 of the Report.

Against the background of the improvement in the economic situation in Israel, the Leumi Group continued to extend its activities both in Israel and abroad in 2007.

Total assets under management of the Group (both balance sheet and off-balance sheet*) amounted to NIS 764 billion, as compared with NIS 695 billion at the end of 2006, an increase of some 9.9%.

The continued recovery in economic activity which started in the second half of 2003 brought about a decrease in the volume of provisions for doubtful debts, together with an improvement in net interest income and in operating income, despite the decrease in income from mutual funds and provident funds.

The Group’s net operating profit was affected by an increase in the Bank’s income and the improved profitability of a number of subsidiaries in Israel and abroad, and by a reduction in special salary expenses related to the Bank’s

* Total assets and customers' securities portfolios, the value of securities held in custody for mutual funds, provident funds and supplementary training funds for which operational management and custodial services are provided.

privatization and to certain employment-related provisions especially in 2006, as detailed on page 58 of the Report. On the other hand, the profits of the overseas subsidiaries were adversely affected due to the appreciation of the shekel against the foreign currencies, mainly the US dollar.

The net operating profit of the Group totaled NIS 2,984 million in 2007, as compared with NIS 1,454 million in 2006, an increase of 105.2%. After neutralizing special salary expenses, net operating profit increased by 51.1%.

The net profit of the Group totaled NIS 3,357 million, a decrease of 5.0% as compared with 2006. The decrease in the Group's net profit from extraordinary items derived mainly from the sale of the last of the Bank's provident fund and supplementary training fund activities, in contrast to the income from the sale of non-banking (real) holdings and from the sale of the capital market activities in 2006, as detailed on pages 133-134 and 160 below.

Return on equity of net profit reached 17.4%, compared with 20.1% in 2006 (after neutralizing special salary expenses, there was a decrease in the net profit of 15.5%, and a return on equity of 18.2%).

The net profit per share in 2007 was NIS 2.37, compared with NIS 2.50 in 2006. The dividend per share in 2007 was NIS 1.0 per share, as compared with NIS 1.768 per share in 2006.

On 30 March 2008, the Board of Directors proposed an additional dividend for 2007, of some NIS 0.18 per share (some NIS 270 million) (on the basis of the issued share capital as of 10 March 2008) subject to the approval of the General Meeting.

Diagram To Be Inserted – Separate document in powerpoint - page 9

The following table sets out a breakdown of the investments and the contribution of profit centers in the Group to net operating profit:

	2007			2006		
	Scope of Investment	**Contribution to Net Profit**		Scope of Investment	Contribution to Net Profit	
		(1)	**(2)**		(1)	(2)
	NIS billions	**In percentages**		NIS billions	In percentages	
The Bank	**8.7**	**64.8**	**71.3**	5.9	52.3	59.0
Subsidiary companies in Israel	**5.2**	**23.8**	**23.8**	6.1	25.0	25.0
Overseas subsidiary companies	**4.4**	**7.4**	**0.9**	4.4	10.8	4.1
Non-banking companies	**1.2**	**4.0**	**4.0**	1.1	11.9	11.9
Total	**19.5**	**100%**	**100%**	17.5	100%	100%

(1) After neutralizing the effect of exchange rate differentials at the Bank and the foreign subsidiaries in respect of the financing of overseas investments.
(2) According to the Financial Statements (without neutralizing the effect of exchange differentials).

Business Strategy

Leumi's Vision

The Leumi Group has formulated a multi-year business strategy, which is based on Leumi's vision:

- To be the most profitable banking group in Israel in the long-term.
- To be an international Israeli banking group.
- To be a group that provides the highest level of added value to its customers; to be innovative and to demonstrate initiative adapted to its customers' needs.
- To be the first choice of its employees, by being a solid and stable work-place that cares for its human resources and remunerates in accordance with contribution.
- To be a banking group that continually strives to maximize value for its shareholders.
- To be a banking group that is involved in and contributes to the welfare of the community, with an emphasis on the generation of the future.

Part of the information in this chapter is "forward looking information". For the meaning of this term, see the section "Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report" on pages 43 below.

Background Conditions

Changes in the business environment

In recent years there have been many changes in the business environment, which necessitated the adaptation of strategy. These changes include increased competition, the capital market reform, regulation and the global activities of the Bank’s customers.

Increased competition

In the banking system: The privatization and changes in the ownership of banks, and the renewal and expansion of the activities of overseas banks in Israel, serve to increase competition between the banks. In addition, regulation supports the reduction of the strength of the large banks and creates “affirmative action” mechanisms that favor small and medium-sized banks. In addition, new players may enter the banking field, including the Postal Bank and internet banks.

***Vis-a-vis* insurance companies and pension funds**: The reduction of State involvement in pensions, by way of the sale of the pension funds and the down-sizing of the designated debentures market, together with the expected strengthening of the insurance companies following their purchases of the provident and mutual funds, have made the insurance companies into the banks’ competitors in the fields of credit and the capital market. These entities are subject to lower regulatory requirements and less stringent supervision, in comparison with those applied to on the banking system.

Institutional entities will continue to constitute a source of financing for (primarily long-term) business/commercial credit, and will increase their involvement in the capital market and in the field of brokerage.

***Vis-a-vis* investment houses**: The new legislation expands the spheres and volume of activity of the private investment houses and similar entities in many fields that overlap with banking activities, and thus increases competition with them in the wealthy customer sector, and also in the raising of non-banking financing. These entities also benefit from lower supervisory and regulatory requirements in comparison with those applied to the banking system.

Increased regulation

Regulation in Israel: In recent years, there has been an increase in the involvement of regulatory bodies in various activities of the banking system, such as the Capital Markets, Insurance and Savings Department of the Ministry of Finance, the Banking Supervision Department, the Antitrust General Director and the Israel Securities Authority, as well as Knesset members’ who have presented private members bills.

The increased regulation has created a heavy expense burden in addition to administrative costs required for meticulous preparation for and compliance with these regulatory requirements.

Worldwide regulation: Beside the local regulatory activities, the banks are also affected by global regulation. The local regulation lines-up with international treaties and provisions, such as the "Basel II" directives, IFRS, the Sarbanes-Oxley Act, etc., some of which apply specifically to banks and some of which to all business organizations. The increased uniformity of international regulation increases competition in the financial markets.

Globalization and international competition

Notwithstanding the growth of the Israeli economy in recent years, it is still a comparatively small economy. This, together with the development of the Israeli entrepreneur's ability to act in overseas markets, causes high caliber Israeli companies to expand their overseas activities. At the same time, the increased uniformity in the regulatory requirements in Europe, and in particular the progress towards the adoption of the "Basel II" rules, combined with the entry of international banks into Israel, is expected to increase the competition with overseas banks for the Israeli customer operating in those markets, and will enable those banks to finance customers of the Bank overseas and also to develop activities with them in Israel.

Leumi's Strategy

In order to realize Leumi's vision of being the leading bank in Israel in terms of long-term profitability, and in accordance with the changes in the business environment, the Leumi Group has set multi-year goals for increasing shareholder value through improved profitability, in both local and international activities. The improved profitability will be sought while managing the risk levels as presently reflected in the capital adequacy ratios and in the risk management policy carried out in the Group and described below.

Although Leumi strives to adapt its activities to its strategy, and to achieve excellence in all of the areas described above, strategic planning, by its nature, involves a not insignificant amount of uncertainty. Actualization of strategic planning depends on many variables, including: the economic situation in Israel and abroad, including changes in the growth rate especially against the background of the effects of the sub-prime crisis, the security situation, employment relations within the Group, regulatory changes and the ongoing effects of regulatory changes, whose possible scope in the long term cannot yet be definitely defined.

In addition, Leumi is currently undergoing a privatization process, as detailed below. Should the privatization process be completed, and a new controlling entity be determined, this might also lead to changes in emphasis and in the strategy of the Group.

During 2007, the Leumi Group achieved its long-term goal – to become the most profitable banking group in Israel. Preserving this achievement is a challenge, in light of increased competition, regulatory challenges and the processes occurring in the international markets.

In order to ensure continued growth and profitability in the long-term, Leumi is focusing its strategic efforts and its capital resources - human and administrative - on business areas that produce high yields and/or require relatively little capital. At the same time, it is improving profits in areas with low levels of profitability. Additionally, Leumi is investing in building-up its abilities in order to ensure good results in the long-term.

Leumi's strategy therefore rests on three pillars –

1. **Overseas development**
   In order to continue to show high rates of growth and profits while providing a solution to the loss of income resulting from the sale of its local capital market companies, Leumi is continuing to strive for growth in its international activity by leveraging the Bank's strengths – the strong customer base in Israel, a market share of some 30%, its existing geographic distribution – by intensifying support for corporate and commercial customers in their international operations abroad and by servicing wealthy overseas clients. Leumi seeks to achieve this expansion both through organic growth and through the acquisition of operations in complementary areas. Additionally, opportunities for investment in foreign financial institutions will be examined.

2. **Focusing growth on the local market**

   - Recruitment of clients and increasing the Bank's share in high yield areas, especially areas in which the Bank's market share is relatively low; and increasing profitability in sectors in which yields are unsatisfactory, by increasing customers' use of direct channels, among other things;
   - Continued preparation for and engagement in pension counseling and financial planning, as allowed by the legislation;
   - Expansion of nostro and trading room activity.

3. **Consolidating and strengthening organizational infrastructures in various areas**

   - Human resources – improving the Bank's ability to recruit and retain professional employees, and support for future personnel requirements in all the lines of business;
   - Applying technology to achieving the Group's goals – adapting technology to the strategic needs of the Bank and the Group.
   - Increasing operational excellence **–** increasing the correlation between strategic planning and business processes, with special emphasis on strategic discipline and its measurement.

- Intensifying cooperation and participation in the Group’s abilities and know-how – intensifiying the synergy and collaboration between the Bank's various units and the various subsidiaries in Israel and abroad, to leverage improved business activity.
- Improving Leumi’s external relations – promoting social responsibility to the community, and relationships with elements outside of the organization and of the Group.

The strategy is implemented alongside the maintenance of desired risk levels, the use of advanced tools and procedures for the management of different types of risks, and the completion of preparations for the regulatory requirements, including those of Basel II.

The above-mentioned Group objectives have been adjusted to the various lines of business in which Leumi operates and which are described below. Each line of business specializes in a particular market sector and its purpose is to create a comparative advantage in relation to its targeted market.

It should be taken into account that the Bank is currently in an advanced stage of privatization, and near completion of the sale of the controlling core, as detailed below. If this process is successfully completed, changes are likely to be made in the goals of the Group and the above-mentioned points of strategic emphasis.

Part of the information in this chapter is "forward looking information". For the meaning of this term, see the section "Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report" on page 43 below.

Control of the Bank

On 31 December 2007 the State of Israel held 11.94% of the issued share capital of the Bank (fully diluted - 11.26%) and 19.78% of the voting rights in the Bank (fully diluted – 18.66%). On 10 March 2008, the State held 11.56% of the issued share capital of the Bank (fully diluted – 11.27%) and 19.15% of the voting rights in the Bank (fully diluted – 18.67%).

Sale of Shares in the Bank by the State

On 15 November 2005, the Bank was informed by M.I. Holdings Ltd. ("MIH") that, further to the procedure for the sale of up to 20% of the shares of the Bank held by the State, which was published by the Accountant-General of the Ministry of Finance and MIH on 14 September 2005, Barnea Investments B.V. ("Barnea") had been chosen as the preferred bidder. Barnea was incorporated in the Netherlands, and is a wholly owned subsidiary of Barnea S.A.R.L., which was incorporated in Luxembourg, and which is held jointly and indirectly by Stephen Feinberg and Ezra Merkin, through the Cerberus and Gabriel private investment fund groups which are controlled by Mr. Feinberg and Mr. Merkin respectively.

The sale was completed on 24 November 2005 (the "Closing Date"), when Barnea paid some NIS 2.474 billion for 9.99% of the Bank’s share capital (NIS 17.51 per share), together with interest, a total of some NIS 2.475 billion.

Of the shares purchased, shares representing 4.99% of the Bank's share capital are being held in trust and Barnea and the trustee have signed a power of attorney empowering the committee appointed pursuant to Section 12 of the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993 (the "Committee"), including whoever succeeds it in this capacity, as provided under the said Law, or any other person whom the Minister of Finance shall empower, to (1) participate and vote at all meetings of the Bank by virtue of the said shares and (2) to exercise the right to appoint directors in the Bank with respect to all the shares of the Bank held by Barnea.

The government also granted Barnea an option to purchase a further 10.01% of the capital of the Bank, pursuant to the provisions of the option agreement signed between the government, MIH and Barnea on 23 November 2005 (the "Option Agreement"), and conditional, *inter alia*, on their having obtained all necessary permits from the Bank of Israel and the other relevant supervisory bodies in Israel and overseas for the purchase of the shares and control of the Bank. The option, which took effect from the Closing Date, was exercisable 180 days after the Closing Date, subject to an extension of up to an additional 12 months under certain conditions. On 24 May 2006, MIH advised the Bank that, on the same day, an application had been received from Barnea requesting the extension of the exercise period of the said option for an additional 12 months, until 24 May 2007, and that in said application, Barnea stated, *inter alia,* that they had filed a request with the Bank of Israel for a permit to control the Bank. On 6 July 2006, the Bank was notified that the date for the exercise of the option had been deferred to 24 May 2007.

On 21 May 2007, the Bank was advised by MIH that Barnea's application for an additional extension of the exercise period of the option had not been granted.

The option therefore expired on 24 May 2007. According to the conditions of the sale procedure, Barnea is required to sell at least 4.99% of the shares of the Bank (of the 9.99% that it purchased) within a year.

Following the expiration of the option, MIH notified the Bank's Management, at a meeting held in August 2007, that the Ministry of Finance intends to continue the privatization of the Bank through one of two methods: sale of the balance of the shares to an international banking institution through an investment bank, or the sale of the balance of the shares in one or more private bloc sales, the preferred method being a sale to a foreign banking institution. MIH and the Ministry of Finance have chosen N.M. Rothschild & Sons Ltd. to serve as a consultant for advancing this method.

For details regarding the issue of options to employees see pages 20-21.

Description of Operational Segments

The Bank in Israel is organized into five business lines, operated though five divisions of the Bank, each headed by a member of the Management of the Bank. Each business line specializes in the provision of service to segments of customers with similar characteristics and needs. This specialization allows for the provision of a high level of professional service. In addition, there are a number of management units that provide various services to the business divisions.

The subsidiary companies in Israel and abroad have been assigned to the relevant divisions in the Bank according to the nature of their activities and the characteristics of their customers.

The following are the Bank's five major business lines:

Retail banking deals with private and small business customers, with the strategic aim of consistent growth in profits and the volume of customers and their activities, through the provision of differential service suited to the different customer segments, the expansion of the branch and direct distribution networks (Leumi Call, the internet and electronic terminals), the provision of high quality and objective consultation in all investment fields, systematic information-based initiatives *vis-à-vis* the customers in all fields of activity: investments, consumer and commercial credit and current account services, and improving the level of service to customers.

Commercial banking deals with the middle-market range of business customers and their connected parties. The strategic goal of commercial banking is to continue to strengthen its leading position by means of expanding the volume and range of activities with existing customers and by recruiting new customers, whilst providing comprehensive solutions for its customers operating in Israel and abroad.

Corporate banking deals with the large business customers segment, including contracting companies and large projects whose main area of activity is construction and real estate. Its strategic goal is to continue to be a leading financial center in the economy, providing a variety of financial solutions and associated services to the major corporations in the economy. The objectives of corporate banking are to provide the entire spectrum of customers with all necessary financial services, involving the various units in the Leumi Group, in Israel and abroad, as necessary; to increase the variety of products and services offered to customers and to be active in the field of Advanced Lending.

International and private banking deals with the population of wealthy private clients in Israel and worldwide. The division operates through specialist centers in Israel that are designated for foreign and Israeli residents and also through the Bank's subsidiaries in the USA, the UK, Switzerland, Luxembourg and Jersey and the representative offices in Europe, Latin America, Canada and Australia and manages the operations of those overseas companies and representative offices. The strategic goal is to expand the customer base and to enlarge the scope of activities of customers of the sector, in Israel and overseas, primarily by providing high quality professional service based on specialist service centers, having a competitive advantage in the professionalism of their employees and their products, which are adapted to the customers' requirements.

Capital markets banking and financial management deals with the management of the Bank’s nostro, foreign currency and securities trading and brokerage activities, management of market risks and the operation of all the Bank’s dealing rooms, the development of financial and investment products, and the management of the Bank’s assets and liabilities. The division also manages the relationship with overseas financial institutions and is responsible for the provision of services to customers who are active in the capital and money markets, including institutional customers.

Principal Operational Segments

Pursuant to the Bank of Israel’s directives, an operational segment is a component which has three characteristics:

1. It engages in business activities from which it is likely to produce income and bear expenses (including income and expenses from transactions with other segments at the Bank);

2. Its operating results are regularly examined by the Management and the Board of Directors in order to make decisions relating to the allocation of resources to the segment and the appraisal of its performance;

3. There is separate financial information with regard to the segment.

The principal operational segments that have been determined under the directives of the Bank of Israel in accordance with the said characteristics are as follows:

1. Households - providing comprehensive banking services to households and private customers.

2. Small Businesses - providing banking services to small businesses and local authorities.

3. Corporate Banking - providing banking and financial services to the major and international companies for their operations in Israel and abroad.

4. Commercial Banking - providing banking and financial services to the middle market companies and their connected parties.

5. Construction and Real Estate - providing banking and financial services to major construction companies and projects operating mainly in the construction and real estate sector.

6. Private Banking - providing local and global financial services and solutions to private customers resident in Israel and overseas with large financial asset portfolios.

7. Financial Management and Capital Markets - the nostro activities and dealing rooms, the provision of services to institutional clients, including the investments in non-banking (real) companies.

8. Others* - activities not assigned to other segments.

The segmented operations also include inter-segment activity, such as services that are provided to customers in another segment and also activities (derived from products) such as mortgages, credit cards and capital market services.

* This includes other activities of the Group, none of which constitutes a profit center according to the directives of the Supervisor of Banks.

For further details page 91 below and Note 28 to the Financial Statements.

The criteria for the attribution of customers according to the operational segments at the Bank in Israel are generally as follows:

A. Business Customers:

Division/Segment	**Scope of Obligo**
Corporate	above NIS 80 million
Commercial	above NIS 10 million and up to NIS 80 million
Small businesses	up to NIS 10 million

B. Private Customers According to Financial Assets:

Division/Segment	**Israeli Residents**	**Overseas Residents**
Private Banking	above US$ 1 million	above US$ 0.5 million
Households	up to US$ 1 million	up to US$ 0.5 million
Commercial	up to US$ 1 million	up to US$ 0.5 million

It should be noted that attribution to a specific operational segment is sometimes carried out in accordance with additional criteria to those indicated above – i.e. the size of the obligo with regard to business customers, and financial wealth, in connection with private customers. Criteria such as the nature of a corporation’s business operations and the scope of its business, such as activity volumes, international trade volumes, complex and special transactions, complex projects and construction financing, can change the segmental attribution of a certain customer.

Also, segmental attribution is determined according to the sector in which the customer's account is actually operated, and so long as segmentation has not been carried out, the segmental classification does not change.

C. Banking Subsidiaries have been attributed to the operational segments as follows:

- The Arab Israel Bank Ltd. – to households, small businesses and commercial banking.
- Leumi Mortgage Bank Ltd. – to households, construction and real estate and commercial banking.
- Leumi USA operates in 4 main business lines*.
- Leumi Switzerland and Luxembourg – to private banking.
- Leumi UK – to commercial banking.
- Leumi Romania – to small businesses.

* Leumi USA
  - corporate banking – obligo of over US$ 2 million or customers with growth potential
  - construction and real estate – real estate credit.
  - private banking – local customers with financial assets of over US$ 100,000 and overseas customers with financial assets of over US$ 1 million.

The segment data provided here, on a consolidated basis, are the result of a summarization of the segments based on the segment definitions within each of the Group's organizations, which are not identical in terms of size. In terms of materiality, the Bank generally constitutes some 80% of each segment.

Financial Measurement System

To provide administrative support for the operations according to segments, an operating and administrative system exists in the Bank to manage profit centers according to business lines and additional classifications (the "Bahan" system).

The system's objects:
- measuring the profitability of the various profit centers;
- measuring the business activity volume of the various profit centers according to various classifications;
- measuring performance against the goals in the work plan;
- uniformity in analyzing the business activity;
- overall control of the business activity and the profitability from such activity;
- directing the branches and other business units to achieve the Bank's targets, including profitability targets;
- to provide a tool for allocating the Bank's resources in a rational manner, on the basis of cost-benefit analysis;
- to provide a basis for appraisal and remuneration.

The basis of the Bank's system is the "data warehouse" that centralizes all the Bank's transactions and, with the assistance of an appropriate index, enables transactions to be sorted and classified between the various profit centers.

The data presented below regarding operational segments includes the Bank's data according to the principles of the Bahan system as explained below, while the segmented data of the subsidiaries in Israel and abroad has been taken from their financial statements, and as defined by them.

In measuring the profitability of overseas subsidiaries, the exchange rate differentials after the effect of taxes arising from financing the investment in overseas, subsidiaries are allocated to the net interest income of the overseas subsidiaries.

The attribution of income and expenses according to business lines at the Bank is effected as follows:

Income

Net Interest Income:

The profit center is credited with the interest received from the loans that it granted or is debited with the interest that is paid on deposits it raised.

At the same time, the profit center granting the loan is debited, and the profit center receiving the deposit is credited with transfer prices. The transfer prices are usually determined according to market prices following certain adjustments and generally reflect risk-free returns or the marginal costs of raising funds with the same linkage sector and currency and for a similar term. The effects arising from exchange rate differentials between the shekel/foreign currencies, including adjustments from translating data of overseas subsidiaries, and also changes in the CPI on surplus uses and/or sources are attributed in the Group to the financial management segment. With the method described above, the profit centers bear credit risks but do not bear market risks.

The profit and loss statements of each of the segments also take into account the capital allocated to the segment. Every profit center is credited on the capital that was allocated to it in respect of the risk assets in accordance with risk free yield and is charged in respect of the additional cost of the Tier II capital. In this way the Bank's available capital is credited with interest equal to the marginal cost of raising funds in accordance with the segment that it is financing, or invested in the capital market. The income from the management of the nostro is reflected in the financial management and capital markets segment.

The provisions for doubtful debts are charged to the profit center in which the customer's account is managed. The same applies to the additional provision required pursuant to the directives of the Bank of Israel.

Operating Income

All the operating income (commissions and other operating income) that the Bank charges its customers and/or subsidiaries in respect of various services is credited to the profit center in which the customer's account is managed. Income from nostro securities, profits of the severance reserve and dividends that the Bank receives are credited to the capital market - financial management profit center.

Expenses

The Bank's expenses are attributed to the various profit centers based on an "operations costing" system and according to the activity volumes (the amount of the operations of the profit center).

Costing is ABC (activity based costing) - a costing system which calculates the cost per transaction after considering the transaction type, line of business and distribution channel. The system costs some 6,200 transactions of different types.

Expenses that are not connected with the direct activities of the profit center (the activity segment), such as expenses in connection with the actuarial pension liability, are not charged to the profit centers and are reflected in the financial management segment.

For further details regarding operational segments, see pages 91-141 of the Directors' Report and Note 28 to the Financial Statements.

Capital Resources and Transactions in the Shares of the Bank

Shareholders' Equity of the Group at 31 December 2007 amounted to NIS 19,549 million, compared with NIS 17,491 million at the end of 2006, an increase of 11.8%. The increase in shareholders' equity mainly derives from the profit for the year, from an increase in the capital fund against the recording of salary expenses in respect of the issue of options to employees, less the changes in adjustments in respect of the presentation of securities available for sale according to fair value, and from the increase of capital in respect of the repayment of loans made available to the employees for the purchase of shares of the Bank, less the dividend to be paid.

The securities portfolio (nostro) mainly holds government debentures and debentures of overseas banks, which generally represent the use of raised sources and the available capital. The majority of the securities portfolio is classified as available for sale securities and is included in the balance sheet on the basis of fair value. The income is recorded in the statement of profit and loss on an accrual basis, and the difference between the value on an accrual basis with regard to debentures and on a cost basis with regard to shares and the fair value is directly recorded in a separate item in shareholders' equity, following the deduction of the effect of related taxes.

In consequence of the change in the fair value of securities available for sale in all the segments, a decrease in value of NIS 121 million, net, was recorded in shareholders' equity, compared with an increase in value amounting to NIS 577 million in 2006 (all of the amounts are net after the effect of related taxes). The decrease in 2007 is derived mainly from the fall in the market value of the debentures and the realization of some of the debentures.

The following are the details of the amounts in the capital fund (adjustment in respect of available for sale securities before taxes):

	31 December 2007	Movement	31 December 2006
	(in millions of NIS)		
Shares	**1,161**	182	979
State of Israel debentures	**20**	(175)	195
Debentures of foreign governments	**1**	43	(42)
Other debentures	**(387)***	(257)	(130)
Other debt instruments	**(30)**	3	(27)
Total	**765**	(210)	975
Related taxes	**(263)**	89	(352)
Total, net	**502**	(121)	623

* On 31 December 2007, NIS (47) million of this amount consisted of mortgage backed securities.

The total net aggregate balance of adjustments to market value of securities held in the available for sale portfolio as of 31 December 2007 amounted to NIS 502 million (after the effect of taxes), compared with NIS 623 million at the end of 2006.

According to the principles of the capital adequacy computation, the balance in respect of adjusting securities to fair value does not affect the capital computation for the purpose of the minimum capital ratio, save for net losses that have not yet been realized from adjustments to fair value of shares available for sale, less the effect of taxes.

Shareholders' Equity relative to Total Assets on 31 December 2007 reached 6.5%, compared with 6.0% on 31 December 2006.

Shareholders' Equity relative to Risk Assets was 11.52% on 31 December 2007, compared with 11.56% on 31 December 2006. This ratio is higher than the minimum ratio of 9% set by the Supervisor of Banks. The ratio of Tier I capital to risk assets reached 7.55% on 31 December 2007, compared with 7.53% at the end of 2006.

Issue of Subordinated Capital Notes

In March 2007, the subsidiary, Leumi Finance Company Ltd. ("Leumi Finance"), through which the Bank raises Tier II capital and raises funds through the issuance of debentures in Israel, carried out a private offering to institutional investors of subordinated capital notes (Series G), in the amount of NIS 428.4 million, bearing an annual interest rate of 4.1%, and linked to the CPI. In May 2007, an additional issue of the same series was carried out, in an amount of NIS 514.5 million.

Leumi Finance published a shelf prospectus on 8 August 2007. The prospectus allows offerings of subordinated capital notes and/or debentures, of various series and on various terms, to be made during a period of 24 months. The prospectus also included the listing of the capital notes (Series G) for trading on the Stock Exchange.

In October 2007, an offering was made to qualified investors and to the public of capital notes (Series G) in the amount of some NIS 1 billion, and the issue of the entire series was thus completed, in a total amount of NIS 2 billion.

In November 2007, pursuant to the shelf prospectus, Leumi Finance carried out an additional offering to qualified investors and to the public of subordinated capital notes (Series H). The subordinated capital notes bear annual interest of 4.4% and are linked to the CPI. The company raised a total of NIS .1.1 billion.

These subordinated capital notes have been recognized by the Supervisor of Banks as part of the Bank's Tier II capital.

In total, Leumi Finance raised some NIS 3.1 billion in CPI-linked subordinated capital notes in 2007.

On 12 February 2008, pursuant to the shelf prospectus, Leumi Finance carried out an offering of some NIS 2.5 billion to qualified investors and to the public, consisting of two series of subordinated capital notes. The offering included an expansion of Series H, in the amount of NIS 814.53 million, and the offering of a new series, Series I, in the amount of NIS 1,700 million. The Series I subordinated notes are not linked to the CPI, bear annual interest of 6.29%, and are redeemable in a single payment in August 2013.

On 12 March 2008, the Bank raised NIS 400 million through an issue of commercial paper, with variable interest – Bank of Israel interest plus 0.18%. The issue has a 90 day maturity with the Bank able to renew each quarter until the end of 5 years from the date of the issue. The purchasers of the paper have the right to sell the securities back to the issuer on any day, after giving one week's advance notice, and to receive the accumulated interest.

Interested Persons' Transactions in the Shares of the Bank

On 3 September 2007, Otsar Hityashvuth HaYehudim B.M. and JCT Trust Company Ltd. ceased to be interested persons in the Bank, following the transfer of shares in the Bank from JCT Trust to the Tracing and Return of Property of Holocaust Victims Company Ltd.

Issue of Options to Employees

On 2 February 2006, the Bank's General Meeting approved a plan for the issue of options to eligible employees, as determined in the outline published by the Bank on 24 January 2006 (the "Outline"). In accordance with this program, on 14 February 2006, 84,853,960 options, exercisable into 84,853,960 ordinary shares of the Bank, were allotted. (Of these, 122,644 options were allotted to the Chairman of the Board of Directors and 156,659 were allotted to the CEO.) The balance of options as at 31 December 2007 was 83,595,949. The said options are subject to all the provisions of the Outline, including:

1. The options were exercisable in two equal tranches, the first tranche at the end of two years from the date of the allotment of the options and the second tranche as from the end of the second year from the date of the allotment of the options and up to the end of the third year from the date of the allotment of the options.
2. The options were issued to the employees free of consideration.
3. The exercise price per share will be NIS 13.465 and will be linked to the CPI (commencing from September 2005). The price will be adjusted for the distribution of dividends (the amounts being linked to the CPI), bonus shares and the bonus element of rights issues, should there be any. The adjusted exercise price as of 31 December 2007 and as of 16 March 2008 was NIS 11.205 and NIS 10.3179, respectively.

The exercise date for the first tranche of the options was in the middle of February 2008, and all the options of this tranche that were in issue, in the aggregate amount of 41,723,516, were exercised at an exercise price of NIS 10.3381. From then and through 10 March 2008, 4,870,135 additional options have been exercised.

In respect of the issue of the said options, the Bank records salary expenses in accordance with the fair value of the options at the date of allotment with the addition of salaries tax and national insurance contributions. This expense will be recorded in the Bank's Financial Statements over a period of two years from the date of allotment.

In 2007, the Bank recorded salary expenses of some NIS 247 million, compared with some NIS 235 million during the same period in the previous year. Of this, NIS 52 million was recorded in the fourth quarter, compared with some NIS 72 million during the corresponding period in the previous year.

In light of the restriction imposed on the Bank preventing it from granting loans to employees to finance the exercise of the options, and following an agreement in principle reached by the representatives of the Leumi employees and the Israel Discount Bank Ltd., in February of 2008, the latter bank provided – to Leumi employees who requested them – loans to finance the exercise of the options. The total amount of such loans was NIS 277 million.

The loans bear annual interest at the rate of prime minus 0.5%, for a period of up to one and a half years, which is the end of the period during which the trustee holds the shares in trust for the employees in accordance with the option plan. The shares are not pledged, but the lender has full rights of recourse against the borrowers. Bank Leumi is not responsible for, nor does it in any way guarantee, the repayment of the loans.

The Supervisor of Banks has allowed Bank Leumi to provide operating services to Israel Discount Bank in connection with the said loans.

Sale of Shares to Employees - 2006

On 14 June 2006, Bank employees purchased 2.8478% of the share capital of the Bank (40,274,560 shares, of which 75,532 were purchased by the Chief Executive Officer), in accordance with an outline published on 9 May 2006 (and amended on 10 and 25 May 2006). On 3 July 2006, the General Meeting approved the purchase of 59,131 shares by the Chairman of the Board of Directors of the Bank, which purchase was carried out on 5 July 2006.

The purchase of the shares was carried out in accordance with an agreement of March 2006 with the Accountant-General regarding an offer of the Bank’s ordinary shares to employees of the Bank by the State, in accordance with the agreements in respect of the privatization of the Bank and decisions of the Finance Committee of the Knesset. According to the above agreement, the shares would be offered to the employees in two stages, the first of which, an offer of 2.873% of the share capital, has been carried out, as mentioned above. The base purchase price was set at NIS 16.10 per share (the average price of the share, as agreed by the Ministry of Finance and matching the average price of the sale to "Barnea"). The shares were offered to the employees at a discount of 25% below the base price, the price being linked to the CPI for September 2005 up to the date of exercise of the offer, with the addition of interest at 2% per annum from 24 November 2005 (the "Exercise Price"). The Exercise Price was therefore NIS 11.652 per share (NIS 11.665 for the Chairman of the Board of Directors).

The second stage, in which a further 1% of the Bank’s share capital will be offered to the employees, will be carried out after completion of the privatization process.

The value of the benefit granted to the employees and the Chairman of the Board of Directors in respect of the said purchase (the first stage only), as evaluated by an external appraiser, includes a number of components and totals some NIS 217 million (including salary tax and national insurance). This amount was recorded as a salary expense in 2006, of which NIS 203 million was against the capital account.

In accordance with accepted accounting principles, the changes in the value of the profit benefit portion are updated on an ongoing basis in the profit and loss statement, according to the share's market value, and in 2007, an amount of NIS 3 million was recorded as salary expenses

To finance the purchase of the shares, the employees were granted loans, repayable at the end of the 4 years' lock-up period of the shares. The loans are linked to the CPI, do not bear interest and are not subject to non-recourse conditions. The granting of the loans was approved by the Supervisor of Banks, who, in his approval, noted that when determining the repayment terms, the Bank was requested to take into account the fact that approval would not be given for the extension of the repayment period of the loans beyond the end of the lock-up period. The total of the loans granted to the employees (including the Chairman) was some NIS 466 million, which was deducted from the Bank's capital. For so long as the loans remain unpaid, they will be deducted from Bank's capital at the level of their revalued balance.

Increase of the Bank’s issued share capital

As of 10 March 2008, 46,593,651 options issued to Group employees pursuant to the outline dated 24 January 2006 had been exercised, and on that date, the Bank’s issued capital came to NIS 1,460,826,331 par value.

Distribution of Dividends

A. Dividend Policy for 2006-2008

On 29 March 2006 the Bank's Board of Directors resolved to determine the dividend policy as follows:

It is the intention of the Board of Directors to recommend to the General Meeting the distribution of an annual dividend, for the years 2006 and 2007, in an amount constituting at least 50% of the net annual distributable profit of the Bank, should there be no adverse change in the profits of the Bank and/or in its business and financial position and/or in the general position of the economy and/or in the legal and fiscal environment.

All dividend distributions will comply with the provisions of the Companies Law, 1999, which provides, *inter alia*, that the Bank may make a distribution out of its profits provided that there is no reasonable concern that the distribution will prevent the Bank from meeting its present and anticipated obligations, when they become due. Moreover, the Bank is required to comply with the limits laid down by the Supervisor of Banks such as: a minimum capital ratio of not less than 9%, compliance with the requirements of Section 23A of the Banking (Licensing) Law, 1981, which set limits on the percentage of equity that a banking corporation may invest in non-banking (real) corporations, and also compliance with the limits determined by the Supervisor of Banks regarding granting credit as a percentage of equity and the limits he set regarding dividend distributions, such as: no dividend will be distributed out of capital reserves or positive differentials arising from the translation of the financial statements of autonomous overseas units; or where one or more of the last three calendar years ended with a loss.

The aforementioned policy declaration does not constitute any undertaking towards any third party (including concerning the dates of payment of the dividend or the rates of dividends in the future).

In January 2008, the Bank’s Board of Directors resolved to extend this dividend policy also to the year 2008.

Certain declarations appearing above in the above paragraphs contain "forward-looking information". For the meaning of this term, see the section "Description of the Banking Corporation's Business and Forward-Looking Information in the Directors Report" on page 43 below.

B. Dividend for 2007

The Special General Meeting convened on 17 January 2008 approved the Board of Directors’ recommendation of 11 December 2007 regarding the distribution of a cash dividend at the rate of some 49.8% of the net profit for the first nine months of 2007 (some NIS 1,414 million), at the rate of 100.0% of the paid-up capital.

The dividend was paid on 5 February 2008 to shareholders of record on 20 January 2008 (the record date). The shares traded “ex” dividend on 21 January 2008. The dividend was at the rate of NIS 1.0 for every ordinary share of NIS 1.0 par value.

At its meeting on 30 March 2008, the Board of Directors resolved to recommend to the upcoming Annual General Meeting, the distribution of an additional cash dividend for 2007 of some 52.2% of the net profit for the fourth quarter of 2007 (some NIS 270 million), some 18 agorot per share. Subject to the approval of the General Meeting, the dividend will be paid on 30 June 2008, to shareholders of record on 17 June 2008 (the record date). The stock will trade “ex” dividend on 18 June 2008.

Based on the paid-up share capital as of 10 March 2008, the dividend is at a rate of some 18.5% of the paid-up capital. Should additional options be exercised up until the record date, the rate of the dividend in relation to the paid-up capital, and the amount of the dividend per share will be reduced accordingly.

The total dividends for 2007 will amount to NIS 1,684 million, which is some 50.2% of the net profit for 2007 and NIS 1.185 per ordinary share of NIS 1.0 par value (subject to changes in the consequence of the exercise of options as previously mentioned).

C. Dividend for 2006

The Special General Meeting convened on 14 February 2007 approved the recommendation of the Board of Directors of 24 December 2006, regarding the distribution of a cash dividend at the rate of some 101.6% of the net profit for the first nine months of 2006 (some NIS 2.5 billion), at the rate of 176.8% of the paid-up capital. The dividend constituted 70.7% of the net profit for 2006.

The dividend was paid on 28 February 2007 to shareholders of record on 15 February 2007 (the record date). The shares traded “ex” dividend on 18 February 2007. The dividend was at the rate of NIS 1.768 for every ordinary share of NIS 1.0 par value.

D. Following are details of cash dividends declared and/or paid in the Group*:

	2007	2006	2005
1. Bank Leumi le-Israel B.M. - in NIS millions	**1,684**	2,500	1,103
2. The Arab Israel Bank Ltd. - in NIS millions	**89.7**	60	60
3. Leumi Mortgage Bank Ltd – in NIS millions	**-**	-	54
4. Various wholly-owned companies of the Group - in NIS millions	**25**	18	15
5. Bank Leumi USA - in US$ millions	**-**	-	20
6. Leumi Re – in US$ millions	**5**	5	-
7. Bank Leumi (UK) – in £ millions	**5.7**	37.6	4.7
8. Bank Leumi (Switzerland) – in CHF millions	-	62.8	-
9. Migdal Insurance and Financial Holdings Ltd. - in NIS millions**	**62.1**	42.0	139
10. Israel Corporation Ltd. – in NIS millions	**45.3**	54	55

* The Group's share in the dividend in accordance with its entitlement to receive profits as set out in Note 6 to the Financial Statements relates to the reporting year in respect of which the dividend was declared and not necessarily to the year of payment.

** Half the holding was sold in the first quarter of 2006.

Bank Leumi le-Israel B.M. and its subsidiaries

Principal Data of Bank Leumi Group

	2007	2006	2005(c)	2004	2003
	Reported amounts			Adjusted amounts	
Income, expenses and profits (in NIS millions)					
Net interest income before provision for doubtful debts	**7,648**	6,922	6,629	6,359	5,975
Provision for doubtful debts	**407**	933	1,426	1,514	1,883
Total operating and other income	**4,222**	3,881	3,727	3,403	3,216
Total operating and other expenses	**6,937**	7,267	6,080	5,488	5,603
Of which: costs of voluntary retirement	**-**	175	107	14	147
costs of privatization (issue of shares and options to employees)	**250**	452	-	-	-
Operating profit before taxes	**4,526**	2,603	2,850	2,760	1,705
Net operating profit	**2,984**	1,454	2,059	1,904	1,159
After-tax net profit (loss) from extraordinary items	**373**	2,080	77	(8)	(14)
Net profit	**3,357**	3,534	2,136	1,864	1,145
Net operating profit per share	**2.11**	1.03	1.46	1.35	0.82
Net profit per share	**2.37**	2.50	1.51	1.32	0.81
Dividends paid (in respect of the reported year)	**(d)1,684**	2,500	1,103	1,004	400
Assets and liabilities at end of period (NIS millions)					
Total assets (total balance sheet)	**302,151**	289,341	276,119	260,531	249,343
Credit to the public	**198,557**	183,800	180,881	174,367	172,175
Securities	**47,169**	46,375	47,825	43,543	40,262
Deposits of the public	**238,045**	231,823	221,828	209,652	203,586
Shareholders' equity	**19,549**	17,491	16,000	14,986	14,213
Major financial ratios in annual terms (in %)					
Credit to the public to total assets	**65.7**	63.5	65.5	66.9	69.1
Securities to total assets	**15.6**	16.0	17.3	16.7	16.1
Deposits of the public to total assets	**78.8**	80.1	80.3	80.5	81.6
Total shareholders' equity to risk assets (a)	**11.52**	11.56	11.55	11.25	10.79
Tier I capital to risk assets	**7.55**	7.53	7.46	7.53	7.29
Shareholders' equity (excluding minority interest) to total assets	**6.5**	6.0	5.8	5.8	5.7
Net profits to average shareholders' equity (excluding minority interest)	**17.4**	20.1	13.5	12.6	8.4
Net operating profit to average shareholders' equity (excluding minority interest)	**15.4**	8.3	13.0	12.9	8.5
Rate of tax provision from profit	**38.0**	50.7	41.9	45.1	48.3
Provision for doubtful debts from credit to the public	**0.20**	0.51	0.79	0.87	1.09
Provision for doubtful debts from total credit risk to the public	**0.13**	0.34	0.54	0.61	0.77
Net interest income before provision for doubtful debts from total assets	**2.53**	2.39	2.40	2.44	2.40
Total income to total assets (b)	**3.93**	3.73	3.75	3.75	3.69
Total income to total assets managed by the Group (b)	**1.55**	1.55	1.62	1.98	2.00
Total operating and other expenses to total assets	**2.30**	2.51	2.20	2.11	2.25
Total expenses to total assets managed by the Group	**0.91**	1.05	0.95	1.11	1.22
Net profit from total average assets	**1.13**	1.29	0.82	0.75	0.48
Net operating profit from total average assets	**1.01**	0.53	0.79	0.77	0.48
Financial margin including income and expenses from derivative financial instruments	**1.71**	1.82	1.60	1.76	1.61
Operating expenses (excluding costs of voluntary retirement) to total income (b)	**58.4**	65.6	57.7	56.1	59.4
Operating and other income to operating and other expenses (excluding cost of voluntary retirement)	**60.9**	54.7	62.4	62.2	58.9
Operating and other income to total income (b)	**35.6**	35.9	36.0	34.9	35.0

(a) Shareholders' equity – plus minority interest, less investments in capital of companies included on equity basis and various adjustments.
(b) Total income – net interest income before provision for doubtful debts plus operating and other income.
(c) Re-classified
(d) Of which NIS 270 million is yet unpaid

C. Other information

Principal Developments in the Economy*

General

In 2007, the Israeli economy grew at a real rate of some 5.3%, a continuation of the similar growth rate in the years 2004-2006. The expansion of economic activity included most branches of the economy and was reflected in a rapid rise in employment and a decrease in unemployment, down to some 6.7% in the fourth quarter of 2007. Growth in 2007 was positively affected by a significant increase in domestic demand, and in particular by an increase in private consumption and investments. Private consumption rose at the rate of some 4.8% per capita and investments in fixed assets rose at the rate of some 14.2%. However, exports of goods and services also made a significant contribution to growth this year expanding at the rate of some 8.4%, accompanied by an increase in imports of some 12.3%. The rapid growth resulted in a substantial increase in state tax revenues and a minimal deficit in the State budget of some 0.02% of GDP. The exchange rate of the shekel, especially against the dollar, was very volatile, and over the course of the past year, it rose by some 9.0%, primarily against the background of the weakening of the US dollar against the main global currencies. At the beginning of 2008, the shekel continued to rise against the dollar, at the sharp rate of some 12.1% by 18 March 2008, when the exchange rate stood at NIS 3.38. Notwithstanding the shekel's increased strength, inflation rose beyond the government's price stability target (1% to 3%) and reached 3.4%. As a result, the Bank of Israel began to raise the interest rate in the third quarter of 2007 and in January of 2008 it was raised to 4.25%. The interest rate was reduced in March by 0.5 percentage points to 3.75%, as a result of possible negative effects of the global economic slowdown on the Israeli economy. The securities market posted sharp rises in prices in 2007, mostly during the first half of the year. During the second half, following the crisis in the world financial markets derived from the crisis in the (sub-prime) mortgage market in the United States, share prices dropped sharply worldwide, and impacted on the Tel Aviv Stock Exchange as well. The crisis in the United States deepened at the beginning of 2008, and the Chairman of the US Federal Reserve Board reacted by drastically lowering the interest rate during the month of January at a cumulative rate of 1.25 percentage points, down to 3.0%. In March 2008, the interest rate was reduced by 0.75 percentage points, to 2.25%. Between the beginning of 2008 and 18 March 2008, the Tel Aviv 100 index dropped by some 22.1%, a rate similar to the sharp falls recorded in other stock exchanges throughout the world.

Business product and economic sectors

Israel's business sector product rose at a real rate of some 6.1% during 2007. The rate was slightly less than that of its expansion in 2005-2006, when it was some 6.5% each year. The most remarkable levels of expansion were in the finance and business services sectors, 6.3% and in the trade, food services and accommodations sectors, 7.2%. According to the Bank of Israel's companies' survey, the accelerated economic activity continued during the fourth quarter of the year, although at a slightly lower rate than the increase during the year's third quarter. The expectation for the first quarter of 2008 is for continued growth in activity, although at a somewhat more moderate rate than during the fourth quarter of 2007. The survey's findings, as reported by the Bank of Israel, indicate that the expansion of activity included all economic sectors. These data, along with the high inflation expectations, indicate that, according to the Bank of Israel's estimation, the Israeli economy is approaching its full output capacity.

The tourism sector, which suffered during 2006 as a consequence of the Second Lebanon War, recovered in 2007. Overnight hotel stays amounted to some 20.5 million – an increase of 6% compared with 2006. This is a record amount, resulting from an increase of some 23% in overseas tourist overnight stays, as compared with a reduction of some 3% in overnight stays by Israelis. Hotel room occupancy rates also rose, from 58% in 2006 to some 62% in 2007.

* Source of data: publications of the Central Bureau of Statistics, the Bank of Israel, the Ministry of Finance and the Tel Aviv Stock Exchange

The State Budget and its financing

The State Budget deficit amounted in 2007 to a minimal amount of some NIS 0.1 billion. This is the lowest rate in the past decade. Since 2003, in parallel with the recovery in the economy, there has been a clear trend towards reductions in the deficit. The main explanation for the low deficit compared with the originally planned amount of some 2.9% of GDP is that revenues from taxes were more than NIS 11 billion higher than had been forecast. Some NIS 2 billion of this increase can be attributed to one-off increases in tax revenues from exceptional transactions and from the completion of the market reforms, and the balance of the increase can be attributed to the economy's rapid growth. According to the Ministry of Finance statistics, the real growth in revenues from indirect taxes was 10.7%, which was higher than the increase in direct taxes, which came to some 6.9%. The increase in tax revenues, against the background of rapid growth in the economy, was accompanied by under-execution in terms of budgeted expenses, with the overall rate of execution of (net) expenses amounting to some 98.2%. This situation, in which some government ministries have not utilized their entire approved budgets, also contributed to the significant gap between the actual and projected deficit amounts.

Foreign trade, capital flows and exchange rates

Israel's trade deficit in 2007 amounted to some US$ 10.2 billion, an increase (in nominal dollar terms) of some 34% in comparison with the deficit in 2006. The increase was due to the more rapid rise in imports of goods (some 19%) as compared with exports of goods (some 16%). An examination of the various components of imports shows a significant increase in imports of consumer goods, reflecting the significant increase in private consumption in 2007, while the increase in investment goods amounted to some 22%, indicating that the country's companies and businesses are feeling optimistic about future growth. An analysis of the components of exports shows an especially notable expansion of industrial exports – some 17%, alongside a remarkable increase of some 24% in chemical exports and oil refining (such increases in exports having been influenced, *inter alia*, by the rise in dollar prices throughout the world.)

Direct investment in foreign currency by foreign residents in Israel amounted to some US$ 10.3 billion in 2007, as compared with direct investments by Israelis abroad, which amounted to some US$ 7.1 billion. These data indicate inward long-term capital flows (net) which supported the shekel's exchange rate against the dollar. In contrast, the financial capital flows indicated a (net) outward flow of capital from Israel in the amount of some US$ 6.2 billion.

The shekel strengthened by some 9% against the dollar during 2007, with a significant increase in the degree of volatility in comparison with previous years. The global weakening of the dollar (for example, the dollar weakened some 10% against the euro) was a primary factor in the explanation for the strengthening of the shekel. The positive background conditions of the Israeli economy, featuring the current account surplus of the balance of payments and the rapid rate of growth, also helped to strengthen the shekel. At the beginning of 2008, the shekel continued its rise against most currencies. Thus, since the beginning of the year, the shekel has risen some 12.1% against the dollar. On 18 March 2008, the representative exchange rate was NIS 3.38.

In light of the unusual behaviour of the shekel's exchange rate, the Bank of Israel purchased foreign currency during the course of trading on 13 and 14 March 2008, and the dollar's exchange rate consequently rose by some 2% to 3%.

On 20 March 2008, the Bank of Israel announced that from 24 March 2008, it will implement a program to increase foreign currency levels by some US$ 10 billion over two years, by means of the purchase of some US$ 25 million in foreign currency per day, during trading hours.

Inflation and monetary policy

The CPI rose by 3.4% in 2007, a rate which exceeded the upper limit of the government's price stability target of 1% - 3%. Inflation in the past year was affected by a number of factors: food prices (excluding fruits and vegetables) which rose by some 6.3%, mostly as a result of the global increases in prices of raw materials, which led to a rise in domestic prices. This increase was also made possible by the improved financial condition of households. The second factor in the CPI's rise was the increase in prices of resident-owned housing. These prices that increased by some 3.6%, are an important component in the housing item. This was despite the strengthening of the shekel by some 9% against the dollar in 2007, which in the past has moderated price increases. This means that there was a significant dollar (and shekel) increase in the price of resident-owned housing – a characteristic of surplus demand in the housing market. This increase was affected by the improved financial condition of households, and mainly because of a lower amount of building starts than would have been desirable. In a number of regions in Israel, this led to a significant decrease in the housing supply. The third factor in the relatively sharp rise in the CPI this year was the worldwide increase in energy prices.

Over the course of 2007, the Bank of Israel reduced interest rates from 5.0% in December of 2006 to 3.5% in June of 2007. This was against a background of inflation which was at the time lower than the lower limit of the government's price stability target and reflected a desire to return inflation to the target area. During the third quarter of 2007, the trend reversed and interest was raised by 0.5 percentage points to 4.0%, a level which was also maintained throughout the year's fourth quarter. This change in direction resulted, *inter alia*, from actual inflationary data and inflation forecasts that had been updated upwards and which were influenced by the devaluation of the shekel's exchange rate against the dollar, mainly in the year's second quarter. All this occurred against the background of the economy's continued rapid growth and the closing of the output gap. This trend continued at the start of 2008, with the interest rate for January rising to 4.25% and also remaining at this level during the month of February. The interest rate for March was reduced by 0.5 percentage points to 3.75%, mostly as a result of possible negative effects of a global economic slowdown on the Israeli economy.

The capital market

In 2007, the share and convertible securities indices rose by some 22.9%, following a more moderate rise of some 5.8% in 2006. Most of the increase occurred during the first half of the year, against the background of the economy's continued rapid growth and the increase in the companies' profitability, while during the second half of 2007, the share prices and those of convertible securities remained stable but fluctuated greatly. The reason for the change in direction was the crisis in the (sub-prime) mortgage market in the United States, which led to sharp declines in share prices throughout the world and to significant fluctuations in the indices. These affected the domestic stock market as well. The trading turnover for shares and convertible securities on the Tel Aviv Stock Exchange and off of it grew significantly in 2007 and amounted to a daily average of some NIS 2.1 billion, as compared with an average daily balance of some NIS 1.45 billion in 2006 – an increase of some 43%. The intensive activity on the domestic stock market was also reflected in the fact that more than NIS 10 billion was raised in offerings carried out by some 56 new companies.

Notwithstanding the increase in capital market activity, income from customers' securities transactions declined, mainly from a decrease in mutual fund management fees from some NIS 1,124 million in 2006 to some NIS 1,031 million in 2007, a decrease of (8.3)%, a consequence of the sale of the capital market companies by the banks, in accordance with the capital market reforms.

In 2007, the debenture market was characterized by intensive activity and by a trading turnover with a daily average of some NIS 3.3 billion, a sharp increase of some 92% compared with the trading turnover during the previous year. The CPI – linked government debentures index rose by some 6.7% during this period, while the non-linked fixed interest debentures index rose by only some 2.4%. This was a result of an increasingly inflationary environment, which improved the attractiveness of CPI-linked assets. In addition, a decrease in government debenture issues due to the reduced government deficit also led to a rise in prices for CPI-linked debentures.

Financial assets of the public

The financial assets portfolio in the hands of the public increased in 2007 by some 13.2%, amounting to some NIS 2,106 billion. The NIS 246 billion increase in the value of the portfolio is mostly explained by the domestic shares component. The sharp increases in the prices of these shares contributed some 43% of the total increase in the portfolio's value. Moreover, the portion of the portfolio consisting of (domestic and foreign) shares rose to some 27.9%, as compared with 25.5% at the end of 2006. This was in contrast to the other elements of the portfolio (non-CPI-linked assets, CPI-linked assets, and foreign currency-linked assets) whose share in the portfolio declined, even though their value increased. In particular, the value of CPI-linked assets increased by some 12.8% and they contributed some 29% of the portfolio's growth. This was due mostly to significantly large offerings of CPI-linked bonds.

The public's total monetary assets managed by the Group (deposits of the public, debentures and capital notes, securities portfolios including mutual funds and also provident funds and supplementary training funds) amounted at the end of December 2007 to some NIS 719 billion compared with some NIS 653 billion at the end of December 2006, an increase of 10.1 %.

Bank credit

In 2007, a slight increase of some 5.7% (an increase of some NIS 36 billion in the credit balance) was recorded, in nominal terms, in the volume of bank credit in the economy (including mortgage banks and on the basis of monthly averages). During the year's fourth quarter, the credit balance rose moderately by less than one percent, under the influence, *inter alia*, of the shekel's appreciation against the dollar. During all of 2007, the shekel's appreciation against the dollar deducted some 1.5 percentage points from the rate of increase in credit. In real terms, credit expanded by some 2.2% over the past year. As in recent years, the year 2007 was characterized by an increase in the weight of the non-bank financial sector's financing (i.e., loans provided primarily by institutional investors) at the expense of bank credit. Thus, the credit granted to the business sector by the banking system amounted to some 51% of credit granted to that sector at the end of 2007, compared with some 55% at the end of 2006, and some 74% at the end of 2002. In 2007, debentures issues of companies in the economy, which constitute an alternative to bank credit, amounted to some NIS 67-71 billion (according to an estimate based on Tel Aviv Stock Exchange data). When the increase in bank credit, as indicated above, is added to these, we reach an estimated annual increase of more than NIS 100 billion in the credit balance (bank and non-bank). This is a double digit rate of increase, which is significantly higher than the rate of growth in the economy, due primarily to the rapid expansion of non-bank financing.

The Bank's credit to the public amounted at the end of December 2007 to some NIS 133.7 billion, an increase of some 6.6% as compared with the end of 2006.

Global economic developments

In the year 2007, the global growth rate moderated to 5% from 5.3% in 2006. Correspondingly, it appears that the volume of global trading in 2007 also posted a more moderate rate of expansion, with the main slowdown occurring amongst the developed countries.

The rate of growth in the US economy had already begun to experience a trend of more moderate growth during 2006, which worsened during the second half of 2007, and at the beginning of 2008, the signs of a recession in economic activity became more significant. This was against the background of shocks in the US mortgage market, mainly in the weaker segment, the sub-prime segment. These loans, on the basis of which sophisticated financial instruments were structured, led large banks in the US and other countries to revalue the value of these instruments, with losses being consequently recorded in significant amounts.

The crisis in the residential real estate and the mortgage markets, which also impacted negatively on the banking and financial systems, led to a financial crisis in the capital and money markets in the first quarter of 2008. Accordingly, the large banking groups in the US recorded major write-offs. The Bear Sterns investment bank was sold to JP Morgan in the middle of March at a price that reflected only 1% of its value two weeks prior to the sale. The US central bank is taking action through various means to solve the liquidity problem that has been created in the banking system against the background of the financial crisis. The main negative impact on the US economy is expected to be reflected in a worsening of the financial condition of households, and a slowdown in the rate of growth in private consumption, which is the primary driving force behind growth in the American economy. Most of the effect of this crisis on

Israel is due to an expected slowdown in economic global activity, mainly in the US, as well as the effects of the global financial crisis, which also led to sharp falls in prices in the Israeli capital market.

Alongside the many difficulties, the crisis in the housing and mortgages market in the United States was accompanied by a certain reduction in the current balance of payments account deficit. As to monetary policy, the interest rate, which began to drop in September 2007, was reduced sharply by 125 basis points, cumulatively, by the end of January 2008, down to 3.0%, and an additional reduction of 75 basis points in March 2008, to 2.25%.

After five years of economic slowdown, Europe’s economic activity has revived during the years 2006-2007. Consequently, European economic growth amounted to some 2.5% to 3.0% per year during these years. The ability of the European economy to free itself of the negative impact of the expected economic slowdown in the United States will depend on the degree to which domestic demand in Europe rises, primarily from private consumers, and this is dependent on the degree to which the labour market there continues to improve. An additional factor that could enable a certain reduction in the exposure of European business turnover to that of the United States is the weight of European exports to the United States, which has continued to drop, and the volume of exports to developing markets, where the growth rate is relatively rapid, and which is continuing to grow.

In Southeast Asia, the economic activity is dependent on exports. Nevertheless, in light of the improvement in the standard of living, domestic demand from households and for real investment requirements continues to grow. This development could set off, if only partially, the influence of the reduced demand from the west. The intra-continental trade in Southeast Asia is also a significant stimulus for growth, with China’s economy constituting the most significant stimulus for long-term growth. The growth rate in China was some 11% per year during the years 2005-2007.

Credit rating of the State of Israel and of Bank Leumi

On 27 November 2007, the S&P credit rating company announced that it was raising the long-term foreign currency credit rating of the State of Israel from 'A-' to 'A' and that it was leaving the rating outlook at Positive. The upgrade of the rating reflected the improved economic and fiscal resilience against geo-political shocks, after a period of four years of improvement beyond expectations in budgetary terms, the accumulation of foreign assets and strong economic growth. The maintenance of the positive outlook rating expresses the expectation that the reduction of government debt would remain a key policy factor.

The Moody’s credit rating company announced on 13 March 2008 that it was considering the possibility of raising Israel’s rating. Israel’s current rating is 'A2' with a Positive rating outlook.

The Fitch credit rating company announced on 11 February 2008 that it was raising Israel's credit rating outlook from 'A-' to 'A', and giving a rating outlook of Stable. The rating increase was explained by the rapid decline in the public debt to GDP ratio, which reached just over 80% in the past year, its lowest level ever. On 14 February 2008, the company announced that it was raising the Bank’s credit rating from 'A-' to 'A', and giving a rating outlook of Stable. This was further to the State’s improved credit rating and the company’s view of the strengthening of the State’s ability to provide support to the Bank, if needed.

The Israeli credit rating company Midrug, a strategic partner of Moody's, announced on 21 June 2007 that it had set a rating of 'Aaa' for the Bank’s deposits, debentures and notes, including the rating for the framework for additional issues in the amount of NIS 4 billion given to Leumi Finance Company, the Bank’s wholly-owned subsidiary.

The Israeli credit rating company Maalot, a strategic partner of S&P, set a rating on 20 June 2007 of 'AAA' for subordinated capital notes and/or debentures issued by Leumi Finance Company in the amount of NIS 5 billion, through 30 June 2008.

On 4 March 2008, S&P Maalot announced a rating of 'A-1+' for the commercial paper to be issued by the Bank in an amount of up to NIS 1 billion.

The following table sets out details of representative exchange rates and the Consumer Price Index, and the rates of change thereof:

	31 December				
	2007	2006	2005	2004	2003
	NIS				
Exchange Rate of:					
US dollar	**3.846**	4.225	4.603	4.308	4.379
Euro	**5.659**	5.564	5.446	5.877	5.533
Pound Sterling	**7.710**	8.288	7.941	8.307	7.849
Swiss Franc	**3.420**	3.465	3.498	3.806	3.552
Consumer Price Index:	(points)				
November – known CPI	**105.8**	102.9	103.2	100.5	99.6

	Change in				
	2007	2006	2005	2004	2003
	(%)				
Exchange Rate of:					
US dollar	**(9.0)**	(8.2)	6.8	(1.6)	(7.6)
Euro	**1.7**	2.2	(7.3)	6.2	11.3
Pound Sterling	**(7.0)**	4.4	(4.4)	5.8	2.8
Swiss Franc	**(1.3)**	(0.9)	(8.1)	7.2	3.9
Consumer Price Index:					
November – known CPI	**2.8**	(0.3)	2.7	0.9	(2.0)

The following table sets out exchange rates shortly before publication of the Financial Statements, on 24 March 2008:

	NIS
US$	3.523
Euro	5.437
GB£	6.988
CHF	3.468

General Environment and the Effect of External Factors on Activities

Part of the information in this Section is **"forward-looking information"**. For the meaning of this term see the section "Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report" in this chapter.

Capital Market Reform Legislation and Proposed Legislation

On 9 November 2004 the team which was appointed by the Minister of Finance for the purpose of examining and recommending the steps required in order to intensify competition in the Israeli capital market, published its recommendations. The team's recommendations were approved by the government.

Following their recommendations, on 10 August 2005 three laws implementing a substantial reform of the capital market were published. These were:

The Intensification of Competition and Reduction of Concentration and Conflicts of Interest in the Israeli Capital Market (Legislative Amendments) Law, 2005;
The Financial Services (Control) (Engagement in Pension Counseling and Pension Marketing) Law, 2005 (the "Pension Counseling Law");
The Financial Services (Control) (Provident Funds) Law, 2005 (the "Provident Funds Law").

The above-mentioned legislation (the "Capital Market Reform") obligated the Bank to dispose of its holdings in mutual fund and provident fund management companies, and it allows the Bank to provide pension product counseling, after obtaining a license from the Supervisor of Capital Markets, and to continue to engage in investment counseling regarding financial products.

With regard to the above activities, the Bank is entitled to receive distribution commissions from institutional entities which manage mutual funds and supplementary training funds. After the Bank obtains a pension counseling license, the Bank will also be entitled to receive such fees from institutional entities which manage additional types of provident funds. The Bank may also provide operating services to institutional entities and may receive operating commissions from them.

Regulation of the Engagement in Pension Counseling, in accordance with the above-mentioned Legislation and according to the Outline agreed upon between the Supervisor of Capital Markets, Insurance and Savings and the Chairman of the Knesset Finance Committee

According to the Pension Counseling Law, a pension counseling license given to a banking corporation is restricted such that during the period established in the law (the "Restriction Period"), and which is longer for the Leumi and Hapoalim groups than for other banking groups, the banks may only counsel regarding certain pension products – i.e., provident funds providing payments, pensions or compensation which are not insurance funds – and they may not provide counseling regarding insurance funds or life insurance products included in or accompanying provident funds.

The Restriction Period for the Leumi and Hapoalim Groups, as established in the Pension Counseling Law when it was enacted in 2005, was five continuous years from the date on which each of the banks complied with the conditions entitling them to obtain a pension counseling license. For other banks, the Restriction Period was to continue until the date on which such a bank meets the conditions for obtaining a pension counseling license, but not before 31 December 2009.

During the Restriction Period, the Bank must notify any customer that the pension counseling which it provides is restricted with regard to the types of products it may cover, but the law nevertheless provides that when choosing which product is most suitable for a customer, the license holder must examine all types of pension products – both those which are permitted and those that are restricted. However, the only products that may be chosen as being most appropriate for the customer must be unrestricted ones, provided that the product which is indeed the product which is most appropriate for the customer, is among the unrestricted products.

The Pension Counseling Law was amended in January 2008, and the Restriction Period was shortened, after the Chairman of the Knesset Finance Committee and the Supervisor of Capital Markets, Insurance and Savings agreed upon an outline which allows the large banks (Leumi and Hapoalim) to engage in pension counselling.

The outline provides that:

Upon obtaining the license to engage in pension counseling, each of the large banks will be permitted to provide pension counseling to self-employed customers (including minors and customers above the age of 55, who are not salaried employees) throughout the country, and to salaried employees in the peripheral areas, which are listed in a supplement to the amended law;

As of 1 January 2009, the large banks will also be able to provide counseling regarding insurance funds and life insurance products that are included in or which accompany provident funds, to customers who live in periphery areas;

As of 1 April 2009, the large banks will also be able to provide counseling to self-employed customers, throughout the country, regarding insurance funds and life insurance products that are included in or which accompany provident funds;

And as of 1 August 2010, the large banks will be permitted to provide pension counseling regarding all pension products, to any customer in Israel (the other banks can provide such services as of 1 January 2009).

Regulation of Distribution Commissions

Distribution commissions for the distribution of mutual funds and provident funds are governed by regulations. With regard to mutual funds, four levels of maximum rates of distribution commission were established, which are to be calculated in respect of the mutual fund units held through the distributor, according to type of mutual fund, being: 0.125% regarding money market funds, 0.25% in respect of funds investing mainly in short-term, low risk investments, 0.8% in respect of funds investing mainly in equities and 0.4% in respect of other funds. The regulations establish the circumstances and types of funds regarding which the banks are not entitled to receive distribution commissions.

In relation to provident funds, including supplementary training funds, and in relation to pension funds, the maximum distribution commission rate is 0.25% regarding new deposits made as from 1 January 2006, and 0.1% regarding deposits made up to and including 31 December 2005, excluding monies in a fund controlled by a banking corporation on 10 August 2005, and monies to be transferred, as from 1 April 2006, from a fund that was controlled by a banking corporation on 10 August 2005, to another fund. In both of these cases, monies deposited prior to 31 December 2005 will bear the maximum commission rate of 0.25%. The commission calculation will be made with regard to the value of the fund assets deposited, transferred or that remain in the fund following continuation of membership as a result of advice that will be given to the member, including profits accrued thereto, and in a provident fund for pension, the value of the assets standing against the obligations of the fund to the customer.

Regulation of Operating Services and Commissions for Such Services

In 2006 the Supervisor of the Capital Market, Insurance and Savings (the “Supervisor”) distributed a circular intended to regulate operating agreements between a pension counselor and an institutional entity. According to the circular, the maximum annual rate to be collected by a pension counselor in respect of providing operating services to provident funds will not exceed 0.1%.

In December 2007, the Supervisor issued a draft circular the purpose of which was to establish the framework for the services that a banking corporation may provide to the members of provident funds of a management company that had been purchased from it, or which had purchased provident funds from the banking corporation (a “Purchasing Management Company”). According to the draft, in order to enable a Purchasing Management Company to prepare for the provision of services to members of the provident funds it manages, the continued provision of the services that are currently provided will be permitted, but on a temporary basis only. The services that may be provided temporarily by the selling banking corporation include the provision of information to members, the intake of information from members and employers, and the handling of deposits and withdrawals of monies by members, as part of the operating services that it provides. According to the draft, the banking corporations may continue to provide these services until the end of 2009. The draft circular does not relate to the manner in which the matters detailed therein are to be managed following said date, although pursuant to the stated purpose of the circular, the assumption is that the Purchasing Management Companies will thereafter be prepared to provide the services themselves, while at the same time, some of the services will be provided as part of pension counseling to be provided.

Amendments to the Joint Investment Trusts Regulations

During 2007, various amendments of the regulations enacted pursuant to the Joint Investment Trusts Law were published in the Official Gazette (*Reshumot*). These amendments provide that beginning from January 2008, it will be possible to establish types of mutual funds which did not exist in Israel prior to the amendments, including money market funds and exchange traded funds.

Draft of the Regulation of Engagement in Investment Counseling and Marketing and in the Management of Investment Portfolios Law (Amendment Number 11), 2007

The above-mentioned draft was signed by the Minister of Finance in December 2007, and was approved by the Ministers' Committee for Legislation, and it deals primarily with two issues:

1. Allowing foreign entities, who have been licensed to engage abroad in investment counseling and marketing and in the management of investment portfolios, to engage in these occupations and to provide such services to parties in Israel, without obtaining an Israeli license.

   The draft provides that an Israeli bank can contract with a foreign licensee regarding their engaging in counseling in Israel.

2. An expansion of the types of sophisticated clients regarding whom consultants are subject to less stringent requirements in the counseling process, such as being exempt from having a counseling agreement signed and from certain disclosure requirements when providing counseling to institutional investors acting for themselves only, so as to include counseling provided to institutional investors acting for others and corporations with equity capital exceeding NIS 50 million, and individuals the value of whose financial assets and securities exceeds NIS 15 million.

Appointment of the Committee for the Development and Strengthening of Competition in Israel

On 22 November 2007, the Minister of Finance and the Governor of the Bank of Israel announced the appointment of the Committee for the Development and Strengthening of Competition in the Israeli Capital Market. The committee is chaired by the Director-General of the Ministry of Finance.

The letter of appointment requires the Committee to examine and make recommendations regarding the measures needed to develop the capital market and to increase its ability to attract overseas capital. This is with a view to positioning the Israeli capital market as a significant global player and increasing its levels of competition and efficiency.

The Committee is to submit its recommendations by 31 August 2008.

Actions Taken by the Bank following the Capital Market Reform Legislation

Following the said legislation, the Bank has taken the following actions:

- In 2006, the Bank sold it activities in the field of the management of provident funds and mutual funds. On 31 January 2007, the sale to Prisma Provident Funds Ltd. of the operations of provident funds, the largest of which were Sion, a Central Severance Pay Fund, Tzur and Sagi, was completed, at a price of some NIS 418 million, following a price reduction arising from adjustments agreed to between the parties. The Bank's net profit, following adjustments and tax provisions, was some NIS 257 million. Together with the signing of the agreements with the purchasers of the provident funds, distribution agreements and agreements for the provision of operating services were signed with Leumi Gemel.

- In July 2007, the sale of the supplementary training funds' activities was completed. The Bank's share of the consideration was some NIS 150 million and the net profit of some NIS 93 million was recorded in the third quarter of 2007. In April 2007, the Bank entered into an agreement for the provision of operating services by the Bank to the supplementary training funds that had been sold, and also entered into a distribution agreement.

- The Bank has completed, together with the employees' representatives, most of the preparations required for the pension funds of the Bank's employees and the employees of Leumi Mortgage Bank (the "Employees Funds"), for the purpose of complying with the provisions of the permit given to the banks under the legislation, for the engagement in management of provident funds, all the members of which are employees of a bank or employees of a corporation controlled by it, and the Employees Funds will be placed under the management of a management company owned by the members of the funds.

- The Bank set up central severance pay funds for its employees and the employees of additional companies in the Group, which are managed by a wholly-owned subsidiary of the Bank.

- In light of new legislation regarding underwriting of securities offerings, which impose material restrictions on underwriting firms controlled by a bank, the Group's securities underwriting activity has been concentrated in a new company in which the Bank holds a 19.99% interest. For this purpose, Leumi & Co. Investment House Ltd. entered into a contract with Psagot Ofek Finances Ltd. regarding collaboration in the field of underwriting, to be carried out in the framework of new company, Psagot Leumi & Co. Underwriting Ltd. Psagot Leumi & Co. Underwriting Ltd. commenced operations during the third quarter of 2007.

Effect of the Capital Market Reform Legislation on the Bank and the Group

- The reform legislation has a material effect on the Group's activities in the capital market. The Group has until now engaged both in managing assets on the capital market for the public, and in counseling and distribution, as well as in underwriting and in providing additional capital market services. Following the reform, which limits the Group's activity in the Israeli market, and as a result the ability to spread risk, the Group's activities in Israel will focus mainly on the provision of investment counseling, the provision of pension counseling when the Bank receives a license to engage in such activities, and the provision of operating services and banking and financial services to entities active in the capital market.

- The legislation has restricted the banks' activities in various ways which may make it difficult to compete with non-bank financial entities which are not subject to the said restrictions.

- Furthermore, the disposal by the Bank of its holdings in mutual fund, provident fund and supplementary training fund management companies will cause a reduction in the Bank's current income from these fields of activity. On the other hand, the legislation allows, as mentioned above, the receipt of distribution commission from institutional entities, and the receipt of commission in respect of operating services to institutional entities, and these commissions will, to a partial extent, reduce the expected adverse effect.

- The following is the effect on the Group's operating income.

	2007	2006	Change	
	NIS millions	NIS milllions		%
From mutual funds	**165**	391	(226)	(57.8)
From provident funds	**16**	216	(200)	(92.3)
From supplementary training funds	**19**	29	(10)	(34.5)
Total	**200**	636	(436)	(68.5)

At the same time it should be noted that operating expenses decreased by some NIS 181 million.

- The amendments to the Joint Investment Trusts Regulations could have indirect effects on the banks, since, as stated, these regulations allow for the establishment of money market funds, which are solid funds making short term investments of less than one year. In his letter to the Knesset Finance Committee regarding the approval of the regulations, the Minister of Finance noted that the money market funds will make a considerate contribution to the development of non-bank credit, both in terms of demand and in terms of supply.

- An additional amendment to the Provident Funds Law entered into force in January 2008, which changes the existing provident funds and the regulations for the withdrawal of funds from them, with respect to monies that are deposited as from January 2008, and which allows the deposit of monies in central severance pay funds only until the end of 2010. The Bank is examining the effect of the Law's amendment.

Legislation Affecting the Banking System

Amendment of the Banking (Service to Customers) Law regarding Commissions

In early July 2007, following the publication of the recommendations of the Parliamentary Committee of Enquiry regarding bank commissions, an amendment to the Banking (Service to Customers) Law, 1981 was enacted with regard to bank commissions.

The amendment to the law is a combination of a number of proposed laws which were discussed in the Knesset Economics Committee, the purpose of which was to increase the transparency of the list of commissions that the banks charge their retail customers (individuals and small businesses, as determined in rules by the Bank of Israel – "Retail Customers"), to transfer the authority to impose supervision on bank commissions to the Bank of Israel, and to deal with the issue of movement of customers from one bank to another.

Pursuant to the amendment to the law, the Governor of the Bank of Israel must establish a list of services for which a banking corporation may charge commissions from its Retail Customers.

In January 2008, the Governor of the Bank of Israel published the Banking Rules (Service to Customers) (Commissions) 2008 in the Official Gazette (*Reshumot*). To these rules was attached a list of commissions for such customers, and three abbreviated lists relating to a number of services provided to such customers.

Among other things, these rules define a "small business" for the purpose of determining the application of the above-mentioned legislation.

In this price list, the Supervisor of Banks reduced the number of commissions for retail customers by cancelling and consolidating various commissions.

The Law provides that the above-mentioned rules, including the price list, are to come into force during April 2008, although the Governor of the Bank or Israel, with the approval of the Knesset Economics Committee, may postpone their coming into force for an additional three month period. On 24 March 2008, the Knesset Economics Committee approved the postponement of the coming into effect of the rules to 5 June 2008, for the purpose of the completion of the preparations required for their implementation. If required, an additional postponement of the coming into effect of the rules may be requested, until 5 July 2008.

The Bank and the subsidiaries have begun preparations for the implementation of the above-mentioned rules and are examining the implications of the changes proposed in the above-mentioned rules on their future income from commissions.

At this stage, the Bank estimates that the Group's income from commissions could decline by an amount of some NIS 200 million, in annual terms. This amount is an estimate, based on the volume of activity and the Bank's income from commissions in 2007, and which does not take into account possible changes in the commission structure. The Bank is examining the meaning of the legislation and the rules and its overall implications on its activities, and at this stage, it is not possible to evaluate such implication exactly.

Income Tax (Adjustments for Inflation) (Amendment No. 20) Law, 2008

On 26 February 2008, the Knesset approved an amendment to the Income Tax (Adjustments for Inflation) Law, 1985. The amendment restricts the application of the law to the years 1968-2007, and lays down transitional provisions regarding the end of its application.

The Bank estimates that, on the basis of the capital eligible for protection as at 31 December 2007, each change of 1% in the CPI will affect the Group's tax expenses by some NIS 47 million, net.

Amendment to the Value Added Tax Law (Amendment No. 35)

Amendment No. 35 to the Value Added Tax Law, which was approved by the Knesset on 26 February 2008, determines that salary tax paid by a financial institution will be recognised as an expense for the purposes of the calculation of profit tax, and makes the employer's portion of National Insurance payments subject to salary tax.

The amendment came into effect as of 1 January 2008. In 2008, half of the employer's portion of National Insurance payments will be subject to salary tax, and half the salary tax paid will be recognized as an expense for purposes of the profit tax calculation.

In the Bank's estimation, the amendment to the law will reduce the current net tax charge of the Group for 2008 by some NIS 13 million, and by some NIS 26 million per year beginning from 2009.

Prohibition on Money Laundering (the Banking Corporations' Obligations regarding Identification, Reporting and Record-Keeping for the Prevention of Money Laundering and the Financing of Terrorism) Order, 2006

On 12 December 2006, the amendment to the Prohibition on Money Laundering (The Banking Corporations' Obligations regarding Identification, Reporting and Record-Keeping) Order, 2001, was published, and will thereafter be known as the "Prohibition on Money Laundering (The Banking Corporations' Obligations regarding Identification, Reporting and Record-Keeping for the Prevention of Money Laundering and Financing Terrorism) Order" (the "Order").

Various subjects were included in the amended Order, including certain concessions for banking corporations. However, its principal purpose is the extension of the Order's directives to credit cards, and the practical implementation of the directives of the Prohibition on Financing Terrorism Law, 2005.

This is the first time that the Order has been applied to credit cards and, as such, it applies to and imposes various obligations both on the banks that themselves issue the cards, and on the issue of cards though companies that are banking auxiliary corporations engaged in issuing credit cards.

See page 179 of the Report below for further details.

Parliamentary Committee of Enquiry Regarding the Tracing and Return of Property of Holocaust Victims

In January 2005, the Parliamentary Committee of Enquiry Regarding the Tracing and Return of Property of Holocaust Victims (the "Committee") published its concluding report. The report indicates that assets of Holocaust victims that had been deposited with the Anglo-Palestine Bank were transferred, pursuant to the directives in force at the time, to the British Custodian of Enemy Property, to the Israeli Custodian of Enemy Property, to the Administrator General or were returned to those entitled thereto. Nevertheless, the report recommended that the funds be revalued, together with retroactive linkage differentials, for the period in the past during which they were held by the Bank.

On 3 January 2006, the Assets of Holocaust Victims (Restitution to Heirs and Endowment for the purpose of Assistance and Commemoration) Law, 2006 (the “Law”) came into effect. The Law provides that a party who holds, in Israel, assets of Holocaust victims (as such terms are defined in the Law) must transfer them to the Tracing and Return of Property of Holocaust Victims Company Ltd. (the "Company"), which was established pursuant to the provisions of the Law, together with linkage differentials and interest in amounts determined by a special revaluating committee. The revaluating committee’s report was delivered to the Bank, and appropriate provisions were made, as estimated by the Bank.

At the beginning of July 2007, the Bank appointed the Honorable Supreme Court Justice (ret'd) Theodore Orr as an external examiner to carry out an independent and impartial examination of the Bank’s obligations pursuant to the Law, if any, and of the Bank’s conduct regarding the assets of Holocaust victims, as such are defined in the Law. The Bank announced that it would provide the examiner with any assistance required.

Additionally, out of sensitivity to public sentiment and to demonstrate its goodwill, the Bank transferred the sum of NIS 20 million to the Company, to be used for making payments to the heirs of victims and to survivors during their lifetime, in accordance with the provisions of the Law and pursuant to appropriate criteria to be established by the Company, as required by the Law.

The Bank has notified the Company that if it is determined that the Bank is not obligated to make any payments whatsoever (which is the Bank’s position), or that it is required to make a payment which is lower than that which has been paid, any balance of the amount will be considered to be a donation to be used for the above purposes. If it is determined that the Bank is required to pay amounts to Holocaust survivors or to the heirs of Holocaust victims which are higher than the amount that has been paid, then the Bank will set off the payment made (linked to the CPI and bearing interest) against the amount of the liability.

On 4 March 2008, the Bank received a first demand from the Company for payment of a revalued amount of some NIS 148 million that the Company claims that the Bank is required to transfer to it according to the provisions of the Law. The Bank is examining the demand, but at this early stage the factual and legal basis of the demand and its accuracy cannot yet be evaluated, and therefore no provision has been made in the Financial Statements.

The Management of Current Account Credit Lines (Directive 325 – Proper Banking Management)

Proper Banking Management Directive No. 325 on the subject of "Management of Current Account Credit Lines" is intended to minimize the uncertainty caused to both the customer and the banking corporation as a result of the practice that allowed for exceeding credit limits in current accounts.

According to the directive, a banking corporation which provides credit to a customer through a current account (including a business account) at the customer's request, will set a credit line for such customer, based on a documented analysis of the credit requirements of the customer, which will be approved by the relevant authorized entity in the banking corporation.

The banking corporation is forbidden from allowing the accumulation of a negative balance in a current account. However, a banking corporation is entitled to provide a credit line unilaterally to a customer with whom it has a credit line agreement, but the customer will not be charged commission for this and the rate of interest will be no higher than the level agreed to with the customer with regard to the last credit line that was agreed to with the customer. In cases where excesses are unavoidable, the banking corporation will be able to charge the client with additional excess interest and commission only after the account has been classified as a problem loan (in arrears). The banking corporation must notify the customer that he is required to act immediately to eliminate the excess, and to cease charging additional amounts to the account, the honoring of which will create or increase excesses over the credit line set for such customer. Interest in respect of an excess which has arisen in an account which has been classified as a problem loan will be credited to the profit and loss account only following the actual collection thereof.

Pursuant to the directive, a banking corporation may choose not to implement the provisions with regard to excesses of less than NIS 1,000, so long as they do not continue for a long period.

As of 31 December 2007, debts classified as problem loans as a result of the above-mentioned directive, amounted to some NIS 1,849 million, and an additional provision for doubtful debts was made in the amount of NIS 7 million.

Measurement and Disclosure of Impaired Debts (Directive – Measurement and Disclosure of Impaired Debts, Credit Risk and Provisions for Credit Losses)

On 31 December 2007, a directive of the Supervisor of Banks was published, an amendment to the directives regarding public reporting, on the subject of “Measurement and Disclosure of Impaired Debts, Credit Risk and Provision for Credit Losses.” The directive is based on US accounting standards (FASB Standards 114 and 118), US banking regulatory directives, and directives of the SEC dealing with banks, and is also in line with the requirements for the reports of US banks. The directive constitutes a material change as compared with the existing provisions regarding classification of problem loans and the measurement of provisions for loan losses in respect of such debts.

For details regarding the main changes included in the directive, see Note 1(X)b to the Financial Statements.

The directive is to apply to the financial statements as from 1 January 2010.

A steering committee has been appointed as part of the Bank’s preparations for the implementation of the above-mentioned directive. The committee’s members include representatives of the business divisions, and the accounting and computer functions.

Sub-committees have been set up to deal with the establishment of work methods and with the directive’s requirements.

The modification of the computer systems has begun, a project which involves material changes in the information systems in order to carry out the required processes.

The Supervisor of Banks has not yet decided whether if, upon the directive’s implementation, there will still be a requirement to make an supplementary provision for unidentified risks in the credit portfolio which are based on risk characteristics in the credit portfolio in accordance with the provisions of Proper Banking Management Directive No. 315. The Supervisor has also not yet decided how to deal with the general provision currently made by the banks. The total general and additional provisions as at 31 December 2007 amounted to NIS 875 million, of which NIS 593 million was at the Bank.

It is not possible at this stage to estimate the implications for the Bank’s future financial results of the implementation of the directive when it is adopted.

Directives for Proper Conduct of Banking Business and Proposed Laws Regarding the Securing of the Investments of Apartment Purchasers

In February of 2008, the Supervisor of Banks published a Directive (Directive No. 326) for the Proper Conduct of Banking Business – Project Finance. The directive requires a banking corporation that provides financing for a construction project through the project finance method (the "Financing Corporation”) to use a payment coupons booklet as the sole method for receiving payments from apartment purchasers in financed projects. This system is intended to insure that all the purchasers’ funds are deposited in the project’s account and to insure that guarantees are issued in accordance with the Sales (Apartments) (Securing of Apartment Buyers’ Investments) Law, 1974 with respect to the payments that are so deposited (the “Coupons Arrangement”). The Directive will enter into force with respect to project financing agreements signed commencing on 1 June 2008.

The Coupons Arrangement is also adopted in the Proposed Sales (Apartments) (Securing of Apartment Buyers’ Investments) (Amendment – Responsibility of the Seller, the Bank and the Appointment of a

Supervisor) Law, 2008, which is a private members' bill submitted by a number of Knesset members and which was published on 4 February 2008. According to this proposed law, a Financing Corporation will be responsible for putting into place the Coupons Arrangement and for providing security to apartment purchasers who pay with the coupons. The proposed law also provides that the violation of any of the provisions relating to this guarantee will constitute a criminal offence of the Financing Corporation, punishable by a fine. Financial sanctions may also be imposed.

Alongside the above-mentioned private bill, there is also a government-sponsored proposed law, dealing with a number of issues that overlap the private members' proposal. Each proposed law suggests different arrangements. For example, the government's proposed law significantly expands the grounds for exercising sales guarantees, by adding as a ground a delay in the delivery of an apartment, regardless of insolvency, while the private members' proposed law adds as a ground for such exercise the existence of an absolute obstacle preventing the delivery of the apartment or the inability to deliver the apartment due to a stay of proceedings order.

The proposed laws remain under discussion.

Reform of the Banking Payment and Settlement Systems

1. Real Time Gross Settlement (RTGS) and Continuous Linked Settlement (CLS)

Since September 2007, the Bank has been participating in the RTGS system, established as part of the reform being led by the Bank of Israel in the payment and settlement systems for carrying-out shekel transfers during the business day between banks in Israel and the other participants in this system. One of the principles of the system is the clear determination of the point in the process when the payment becomes final, and after which the payment order may not be cancelled. The system obligates the banks to manage shekel liquidity in real time.

In addition, the Bank became a member of CLS, and in this framework intends to provide nostro shekel services to the other member banks of CLS and shekel liquidity services to CLS Bank. The CLS Group provides a platform that facilitates the guarantee of mutual payments arising from transactions between the currencies traded through its system, while reducing settlement risks and the need for settlement liquidity. The group includes CLS Bank (a US company) that supplies banking services, and a service company (a UK company) that supplies operating and computer services. Some 60 leading international financial institutions are currently members of CLS, with 15 currencies being settled.

A precondition for the inclusion of the shekel is the existence of the RTGS system in Israel, and its proper operation for a period of half a year, and the enactment of the Payment Systems Law, 2008, which regulates, *inter alia*, the operation of the RTGS and the CLS systems.

Activity in foreign currency as part of the CLS system began on 25 February 2008. The addition of the Israeli shekel to the group of currencies settled through CLS is planned (according to the current updated timetable) for the second quarter of 2008 (May).

2. The Payment Systems Law, 2008

The Payment Systems Law, 2008, published in February 2008, regulates the operation of payment systems, primarily those whose operations are of the utmost importance to the national economy's payment systems. The purpose of the law is to anchor in legislation the provisions that are required in order to minimize the risks and to provide legal certainty for those participating in the systems, in order to ensure the stability of the payments systems for such participants, for banks and for other financial entities, and for their customers.

One of the most basic characteristics of a "Designated Controlled System" as defined in the law, is the finality of the payments carried out through the system. As part of the overall regulation, the law deals with the liquidation of a participant in such a system, in a manner that reduces the instability that such a liquidation can create for the system.

In the first quarter of 2008, the Governor of the Bank of Israel declared that RTGS and CLS are "Designated Controlled Systems."

The law allows the Bank of Israel to grant intra-day credit to a participant in a Designated Controlled System, against the receipt of collateral.

Consortium Arrangements for the Granting of Credit

The Antitrust Authority (in this section, the "Authority") notified the banks in 2002 that consortium arrangements for the granting of credit might be considered restrictive arrangements, and that the General Director would not enforce the provisions of the Antitrust Law with regard to consortium arrangements that complied with the conditions laid down by her. The notice of the Authority has been extended from time to time.

On 8 March 2007, the Authority announced that it had found it appropriate to make minor changes to the conditions under which the General Director would not enforce the provisions of the Antitrust Law.

The updated conditions (some of which are identical to those laid down in the original notice) as formulated in the Authority's approval are:

1. The formation of the consortium is essential in that had it not be formed, the granting of credit to the customer on reasonable conditions would not be possible (the General Director made it clear that what was intended was that were it not for the formation of the consortium, the level of risk of each of the banks would be materially higher when compared with the level existing under the consortium).
2. Advance written consent was given by the customer for formation of the consortium.
3. The customer will be able to negotiate the terms of the credit with any of the banks.
4. The Bank and Bank Hapoalim B.M. will participate in a consortium for the granting of credit only if the amount of the participating credit that each of the two banks is required to grant exceeds NIS 300 million. This restriction will not apply to debt repayments arising from credits granted to a customer prior to 18 August 2002, and it is in addition to the above-mentioned conditions.

In addition, the banks are entitled to apply for specific exemptions for certain joint credit transactions.
The General Director's approval is for a period of one year from its publication. The Bank has applied to the Authority for an extension of the approval.

On 2 March 2008, the Authority announced that it would not be taking further steps against credit consortia, even if the members of the consortium include insurance companies, in addition to banks, and if only insurance companies are members of the consortium. This is subject to the members of the consortium complying with the above conditions, with the requisite changes. The Authority's notice is to be in force for three years from its publication date.

Disclosure Regarding Authorized Signatories of the Corporation

In January 2008, the Israel Securities Authority published an instruction to reporting entities, pursuant to the Securities Law, on the subject of disclosure regarding authorized signatories of the corporation. According to the instruction, where an individual person in a corporation is authorized to bind the corporation by his sole signature in an amount exceeding five percent of the total balance sheet assets of the corporation, as per the last audited financial statements, without the need for the authorization of an additional person, the corporation will disclose same in its reports.

The Supervisor of Banks instructed the banking corporations and credit card companies to implement the terms of the instruction, as from the financial statements for 2007.

As at the date of publication of these Financial Statements, the Bank does not have any sole authorized signatories, as per the definition contained in the said instruction.

Proposed Laws Regarding Credit Cards

During the first quarter of 2007, three private proposed laws were tabled before the Knesset regarding the credit card market. Two of the above proposed laws deal with separating the ownership of credit card companies from the banks, and the third deals with regulation, through legislation, of the acquiring of all credit cards by each of the credit card companies.

If the proposed laws that require the banks to dispose of the operations of the credit card companies owned by them are enacted, there could be an adverse effect on the Bank's income from credit card activity, although it is not possible at this stage to estimate the intensity and scope of the impact.

Private Knesset Members' Bills regarding the Payment of Interest on Credit Balances in Current Accounts

In July 2007, the Knesset Economics Committee held a preparatory discussion before the first reading of two private members' bills, submitted by two Knesset members, for amending the Banking (Service to Customers) Law. These propose that a banking corporation pay interest to customers on credit balances in a current account, and that the Governor of the Bank of Israel, upon consultation with the Advisory Committee of the Bank of Israel and with the approval of the Minister of Finance, will establish a minimal rate for this interest.

Bills regarding this subject have been tabled before the Knesset in the past.

The two proposed laws have been consolidated into one, and the discussion in preparation for the first reading has not yet been concluded.

If the above-mentioned proposed law is enacted, there may be an adverse effect on the Bank's income from interest, although it is not possible at this stage to estimate the intensity and scope of the effect.

Proposed Law – Prohibition on Investment by Institutional Entities in Corporations that Maintain Business Relations with Iran, 2007

The above-mentioned proposed law, submitted by a large number of Knesset members, passed its first reading and is currently being debated in the Knesset Foreign Affairs and Security Committee, in anticipation of its second and third readings.

Its purpose, as expressed in its section 1, is to "take measures to restrict Iran's financial abilities" and to deal in this way with Iran's status as a substantial threat to world peace and to the existence of the State of Israel.

It is proposed by the law that the Minister of Finance appoint a committee to implement the law's provisions. The committee will collect data regarding corporations that maintain "material business relations," as that term is defined in the proposed law, with Iran. The committee will publish this list. If a corporation is included in the list, all corporations that it controls or that control it ("Corporations on the List") will immediately be included as well.

Institutional entities (including banks) will be prohibited from investing in any Corporations on the List. The definition of "investment" is broad and includes "through acquisition or receipt of securities or any other rights in a corporation, or through the provision of loans to a corporation." Thus, the prohibition will apply both to the acquisition of means of control in Corporations on the List and to the provision of credit to such corporations. An additional clause in the proposed law provides that if a corporation is included in the list after such an investment has already been made, the institutional entity will be required to sell the holdings within a period to be established in the law, and a failure to comply with this requirement will constitute a criminal offence.

Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report

On 30 June 2004, Amendment No. 23 to the Securities Law, 1968 was published, further to principles recommended by the Barnea Committee (the "Amendment to the Securities Law").

Together with the Amendment to the Securities Law, on 14 September 2004 an amendment to the Securities Regulations was published, further to the principles recommended by the Barnea Committee (the "Amendment to the Securities Regulations"). *Inter alia*, the Amendment to the Securities Regulations regulates the disclosure rules regarding the information required in a prospectus, substantially expands the disclosure required in periodic reports, changes the structure of the periodic report and also includes requirements for the disclosure of forward-looking information.

In accordance with the Amendment to the Securities Regulations, the requirement to expand the disclosure in the periodic reports (Regulation 8(b) and 8A of the Securities Regulations (Periodic and Immediate Reports)) does not apply to banking corporations.

In light of this, the need arose to apply the requirements of expanded disclosure which were added to the Securities Regulations, as mentioned above, to banking corporations, pursuant to clarifications given by the Israel Securities Authority, and subject to the changes required due to the nature of the business of banking corporations.

In accordance with the above, the Supervisor of Banks amended the public reporting directives and on 19 February 2006 published temporary provisions (the "Temporary Provisions") whereby additional information must be included in the Directors' Report, mostly based on the Amendment to the Securities Regulations, subject to the amendments that the Supervisor deemed appropriate to apply to the banking corporations. Pursuant to the Temporary Provisions, information has been included in the Directors' Report which does not fall into the category of a description of past facts, and is therefore forward-looking information, as defined in the Amendment to the Securities Law.

The Director's Report includes, as mentioned above, in addition to data relating to the past, information that relates to the future, which is defined in the Securities Law, 1969, (the "Law") as "forward-looking information". Forward-looking information relates to a future event or matter, the realization of which is not certain and is not within the exclusive control of the Bank.

Forward-looking information is generally drafted by way of words or phrases such as "the Bank believes", "the Bank foresees", "the Bank expects", "the Bank intends", "the Bank plans", "the Bank estimates", "the Bank's policy", "the Bank's programs", "the Bank's forecast", "strategy", "aims", "likely to affect" and additional phrases testifying to the fact that the matter in question is a forecast of the future and not a past fact.

Forward-looking information included in the Directors' Report is based, *inter alia*, on forecasts of the future regarding various matters related to economic developments in Israel and abroad, and especially to the currency markets and the capital markets, to legislation, to directives of regulatory bodies, to the behavior of competitors, to technological developments and to personnel matters.

As a result of the inability to foresee with certainty that these forecasts will be realized, and the fact that in reality events may turn out differently from those forecasted, readers of the Report should relate to information defined as "forward-looking" with caution, since reliance on such information involves risks and uncertainty and the future financial and business results of the Leumi Group are likely to be materially different.

The Bank does not undertake to publish updates of the forward-looking information in this Report.

Accounting Policy on Critical Subjects

General

The preparation of consolidated financial statements in accordance with generally accepted accounting principles and the directives of the Supervisor of Banks requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the amounts of income and expenses.
The actual results relating to these items may differ from the estimates and/or the assumptions.
The estimates and assumptions are generally based on economic forecasts, assumptions regarding the various markets and considered decisions based on past experience which Management believes to be reasonable at the time of signature of the Financial Statements.
The principle accounting policies applied in the Leumi Group are set out in detail in Note 1 to the Financial Statements.

Set out below is a brief description of the major critical accounting subjects which involve Management's estimates and assumptions and which have been discussed by the Board of Directors, Management and the joint auditors:

Discontinuance of Adjustment of Financial Statements

In October 2001, the Israel Accounting Standards Board published Accounting Standard No. 12 - "Discontinuance of Adjustment of Financial Statements". Pursuant to this standard and in accordance with Accounting Standard No. 17, which was published in December 2002, the adjustment of financial statements for inflation was discontinued as of 1 January 2004. Until 31 December 2003, the Bank continued to prepare adjusted financial statements in accordance with the directives of the Supervisor of Banks, on the basis of the rules determined in Opinion No. 36 of the Institute of Certified Public Accountants in Israel. Since 1 January 2004, the Bank has been applying the provisions of Standard No. 12 and the Supervisor of Banks' transitional provisions. The adjusted amounts included in the Financial Statements as at 31 December 2003 were used as a starting point for the financial reporting in reported amounts.

Provision for Doubtful Debts

Specific provision

Within the context of the Bank's credit policy, principles have been determined for the granting of credit and the administration and supervision of the Bank's credit portfolio, with the aim of improving its quality and reducing the risk inherent in its management. The Bank examines the credit portfolio on an ongoing basis, for the purpose of identifying, as early as possible, those borrowers whose risk level and exposure has risen and who require special management attention and close monitoring, so as to improve their position. An evaluation of the extent of the problem is made by the business entities dealing with the borrower, while exercising business judgement, and in the case of large credits, also by entities in the credit sphere who do not deal with the borrower.

In accordance with the Bank's guidelines, examinations are carried out on an ongoing basis with regard to the obligations in especially sensitive accounts, for the purpose of determining their risk level, and where necessary, classifying them as problem loans or making specific provisions for doubtful debts.

The specific provisions for doubtful debts are made in accordance with an examination of the borrower's business condition and an estimate of its ability to continue to function and service its debt, the calculation of the appropriate specific provisions, the loan's risk rating and on the available information relating to the creditor, such as: the cash flow and business position, the business environment, his past record in fulfilling his obligations and the estimated value of the collateral held by the Bank.

The process described above for estimating potential losses in the credit portfolio involves a high degree of uncertainty and subjective estimations, with regard to the classification of a debt as problematic and to the factors on which the calculations of provisions are based. The assumptions and estimates may have a material affect on the amount of provisions for doubtful debts.

A discussion is held each quarter by the Bank's doubtful debts committee, headed by the Chief Executive Officer, regarding the provisions required for the quarter. The proposals for the quarterly provisions required on a customer-by-customer basis are presented for discussion. In addition, the Board of Directors, within the context of its discussion of the Financial Statements, discusses the provisions for doubtful debts so as to approve their amount. As background material for its discussions, data on the debts and collateral of the major customers in respect of whom a provision is required are brought before the Board and the amounts of the provisions proposed by Management.

Specific provisions in respect of housing loans granted by Leumi Mortgage Bank are mostly made as percentages of the debts according to the extent of arrears. These percentages have been determined in directives of the Supervisor of Banks.

The provisions of consolidated Israeli subsidiaries are made in accordance with the procedures in effect at the Bank and accordance with Bank of Israel directives, with regard to banking corporations.

The provisions of overseas consolidated subsidiaries are determined by their authorized bodies, in accordance with accepted practice in the countries in which they operate and the directives of the local regulatory authorities.

Additional Provision

The additional provision is calculated on the basis of the classification of debts and according to a formula determined in the Supervisor of Banks' Proper Banking Management Directive no. 315. The determination of the classification according to which the provision is calculated is carried out in accordance with fixed guidelines and at the various levels of management, but the classification is ultimately, to a large degree, the result of the exercise of discretion.
Changes in the classification of the debts and changes in the coefficients determined by the Bank of Israel regarding the rate of provision will cause a change in the level of provision required. It should be noted that a change in the additional provision does not affect the tax liability, since the additional provision is not recognized as an expense for tax purposes.

Derivatives

In accordance with the directives regarding financial accounting of the Supervisor of Banks, the Bank applies Financial Accounting Standard FAS 133, as amended, with regard to the treatment and presentation of derivatives. In accordance with the directives, the values of derivatives traded on an active market are determined according to market value.

Derivatives that are not traded on an active market are valued according to accepted models. The Black & Scholes model is used for pricing options. The models and the reasonability of their results are examined on an ongoing basis according to existing monitoring guidelines. The calculation of fair value is based on the yield of the underlying assets used for hedging these instruments, as well as additional parameters such as standard deviation, duration of term to maturity, the risk margin and the exchange rates.

In cases where the Bank does not have a mathematical model for evaluating a derivative, the fair value is determined on the basis of price quotations received from traders in such derivatives. Although these quotations are received from reliable brokers with whom the Bank has chosen to work, it is not certain that the price quoted reflects the price obtainable in an actual transaction in any amount, and especially transactions in large amounts. Derivatives whose fair value is determined on the basis of price quotations represent some 0.07% of total derivatives and some 0.084% of the Bank's assets as at 31 December 2007.

Securities

Securities, other than debentures held to maturity, are stated in the balance sheet at their fair value except for shares and options in respect of which the fair value is not readily available, which are stated at cost.

Fair value is determined, in the case of listed securities, on the basis of market value, based on quotations from Bloomberg, Reuters and the Financial Times, and in the case of non-listed securities (debentures) amounting to some NIS 1.8 billion, according to the quote received from the bank from which the security was purchased.

With regard to securities whose value is determined on the basis of quotations and those whose value is determined according to their stock exchange price (see also regarding derivatives) their fair value does not necessarily reflect the price that may be received on the actual sale of the security in large amounts. For further details, see pages 82-83 of the Report.

Of total debentures, some 35.4% (some NIS 14.8 billion) are investments in listed debentures issued by the State of Israel and some 4.7% (some NIS 2.0 billion) are debentures of overseas governments, mainly the USA.

Obligations regarding Employee Rights

The amounts of the obligations for pension and jubilee grants are calculated according to actuarial models, using a capitalization rate of 4% determined by the Supervisor of Banks, and taking into account the forecast real increase in pay on the basis of past experience, which varies according to the age of the employee. The rates of increase vary between 1.5% and 4.6%. Up to and including 2005, an average set increase of 2.5% in real terms was assumed. Any 0.25% change in the capitalization rate of the above-mentioned obligations will cause an increase/decrease of some NIS 165 million in the total of the obligations, and any change of 0.25% in salary costs will cause an increase/decrease of some NIS 41 million in the total obligations.

The actuarial models include assumptions regarding life expectancy tables, disability rates, turnover rates etc. Although the parameters were determined with appropriate care and professional expertise, a change in any or some of the parameters and/or the capitalization rate and/or the rate of increase in pay will cause a change in the level of the Bank's obligations.

The actuary's valuation of the employees' rights is to be found on the Israel Securities Authority's website, the address being: www.magna.isa.gov.il.

In February 2007, the Chief Actuary of the Capital Market, Insurance and Savings Department of the Finance Ministry published additional circulars to the pension funds and insurance companies which apply to the financial statements as at 31 December 2006, in terms of which pension and life insurance reserves are to be evaluated on the basis of new mortality tables.
The Bank adopted the above tables, and as a result an additional provision for pension and jubilee reserves in the amount of NIS 214 million was recorded in 2006.

Obligations in respect of Legal Claims

Among the Bank's other obligations, there are provisions for various legal claims against the Bank, including applications for class actions. The provisions are determined in a conservative manner in accordance with Management's assumptions, based on legal opinions.
A discussion is held by the Board of Directors once a quarter in respect of provisions for claims above a certain amount, that have been filed against the Bank.

To evaluate the risks in legal proceedings that are filed against the Bank, the Bank's Management relies on the opinions of the outside counsel representing the Bank in these claims.

These opinions are given by the outside counsel in accordance with their most considered opinion on the basis of the facts presented to them by the Bank and on the basis of the known legal position (laws and case law) as at the date of the estimation, and which are often open to possible conflicting interpretations and claims.

The estimation of chances in relation to the approval of class actions involves even more difficulty, since this is a relatively new legal field, the legal doctrine relating to which, even on important matters of principle, is still being formed and not yet settled. There are also claims in respect of which, due to the stage of the proceedings, counsel are unable to estimate their inherent risk, even under the above-mentioned limitations.

In the light of the above, it is possible that the actual results of claims may differ from the provisions made.

Buildings and Equipment

Buildings and equipment are presented at cost, less accrued depreciation and a provision for a decrease in value. Buildings to be sold are presented at the lower of their cost or realization value. The realization value is based on valuations made by assessors. Changes in these valuations may affect the amount of the provision.

Depreciation is calculated from the cost, in accordance with the estimated use period, according to the straight line method.

Direct costs relating to the development of computer programs for own use (as defined in Accounting Standard No. 30 – "Intangible Property") are capitalized as investments in equipment after the conclusion of the initial planning stage of the project and are depreciated from the date of their operation according to an assessment of the duration of their use.

From time to time the Management of the Bank examines the need for provisions for a decrease in value of the assets that it owns. The test for a decrease in value of the assets is made by comparing the book value of the asset with its recoverable value. Recoverable value is the higher of the realization price of the asset and its usage value (which is the present value of an estimate of the forecasted future cash flows from the use of the asset).

Income Tax

The Bank implements Accounting Standard No. 19, “Taxes on Income” (the "Standard”). The Standard provides rules for recognition, measurement, presentation and disclosure with regard to taxes on income and deferred taxes in the financial statements. The Standard provides, *inter alia*, that a deferred tax liability must be recognised in respect of all taxable temporary provisions, and that a deferred tax asset must be recognised in respect of all temporary differences that can be deducted, losses for tax purposes and tax benefits that have not yet been utilised, if it is anticipated that there will be taxable income against which it will be possible to utilise them, except for a limited number of exceptions.

In certain matters relating to the accounting treatment of income tax, including with regard to recognising a deferred tax asset in respect of losses to be carried forward and temporary differences, there are additional limitations in the directives of the Supervisor of Banks which apply to the Bank.

The main subjects in respect of which deferred taxes were not recorded are as follows:

- Adjustments for changes in the buying power of the new shekel relating mainly to structures according to the rules determined by the Israeli Accounting Standards Board in Standard 19. See Note 26F.
- Pursuant to the directives of the Supervisor of Banks, deferred taxes were not recorded in respect of the general provision, the additional provision and the special provision for doubtful debts.
- Investments in consolidated companies that the Bank intends to keep and not realize.

- A receivable tax benefit in respect of temporary provisions where the possibility of realization of the benefit is in doubt.

The deferred taxes are calculated pursuant to the tax rates expected to apply at the time of utilization or realization of the benefit, based on the tax rates legislated or whose legislation is virtually completed by the date of the balance sheet.

Future Implementation of International Financial Reporting Standards – IFRS

In July 2006, the Israeli Accounting Standards Board published Standard 29, "Adoption of International Financial Reporting Standards" (the "Standard").

The Standard determines that entities that are subject to the Securities Law, 1968 will prepare their financial statements in accordance with the Standard. This does not apply to banking corporations.

See Note 1 X(a) to the Financial Statements with regard to implementation of the Standard by banking corporations.

See Note 1 to the Financial Statements for additional details on accounting policies.

Disclosure regarding the Procedure for Approval of Financial Statements

The Bank's Board of Directors is responsible for ultimate supervision within the Bank and for approval of the Bank's Financial Statements. All the members of the Board of Directors have accounting and financial expertise, as described on page 228 of the Directors' Report.

Before the Financial Statements are submitted to the Board of Directors for discussion, the Bank's Disclosure Committee discusses them. The Disclosure Committee is a Management committee, chaired by the President and Chief Executive Officer, whose membership is comprised of members of Management and other senior managers at the Bank. The Disclosure Committee examines, *inter alia*, whether the information in the Financial Statements is accurate, complete and appropriately presented. Representatives of the Bank's joint auditors also participate in the Disclosure Committee's meetings. (The Disclosure Committee was established as part of the implementation of the Directive of the Banking Supervision Department, based on section 302 of the SOX Act.) (See "Evaluation of Disclosure Controls and Procedures for the Financial Statements" on page 220 of the Report.)

First, the Board of Directors holds a preliminary discussion of the Financial Statements, with the participation of the Chief Executive Officer, the Head of the Finance and Economics Division, the Chief Accounting Officer, other members of the Bank's Management in charge of the business divisions, the Chief Internal Auditor and the Bank's external auditors. The background material sent to the Directors prior to the preliminary discussion includes the minutes of the discussion of the Disclosure Committee and its decisions, the draft Directors' Report and the draft Financial Statements – which include the information and a qualitative description, but without the financial data (which at this stage of the discussion are not yet final). The Directors also receive details regarding new disclosure requirements (to the extent there are any) that apply to the Bank (including the text of the directives). Information regarding the Bank's exposure to legal claims and a description of new legal claims, and background material for the discussion regarding the appropriateness of the classification of problem customers and of the provisions, being sensitive and confidential information, is available for advance review by the Directors at the Bank's Secretariat.

In the context of the preliminary discussion, the Board of Directors discusses the appropriateness of the provisions and of the classification of the Bank's problem debts, following the Chief Executive Officer's presentation to the Board of Directors of the scope of the provisions and the classification of problem debts, and the changes and trends in this area, and after the other senior managers present specific issues relating to the provisions within their areas of responsibility, as well as their views regarding specific credits. The subject of the legal claims and of the Bank's exposure in this regard is presented by the

Bank’s Chief Legal Advisor. The Head of the Finance and Economics Division presents to the Board of Directors the main and material matters in the Directors’ Report and Financial Statements, the changes in critical accounting policies, if any, and the main matters discussed by the Disclosure Committee. The Board of Directors also holds a discussion of these matters.

Following the preliminary discussion, there is an additional discussion by the plenary of the Board of Directors of the final draft of the Financial Statements, with the participation of the Chief Executive Officer, the Head of the Finance and Economics Division, the Chief Accounting Officer, the Chief Internal Auditor, representatives of the Bank’s joint auditors, and when the discussion concerns the approval of annual Financial Statements, also the members of the Bank’s Management. As background material for the discussion, the Directors receive the complete draft of the Financial Statements – including the financial data – together with extensive accompanying background material, including in-depth comprehensive analyses of the Bank’s activities in its various areas of business.

In the context of this discussion, the Bank’s Chief Executive Officer reviews the operating results of the Leumi Group and the Head of the Finance and Economics Division presents and analyzes the Group’s operating results in Israel and abroad, including a description of the exposure to risks and compliance with the limits established with regard to such risks. Thereafter, the plenary of the Board of Directors discusses the final draft of the Financial Statements and approves them.

As stated, all the discussions of the Board of Directors regarding the Financial Statements are held with the participation of the Bank’s external auditors, who are available to the Board of Directors to answer questions and provide clarifications during the Board's discussions. The Financial Statements are approved by the Board of Directors following presentation by the auditors to the Board of Directors of any significant weaknesses that may have arisen during the audit processes that they carried out.

It should be noted that since the Bank’s Board of Directors is composed entirely of directors possessing the qualifications of external directors (pursuant to the Bank Shares (Arrangement Shares) (Temporary Provisions) Law, 1993) and since the members of the Bank’s Finance Committee and Audit Committee make up the majority of the Board of Directors (13 out of 15 members), it has been decided that the approval process for the Financial Statements will take place in the plenary of the Board of Directors.

D. Description of the Group's Business According to Sectors and Spheres of Activity

Development of Income, Expenses and Tax Provisions[1]

Net Profit of the Leumi Group in 2007 was NIS 3,357 million, compared with a profit of NIS 3,534 million in 2006, a decrease of NIS 177 million, 5.0%. Net operating profit for 2007 amounted to NIS 2,984 million, an increase of NIS 1,530 million compared with 2006, 105.2%, primarily as a result of an increase in operations, as detailed below.

The following table sets out the main changes in the Group's net profit in 2007:

	2007	2006	Change	Change
	(NIS millions)			%
- Net profit	**3,357**	3,534	(177)	(5.0)
- Net operating profit	**2,984**	1,454	1,530	105.2
- Net operating profit after neutralizing special salary expenses	**3,137**	2,076	1,061	51.1

The decrease in net profit in 2007 as compared with net profit in 2006is the result of a decline in the net profit from extraordinary items, as explained below.

The decrease in net profit from extraordinary items results from the sale of some of the non-banking ("real") holdings and from the sale of the activities of the Psagot-Ofek Group, Pia and some of the provident funds, in respect of which a profit of NIS 2,078 million was recorded in 2006. In 2007, on the other hand, the remaining part of the provident fund activities and Kahal were sold for a profit of NIS 348 million.

For further details see pages 133-134 and 160 and Notes 27 and 31

The increase in operating profit results from a decrease in special salary expenses compared with 2006, which included: the adoption of new mortality tables, provisions in respect of Bank alumni, the recording of the expense in respect of the issue of options to employees, the recording of a benefit in respect of the sale of shares to employees by the State and voluntary retirement provisions, in a total amount of NIS 917 million (NIS 622 million, net), as compared with such special salary expenses in the amount of NIS 250 million (NIS 153 million, net) in 2007.

The increase in operating profit in 2007 as compared with 2006 is mostly explained by the following factors:*

1. An increase in net interest income before provision for doubtful debts amounting to NIS 726 million, before the effect of taxes.

2. A decrease in provisions for doubtful debts in the amount of NIS 526 million, before the effect of taxes.

* Before minority interests

[1] The Financial Statements are prepared in reported values. The known Consumer Price Index increased by 2.8% in 2007. The shekel appreciated in nominal terms by 8.97% against the U.S. dollar and depreciated by 1.71% against the euro. The representative rate of exchange of the U.S. dollar on 31 December 2007 was NIS 3.846.
For further details - see Note 1 C to the Financial Statements.

3. An increase in operating and other income in the amount of NIS 341 million, before the effect of taxes, as detailed below.

4. A decrease in operating and other expenses (including salaries and voluntary retirement expenses) in the amount of NIS 330 million, a decrease of 4.5%, before the effect of taxes. After neutralizing special salary expenses, as detailed below, there was an increase in expenses of NIS 337 million, 5.3%.

5. An increase in the Group's share in the profits of companies included on the equity basis of NIS 13 million, net.

6. An effective tax rate in 2007 lower by 12.7 percentage points as compared with 2006, as detailed below.

In the fourth quarter of the year, the net profit amounted to NIS 517 million, compared with NIS 1,074 million in the fourth quarter of 2006, a decrease of NIS 557 million, 51.9%. The decrease in the net profit in the fourth quarter is explained mainly by the following factors:

1. A decrease in profit from extraordinary items in the amount of NIS 678 million. During the fourth quarter of 2006, a profit of NIS 683 million was recorded as a result of the sale of Leumi-Pia mutual funds and some of the provident funds.

2. An increase in operating and other expenses (including salaries and voluntary retirement expenses) in the amount of NIS 88 million, an increase of 5.0%, before the effect of taxes. After neutralizing the special expenses as detailed below, there was an increase of 12.2%.

3. An increase in provisions for doubtful debts in the amount of NIS 14 million, before the effect of taxes.

For further details see pages 62-65 and Exhibit G to the Management Review.

On the other hand, the following factors partially offset the said decrease:

1. An increase in operating and other income in the amount of NIS 209 million, before the effect of taxes.

2. An increase in net interest income before provision for doubtful debts amounting to NIS 18 million, before the effect of taxes.

3. An increase in the Group's share in the profits of companies included on the equity basis of NIS 10 million, net.

4. A reduction in the effective tax rate, which was lower in 2007 by 5.3 percentage points as compared with 2006, as detailed below.

Net interest income before provision for doubtful debts of the Leumi Group in 2007 amounted to NIS 7,648 million, compared with NIS 6,922 million in 2006, an increase of 10.5%.

The increase in the Group's net interest income before provision for doubtful debts stems mainly from:

	2007	2006	Change
	NIS millions		%
Current activities	**6,958**	6,454	7.8
Collection and reduction of interest in respect of problem loans	**461**	325	41.8
Profit realized from the sale of debentures and adjustments to market value of tradable debentures	**86**	102	(15.7)
Adjustments of derivatives to fair value	**(47)**	4	-
Effect of the known CPI	**190**	37	+
Total	**7,648**	6,922	10.5

For additional details see Exhibit C to the Management Review and Note 20 to the Financial Statements.

The following are additional details regarding the increase in net interest income from current activities:

1. An increase in the volume of financial activity in the unlinked shekel sector of some 26.3%, which increased net interest income by some NIS 628 million.

2. An increase in the volume of financial activity in the CPI-linked sector, which increased net interest income by NIS 173 million.

3. An increase in the volume of financial activities in the foreign currency and foreign currency-linked sector of 10%, which increased net interest income by NIS 198 million.

4. An increase in income from financing commissions in the amount of NIS 26 million.

5. An increase in other net financing income in the amount of NIS 195 million, as described below.

On the other hand, the decrease in the interest margin in the unlinked shekel sector, by 0.55 percentage points, reduced net interest income by NIS 677 million, and partially offset the increase in net interest income:

See Note 28 A to the Financial Statements with regard to the changes in net interest income before provision for doubtful debts according to sectors.
Regarding changes in net interest income during the interim periods see page 62 of the Report.

The following table sets out the development of net interest income according to principal activity segments:

Segment	**2007**	2006	Change
	NIS millions		%
Households	**2,572**	2,324	10.7
Small businesses	**846**	724	16.9
Corporate banking	**1,484**	1,461	1.6
Commercial banking	**1,320**	1,177	12.1
Construction and real estate	**642**	580	10.7
International and private banking	**372**	354	5.1
Financial management – Capital Markets	**454**	300	51.3
Other	**(42)**	2	-

The following table sets out the apportionment of activities by linkage sector, and their contribution to profit from net interest income before provision for doubtful debts:

	2007			2006			Changes in net interest income	
	Scope of activity in %	**Contribution to profit***		Scope of activity in %	Contribution to profit*		In NIS millions	
		%	**NIS millions**		%	NIS millions	Effect of quantity	Effect of price
Israeli Currency:								
Unlinked	**34**	**42**	**3,284**	30	48	3,333	628	(677)
CPI-linked	**15**	**13**	**958**	17	11	767	173	18
Foreign currency, including foreign currency linked	**51**	**30**	**2,293**	53	30	2,059	198	36
	100		**6,535**	100		6,159	999	(623)
Options and other derivatives		**1**	**75**		(1)	(54)		
Financing commissions		**4**	**308**		4	282		
Other interest income, net		**10**	**730**		8	535		
Total		**100**	**7,648**		100	6,922		

***** Including net interest income/expense from derivatives.

The ratio of net interest income before provision for doubtful debts to the average balance of financial assets was 2.75% in 2007, as compared with 2.61% in 2006.

Total Interest Margin (excluding transactions in derivatives) was 2.31% in 2007, compared with 1.85% in 2006 (at the Bank – 2.34% in 2007, compared with 1.84% in 2006). The interest margin including transactions in derivatives was 1.71% in 2007, compared with 1.82% in 2006 (at the Bank – 1.58% in 2007, compared with 1.77% in 2006).

See Exhibit C to the Management Review for further details on income and expense rates according to the different sectors.

Financing Commissions amounted to NIS 308 million in 2007, compared with NIS 282 million in 2006, an increase of 9.2%. These commissions include mainly the income from off-balance sheet activity, such as guarantees for granting credit, guarantees for apartment purchasers and other guarantees, as well as commissions from foreign trade activity.

Other Interest Income and Expenses include mainly profits/losses from the sale of debentures and the adjustment of debentures for trading to fair value or market value, income from early credit repayment commissions, interest collection in respect of doubtful debts from previous years and the reduction of provisions for interest. Net income from these operations amounted to NIS 730 million in 2007, compared with NIS 535 million in 2006.

The following are the main changes in other interest income and expenses:

	2007	2006	Change
	NIS millions		%
Profit/loss from the sale of available-for-sale debentures	**108**	29	272.4
Profit/loss from sale and adjustments to market value of debentures for trading	**(22)**	73	(130.1)
Collection/reduction of interest in respect of doubtful debts	**461**	325	41.8
Early payment commissions on credit	**85**	59	44.1
Other	**98**	49	100.0
Total	**730**	535	36.4

See Note 20 to the Financial Statements for further details

The Provision for Doubtful Debts in the Leumi Group in 2007 amounted to NIS 407 million, compared with NIS 933 million in 2006, a decrease of 56.4%. The provision for doubtful debts at the Bank in 2007 amounted to NIS 318 million, compared with NIS 734 million in 2006, a decrease of 56.7%.

There was a decrease of NIS 398 million in specific provisions for doubtful debts in the Leumi Group in 2007, 41.7%, and at the Bank, a decrease of 37.2%.

The reduction in the specific provisions for doubtful debts in 2007 of 41.7% arises from the continued trend of improvement in the state of the economy and the improvement in the condition of the companies, and from a NIS 137 million reduction in Leumi Mortgage Bank's provisions as a result of the special provisions made in 2006 pursuant to implementation of Bank of Israel directives.

The principal provisions for doubtful debts in 2007 were mostly in the industry, construction and real estate, trade and private individuals sectors of the economy.

Pursuant to directives of the Supervisor of Banks from 1992, an additional provision for doubtful debts is made, in addition to the specific provision, for unidentified risks in the loan portfolio based upon the risk characteristics of the credit portfolio and in respect of a sectoral excess of credit (at the Bank, there was an actual sectoral excess of credit only in construction and real estate, of 0.75%). In accordance with the above-mentioned directive, when the minimum capital ratio is above 10%, the Bank is not required to make a provision for a sectoral excess, in accordance with a formula established in the said directive. Since the Bank’s minimal capital ratio complies with the above directive, the Bank did not make an additional provision in the amount of NIS 40 million for a sectoral excess.

The general and additional provisions decreased in 2007 by NIS 149 million, compared with a decrease of NIS 21 million in 2006. Most of the decrease arises from the decrease of the additional provision in respect of a sectoral excess in the real-estate sector, and from a decrease in problem loans, as detailed below on page 79.

The following are the main data regarding the provisions for doubtful debts:

	For the three months ending 31 December		For the year ending 31 December	
	2007	2006	**2007**	2006
	(NIS millions)			
Specific provision during the period	**532**	541	**1,436**	1,724
Reduction of the specific provision	**(154)**	(220)	**(847)**	(715)
Collection of debts that were previously written off	**(9)**	(13)	**(33)**	(55)
Net addition recorded in the profit and loss statement	**369**	308	**556**	954
Net addition recorded in the profit and loss statement re additional and general provision	**(90)**	(43)	**(149)**	(21)
Total provision for doubtful debts	**279**	265	**407**	933

The provision for doubtful debts in 2007 was 0.20% of total credit to the public at the end of the year, compared with 0.51% in 2006. The specific provision was 0.28% in 2007, compared with 0.52% in 2006. It should be noted that for the second half of 2007, the provision in relation to the credit portfolio on an annual basis was 0.36%, compared with 0.05% for the first half of the year (at the Bank, 0.45%, compared with 0.02% for the first half and 0.24% for the whole of 2007).

The following table sets out the quarterly development of the provision for doubtful debts in 2007:

	2007							2006
	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
								NIS millions
Specific provision	**369**	**90**	**66**	**31**	308	295	184	167
Additional provision	**(90)**	**(11)**	**(28)**	**(20)**	(43)	(13)	1	34
Total	**279**	**79**	**38**	**11**	265	282	185	201
Provision as percentage of total credit to the public (on annual basis)	**0.57%**	**0.16%**	**0.08%**	**0.03%**	0.58%	0.63%	0.41%	0.44%

The aggregate balance of the general provision, the additional provision and the special provision for doubtful debts (according to risk characteristics defined by the Supervisor of Banks) at the Bank and its consolidated subsidiaries amounted to NIS 875 million at the end of 2007 (constituting some 0.29% of total credit risk), compared with NIS 1,024 million at the end of 2006. At the Bank, NIS 593 million, compared with NIS 715 million in 2006. Since the general provision and the additional provision are not recognized as expenses for tax purposes, the balance of the said provision, having regard to the statutory tax rate, is equivalent to a specific provision of NIS 1,423 million.

See Note 4 C to the Financial Statements, Exhibit E to the Management Review and page 79 of the Report for further details concerning credit, problem loans and provisions for doubtful debts.

The following table sets out the development of the provisions for doubtful debts according to principal activity segments:

Segment	**2007**	2006	**2007**	2006
	NIS millions		(in percentages)*	
Households	**177**	329	**0.3**	0.6
Small businesses	**117**	113	**0.7**	0.8
Corporate banking	**(28)**	182	**-**	0.4
Commercial banking	**193**	183	**0.5**	0.5
Construction and real-estate	**(33)**	155	**-**	0.7

* The rate of the provision as a percentage of the balance of the credit of the segment as at the end of the year.

The following table sets out the details of the main provisions for doubtful debts in the Group (the Bank and consolidated subsidiaries) that were recorded in the profit and loss statement:

	2007	2006
	NIS millions	
The Bank	**318**	734
The Arab Israel Bank	**12**	9
Leumi Mortgage Bank*	**43**	191
Bank Leumi USA	**(13)**	(11)
Bank Leumi (UK)	**21**	3
Leumi Card	**16**	5
Leumi Romania	**12**	3
Others	**(2)**	(1)
Total	**407**	933

* For further details, see page 148 of the Report.

The following table sets out the provision for doubtful debts as a percentage of the balance of credit to the public which is at the Bank's responsibility:

	2007	2006	2005
		%	
The banking system in Israel	**(*)**	0.52	0.71
The Bank Leumi Group	**0.20**	0.51	0.78

* Data concerning the banking system is unknown as of the date of publication of this Report.
See page 79 below for particulars of problem loans.

Net Interest Income after Provision for Doubtful Debts of the Leumi Group in 2007 amounted to NIS 7,241 million, compared with NIS 5,989 million in 2006, an increase of 20.9%. The increase derived from an increase in profit from net interest income and a decrease in provisions for doubtful debts. Profit from net interest income after provision for doubtful debts at the Bank amounted to NIS 5,744 million in 2007, compared with NIS 4,799 million in 2006, an increase of 19.7%.

Total Operating and Other Income of the Leumi Group in 2007 amounted to NIS 4,222 million, compared with NIS 3,881 million in 2006, an increase of 8.8% (at the Bank - NIS 2,756 million in 2007, compared with NIS 2,389 million in 2006, an increase of 15.4%). After neutralizing the effect of the increase in income from the severance pay reserve, total operating income in the Group increased by 7.8%, and by 13.9% at the Bank.

The following are the main changes in operating and other income:

	2007	2006	Change	Change
	NIS millions		NIS millions	%
Operating income (1)	**3,350**	3,013	337	11.2
Profits from investments in shares (2)	**461**	128	333	260.2
Other income (3)	**411**	740	(329)	(44.5)
Total operating and other income	**4,222**	3,881	341	8.8

The following are additional details regarding each of the above-mentioned items:

1. Operating income

   a. An increase in income from transactions in securities in the amount of NIS 133 million (18.1%)

   b. An increase in income from credit cards in the sum of NIS 77 million (12.9%)*.

   c. An increase in income from payment system services in the sum of NIS 66 million (8.6%), primarily from foreign currency conversions and transfers.*

   d. An increase in income from credit management and preparation of legal documents in the amount of NIS 59 million (18.6%).

* The said changes are after neutralization of the effect of compensatory income in respect of the operation of the new commission baskets.

2. Profits from investments in shares

   a. An increase in income from dividends in the amount of NIS 106 million. The increase in income from profits on investments in shares derives mainly from recording the partial repayment of a debt of a particular customer amounting to NIS 120 million as a dividend, in accordance with the directives of the Supervisor of Banks (in accordance with the same directives, the debt is presented as an investment in shares available for sale) (NIS 67 million in 2006.)

   b. An increase in net profits from the sale of shares available for sale, in the amount of NIS 217 million, primarily NIS 154 million from the sale of part of the Cellcom shares.

3. Other income

   a. From the second quarter of 2006, the reform of the capital market came into effect, and the Bank began to charge distribution fees in respect of mutual funds that it distributes. A total of NIS 153 million was collected during 2007, compared with NIS 89 million in 2006. On the other hand, the Bank ceased charging fund management companies management and marketing fees for the provision of these services, and income from mutual and provident funds consequently decreased, as detailed below.

	2007	2006	Change	
	NIS millions		NIS millions	%
From mutual funds	**165**	391	(226)	(57.8)
From provident funds	**16**	216	(200)	(92.3)
From supplementary training funds	**19**	29	(10)	(34.5)
Total	**200**	636	(436)	(68.5)

At the same time, it should be noted that operating expenses decreased by some NIS 181 million.

   b. An increase in income from the severance pay reserve in the amount of NIS 40 million.

   c. Income in the amount of NIS 43 million from the operating services to provident funds.

With regard to the proposed laws concerning commissions and the proposal of the Bank of Israel in this regard, see pages 36-37 above of the Report.
See Note 18 O to the Financial Statements with regard to legal claims and discussions with the General Director of the Antitrust Authority with respect to credit card related subjects.

The ratio of operating and other income to total income (i.e. net interest income before provision for doubtful debts and operating and other income) was 35.6%, as compared with 35.9% in 2006.

Operating and other income covered 60.9% of operating and other expenses, and after neutralizing special expenses as detailed below, 63.1%, compared with cover of 53.4% and 61.1% respectively in 2006.

See Notes 21-23 to the Financial Statements for further details.

Total Operating and Other Expenses of the Leumi Group in 2007 amounted to NIS 6,937 million, compared with NIS 7,267 million in 2006, a decrease of 4.5%, and after neutralizing special salary expenses as detailed below, the increase was 5.3% (at the Bank - NIS 5,059 million in 2007, compared with NIS 5,388 million in 2006, a decrease of 6.1% and an increase of 7.2% after neutralizing special expenses).

a. Salary expenses (including the cost of voluntary retirement) amounted to NIS 4,218 million in 2007, a decrease of 7.3% as compared with 2006. The decrease in salary expenses of NIS 334 million arises mainly from special salary expenses related to the privatization of the Bank, and employment-related provisions as detailed below:

	2007	2006
	NIS millions	
Adoption of new mortality tables	**-**	214
Provision for reserves for holiday gifts for Bank alumni	**-**	91
Actuarial changes	**-**	23
Expenses in respect of issue of options to employees	**247**	235
Recording of the benefit in respect of sale of shares to employees	**3**	217
Voluntary retirement expenses	**-**	175
Decrease of salary tax rates	-	(38)
Total	**250**	917

For further details, see Note 15 to the Financial Statements.

Salary and related expenses (excluding special expenses) constitute some 59.3% of total operating expenses, compared with 57.4% in 2006.

b. Operating and other expenses, excluding salary and voluntary retirement, remained unchanged, in 2007. The following are the main changes that did occur:.

1. An increase in expenses for maintaining buildings and equipment in the sum of NIS 47 million (6.1%).

2. An increase in depreciation expenses in the sum of NIS 7 million (1.5%).

3. A decrease in expenses for professional services in the sum of NIS 22 million (7.5%), and a decrease of NIS 29 million for a provision for an exceptional event in a foreign subsidiary in 2006.

Computer expenses of the Group as presented in Note 25 to the Financial Statements do not include the Bank's computer expenses, which are included in the rest of the expenses, since the computer center is a unit of the Bank. These computer expenses mainly include the expenses of subsidiaries for purchasing computer services and/or outsourcing costs.

See Notes 24 and 25 to the Financial Statements for further details.

Additional details concerning components of salary expenses are as follows:

1. As part of the Bank's strategic efficiency drive and in light of the business-managerial needs of the Bank in future years, in 2006 the Bank's Board of Directors approved a voluntary retirement plan at an overall cost of up to some NIS 180 million. The plan was targeted at a portion of the Bank's employees, as approved by the Board of Directors.

   In 2006, 191 employees retired, compared with 137 who retired in 2005 under a voluntary retirement plan. Total costs of voluntary retirement recorded in the 2006 Financial Statements amounted to NIS 175 million. These amounts also include the present value of future pension liabilities in respect of the voluntary retirement plan.

2. The calculation of the Bank's actuarial pension liability is made on the basis of the capitalization rate (4%) determined by the Supervisor of Banks, assuming a real increase in salaries based on past experience and which varies according to the employee's age. The rates of increase vary between 1.5% and 4.6%. Up to and including 2005, a set real average increase of 2.5% was assumed.

3. In 2006, the Bank adopted the mortality tables as published by the Chief Actuary of the Capital Market, Insurance and Savings Department of the Ministry of Finance for insurance companies in November 2005 and February 2007. Pursuant to the evaluation of the Bank's actuary, the pension and jubilee reserves were increased by NIS 237 million as a result of the adoption of the said tables.

4. In addition to pension and/or severance payments (according to individual choice), "Leumi alumni" are entitled to additional benefits, principally gifts on holidays and participation in the costs of additional welfare and social activities.

   "Leumi alumni" – refers to personnel who have ended their employment with the Bank at any age, following completion of 25 years of employment with the Bank, or who have ended their employment at the age of 65 or more, following completion of at least 15 years of employment.

   In 2006, the Bank recorded a provision in the amount of NIS 91 million for the above-mentioned obligations.

5. For expenses related to privatization of the Bank, see page 58 of the Report.

See Note 15 to the Financial Statements for further details

Operating expenses in 2007 constitute 58.4% of total income, compared with 67.3% in 2006 and 58.7% in 2005. After neutralizing the special salary expenses detailed in the Report, operating expenses constitute 56.3% of total income as compared with 58.8% in 2006.

Total operating and other expenses constitute 2.30% of total assets, compared with 2.51% in 2006, and after neutralizing special salary expenses, 2.21% and 2.21%, respectively, of total assets.

Operating Profit before Taxes of the Leumi Group in 2007 amounted to NIS 4,526 million, compared with NIS 2,603 million in 2006, an increase of 73.9% (at the Bank - a profit of NIS 3,441million in 2007, compared with NIS 1,800 million in 2006, an increase of 91.2%). After neutralizing special salary expenses, there was an increase of 35.7%, and an increase of 36.8% at the Bank.

Provision for Taxes on Operating Profit of the Leumi Group in 2007 amounted to NIS 1,722 million, compared with NIS 1,320 million in 2006. The rate of provision for taxes in 2007 was 38.0% of pre-tax profit, compared with 50.7% in 2006, a decrease of 12.7percentage points. The statutory tax rate for financial institutions in Israel in 2007 was 38.53% as compared with 40.65% in 2006.

The provision for taxes in 2007 was principally affected by the following matters:

1. The reduction of the rate of company tax from 31% in 2006 to 29% in 2007, and the reduction in the rate of profits tax from 17% to 15.5% in 2006, which had an effect on the provision for taxes of 2.12 percentage points.

2. A decrease in unrecognized expenses and an increase in exempt income, which had an effect on the provision for taxes of some 4.9 percentage points. (Unrecognized expenses such as expenses related to the issue of shares and options to employees, as compared with exempt income such as the reduction of the additional provision for doubtful debts.)

3. The effect of the positive known CPI in 2007 of 2.8%, as compared with the negative known CPI of 0.29% in 2006, which had an effect on the provision for taxes of some 3.7 percentage points.

4. Exchange rate differentials in respect of overseas investments which are not included in the basic tax calculation were negative in 2007, similar to 2006, and had an identical effect of increasing the effective tax rate by some 3.2 percentage points.

See Note 26 to the Financial Statements for further details on the tax provision.

Regarding the Income Tax (Adjustments for Inflation) (Amendment) Law, 2007, see pages 205-206 of the Report.

Operating Profit after Taxes of the Leumi Group in 2007 amounted to NIS 2,804 million, compared with NIS 1,283 million in 2006, an increase of 118.6%, and after neutralizing special salary expenses, an increase of 55.2%.

The Group's Share in Operating Profit after Taxes of Companies Included on the Equity Basis in 2007 amounted to a profit of NIS 184 million, compared with NIS 171 million in 2006, an increase of 7.6%.

Beginning with the second quarter of 2006, recording of profits on the equity basis was discontinued in respect of Africa Israel Investments, which was sold on 27 March 2006, and in respect of Migdal Insurance and Financial Holdings, 10% out of the holding in which was sold on 15 March 2006. On the other hand, beginning in the first quarter of 2007, the investment in Paz was transferred from the securities available for sale portfolio and became an investment recorded on the equity basis.

Most of the profit in this item derived from the contribution of the following companies:

1. Israel Corporation Ltd.: profits of NIS 110 million in 2007, compared with NIS 129 million in 2006.

2. Paz Oil Company Ltd.: profits of NIS 65 million in 2007; in 2006 the profits of Paz were not included on the equity basis, since they were presented as part of securities available for sale.

For further details, see pages 131-132 of the Report.

Minority Interests in the Profits of the Group amounted to a profit of NIS 4 million, compared with a zero profit in 2006. The low level of profit derives from the share of the minority interests in the Swiss subsidiary in the negative exchange differentials in respect of the investment in Switzerland.

Net Operating Profit of the Leumi Group amounted to NIS 2,984 million in 2007, compared with NIS 1,454 million in 2006, an increase of 105.2%. After neutralizing special salary expenses as detailed previously, there was an increase of 51.1%.

Net After-Tax Profit from Extraordinary Items of the Leumi Group in 2007 amounted to NIS 373 million, compared with NIS 2,080 million in 2006. The profit derives from the sale of some of the provident fund activity and of Kahal, compared with the profit in 2006, which was derived from the sale of the Bank's holding in Africa Israel Investments Ltd., from the sale of 10% out of the Bank's holding in Migdal Insurance and Financial Holdings, and from the sale of the activities of the Psagot-Ofek Group, Leumi-Pia and some of the provident funds.

See pages 133-134 and 160 below and Note 27 to the Financial Statements for further details.

Net Operating Profit per Share reached NIS 2.11 in 2007, compared with NIS 1.03 in 2006 (on a fully-diluted basis – NIS 2.08, compared with NIS 1.03).

Net Profit per Share reached NIS 2.37 in 2007, compared with NIS 2.50 in 2006 (on a fully-diluted basis – NIS 2.34, compared with NIS 2.50).

The following table sets out the average return on shareholders' equity (excluding minority interests) of:

	2007	2006*
	%	
Net profit	**17.4**	20.1
Net operating profit	**15.4**	8.3

The following table sets out the average return on shareholders' equity (excluding minority interests) for the period on a quarterly basis (in annual terms):

	2007				2006*			
	4th Qtr	**3rd Qtr**	**2nd Qtr**	**1st Qtr**	4th Qtr	3rd Qtr	2nd Qtr	1st Qtr
	%							
Net profit	**10.4**	**21.9****	**20.9**	**22.2****	24.7	24.0	8.9	30.4
Net operating profit	**10.3**	**19.4**	**20.9**	**15.6**	8.5	6.9	8.6	10.3

The return on equity was considerably affected by special salary expenses as detailed on page 58 of the Report.

Following are the returns after neutralizing the effect of special salary expenses:

	2007	2006*
	%	
Net profit	**18.2**	23.7
Net operating profit	**16.2**	11.8

	2007				2006			
	4th Qtr	**3rd Qtr**	**2nd Qtr**	**1st Qtr**	4th Qtr	3rd Qtr	2nd Qtr	1st Qtr
	%							
Net profit	**11.6**	**22.6****	**21.5**	**23.2****	27.2	27.8	14.8	34.9
Net operating profit	**11.5**	**20.1**	**21.5**	**16.5**	10.8	10.3	14.5	14.2

*Restated in accordance with the new directives of the Supervisor of Banks.
** Assuming that the profit from extraordinary items was a one-time occurrence, the return of net profit during the first quarter of the year was 17.1%, and 18.0% after neutralizing special expenses; the return was 19.9% and 20.6% respectively, during the third quarter.

Development of Profit in the Interim Periods in 2007

The following is a summary of the quarterly operating profit and loss statements for 2007:

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Annual Total
	NIS millions				
Net interest income (a)	**1,781**	2,265	1,809	1,793	7,648
Provision for doubtful debts	**(279)**	(79)	(38)	(11)	(407)
Operating and other income	**1,192**	909	1,131	990	4,222
Operating and other expenses (b)	**(1,864)**	(1,785)	(1,656)	(1,632)	(6,937)
Operating profit before taxes	**830**	1,310	1,246	1,140	4,526
Provision for taxes	**(355)**	(471)	(376)	(520)	(1,722)
Operating profit after taxes	**475**	839	870	620	2,804

a. The following are additional details regarding the main points of net interest income development, before provision for doubtful debts, on a quarterly basis:

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Annual Total
	NIS millions				
Current activities	**1,740**	1,878	1,634	1,706	6,988
Collection and reduction of interest in respect of problem debts	**121**	103	152	85	461
Profit from the realization of sale of debentures and from adjustments to market value of debentures for trading	**33**	(112)	81	84	86
Adjustments of derivatives to fair value	**(113)**	210	(77)	(67)	(47)
Effect of the known CPI	-	186	19	(15)	190
Total, before taxes	**1,781**	2,265	1,809	1,793	7,648

b. The following table sets out the quarterly development of operating and other expenses in 2007:

	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	**Total 2007**
	NIS Millions				
Salary expenses	**1,083**	**1,104**	**1,004**	**1,027**	**4,218**
Of these: special expenses*	**57**	**69**	**77**	**47**	**250**
Salary expenses after neutralizing special expenses	**1,026**	**1,035**	**927**	**980**	**3,968**
Maintenance of buildings and equipment	**232**	**202**	**195**	**183**	**812**
Depreciation expenses	**122**	**115**	**112**	**113**	**462**
Other expenses	**427**	**364**	**345**	**309**	**1,445**
Total operating and other expenses	**1,864**	**1,785**	**1,656**	**1,632**	**6,937**
Total operating and other expenses, after neutralizing special salary expenses	**1,807**	**1,716**	**1,579**	**1,585**	**6,687**

*** The following table sets out the quarterly development of special salary expenses in NIS millions:**

	2007				
	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	**Annual Total**
Expenses in respect of issue of options	**51**	**66**	**77**	**53**	**247**
Recording of the benefit in respect of sale of shares to employees	**6**	**3**	**12**	**(18)**	**3**
Difference between the severance pay liability and the reserve	**-**	**-**	**(12)**	**12**	**-**
Total	**57**	**69**	**77**	**47**	**250**

	2006				
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Annual Total
Adoption of new mortality tables	78	-	-	136	214
Provision to reserve for holiday gifts for Bank alumni	-	2	89	-	91
Actuarial changes	23	-	-	-	23
Expenses in respect of issue of options	72	75	48	40	235
Recording of the benefit in respect of sale of shares to employees	5	21	191	-	217
Voluntary retirement expenses	11	159	2	3	175
Difference between the severance pay liability and the reserve	(24)	(34)	(2)	60	-
Lowering of salary tax rate	-	-	(38)	-	(38)
Total	165	223	290	239	917

Following are the principal changes in profit and loss according to quarters:

1. Net interest income before provision for doubtful debts:

   In the first quarter of the year:
   - An increase in net interest income due to an increase in the volume of financial activity and an increase in the overall interest margin.
   - An increase in profits from the sale of debentures available for sale and an increase in market value of debentures and unrealized profits from adjustments to fair value of debentures for trading, as compared with the corresponding period in 2006.
   - The adjustments to fair value of derivatives (timing differentials) had a negative impact.

   In the second quarter of the year:
   - An increase in the volume of financial activity.
   - An improvement in the value of debentures and unrealized profits from adjustments to fair value of debentures for trading as compared with the corresponding period in 2006.
   - On the other hand, there was a decrease in adjustments to fair value of derivatives, primarily those that were CPI-linked.
   - An increase in collections and decrease in interest in respect of problem loans in respect of which provisions were previously made.

   In the third quarter of the year:
   - A decrease in profits from the sale of debentures available for sale and a decrease in market value of realized and unrealized debentures for trading.
   - On the other hand, the effect of the positive known CPI increased income in the third quarter; and there was an increase in adjustments to fair value of derivatives.

In the fourth quarter of the year:

- An increase in net interest income, mainly from the increase in reduction and collection of interest in respect of problem loans.
- The adjustments to market value of derivatives (timing differentials) had a negative impact.

2. Provisions for doubtful debts:

- During the first nine months of the year, there was a significant decrease in provisions for doubtful debts, as compared with the quarterly provisions in 2006.
- In the fourth quarter of the year, there was an increase in provisions for doubtful debts relative to the average quarterly provisions in the first nine months of the year, but there was no material change as compared with the fourth quarter of 2006. See further details in the Directors' Report in the section on credit to the public.

3. Operating and other income:

- In 2007, all quarters showed an increase in operating income relative to the average quarterly income in 2006, mainly from payment system services, from credit management and preparation of legal documents, capital market and credit card services.
- In the first quarter of the year there was an increase in the profit from investments in shares item due to a dividend distribution by Bezeq.
- In the second quarter of the year, there was an increase from sales of shares available for sale, in the amount of some NIS 68 million.
- In the third quarter of the year, there was a decrease in income as compared with the second quarter of the year, arising from the reduction of profits in the second quarter from the reserve in the provident fund for severance pay. There was also a decrease in supplementary training fund management fees following the sale of their activity during the third quarter of the year.
- In the fourth quarter of the year there was an increase in the profits from investments in shares item as a result of the sale of part of the holdings of Leumi & Co. in Cellcom shares.

4. Salary and related expenses:

- In the first quarter the full severance pay provision was recorded pursuant to the salary increase at the beginning of the year, compared with the income from the severance pay funds which were spread over the entire year.
- In the second quarter of the year, salary expenses decreased, as compared with the corresponding period in 2006, as a result of a decrease in expenses in respect of the issue of options to employees and the effect of recording the benefit in respect of the sale of shares to employees by the State, and from recording a provision for holiday gifts for Bank alumni in 2006.
- In the third quarter of the year salary expenses increased as a result of an increase in pension liabilities in respect of pensioners whose salaries are CPI-linked.
- The quarterly annual average of salary expenses amounted to some NIS 1,054 million.

5. Other operating expenses:

- In the fourth quarter of the year, there was an increase in the said expenses as compared with the average of the previous quarters. The increase amounted to some NIS 66 million, some 18.3%. On the other hand, there was a reduction of NIS 34 million, some 7.4%, as compared with the fourth quarter of 2006.
- Maintenance of buildings and equipment – there was an increase in the fourth quarter due to a rise in rental expenses and software.
- In the fourth quarter there was an increase in marketing and advertising expenses due to a marketing campaign.
- During the third and fourth quarters, there was an increase in professional consultant expenses and automatic data processing consultant expenses.

6. Provision for taxes:

- In the first quarter of the year, the tax rate was high as a result of negative exchange rate differentials in respect of investments in overseas subsidiaries that are not included in the tax basis, and as a result of the impact of the negative known CPI of 0.44%.
- In the second quarter of the year the tax rate dropped as a result of positive exchange rate differentials in respect of investments in overseas subsidiaries, and as a result of a decrease in unrecognised expenses relating to the issue of options and the sale of shares to employees.
- In the third quarter of the year, the tax rate was low as a result of the positive known CPI of 2.52%, and a decrease in unrecognized expenses and an increase in exempt income.
- In the fourth quarter of the year, the tax rate rose as a result of negative exchange differentials in respect of investments in overseas subsidiaries.

7. The profits from extraordinary items:

- In the first quarter of the year, a profit in the amount of NIS 259 million was recorded from the sale of part of the provident funds that had been managed by the Group, as compared with the NIS 712 million during the corresponding period in 2006, which resulted from the sale of the Bank’s holding in the Africa Israel Investments and from the sale of 10% out of the Bank’s holdings in Migdal Insurance and Financial Holdings.
- In the third quarter of the year, a profit in the amount of some NIS 109 million, of which NIS 93 million is from the sale of the supplementary training funds activity, was recorded, as compared with NIS 674 million in the corresponding period in 2006, resulting from the sale of the activity of Psagot-Ofek
- In the fourth quarter of the year, a profit of NIS 5 million was recorded, as compared with NIS 683 million in the fourth quarter of 2006, from the sale of the Pia mutual funds and part of the provident funds.

For additional multi-quarter date see Exhibits F and G to the Management Review.

Structure and Development of Assets and Liabilities

Total Assets of the Leumi Group on 31 December 2007 amounted to NIS 302.1 billion, compared with NIS 289.3 billion at the end of 2006, an increase of 4.4%. The Bank's total assets on 31 December 2007 amounted to NIS 254.5 billion, compared with NIS 241.1 billion at the end of 2006.

Of the Group's total assets, the value of the assets denominated in or linked to foreign currency was some NIS 121.6 billion, some 40.2% of total assets. In 2007, the shekel appreciated against the US dollar by 8.97% and against the basket of currencies by 5.85%, and depreciated against the euro by 1.71%.
The change in the exchange rate of the shekel in relation to foreign exchange in general contributed to a decrease of 3% in the total assets of the Group.

The total assets under the Group’s management - total balance sheet as well as customers’ securities portfolios, and provident funds and supplementary training funds in relation to which operation management and custody services are provided - amounted to some NIS 764 billion, compared with NIS 695 billion at the end of 2006 (some US$ 199 billion and US$ 164 billion respectively), as detailed below.

A. The following table sets out the development of the main balance sheet items:

	Consolidated			The Bank		
	31 December			31 December		
	2007	2006	Change	**2007**	2006	Change
	NIS millions		%	NIS millions		%
Total assets	**302,151**	289,341	4.4	**254,481**	241,144	5.5
Deposits of the public	**238,045**	231,823	2.7	**208,422**	200,128	4.1
Debentures, capital notes and subordinated capital notes	**19,248**	15,622	23.2	**4,542**	4,821	(5.8)
Deposits from banks	**6,139**	5,241	17.1	**5,457**	3,578	52.5
Cash and deposits with banks	**42,329**	47,609	(11.1)	**62,488**	62,886	(0.6)
Securities	**47,169**	46,375	1.7	**35,723**	31,686	12.7
Credit to the public	**198,557**	183,800	8.0	**133,729**	125,456	6.6
Buildings and equipment	**3,276**	3,056	7.2	**2,807**	2,584	8.6

B. The following table sets out the development of the main off-balance sheet items:

	Consolidated			The Bank		
	31 December			31 December		
	2007	2006	Change	**2007**	2006	Change
	NIS millions		%	NIS millions		%
Documentary credits	**2,582**	2,430	6.3	**1,784**	1,372	30.0
Credit guarantees	**6,993**	5,918	18.2	**12,284**	9,931	23.7
Guarantees to purchasers of apartments	**7,440**	6,011	23.8	**7,168**	5,648	26.9
Other guarantees and liabilities	**13,822**	12,767	8.3	**15,524**	14,782	5.0
Derivatives*	**198,993**	116,274	71.1	**186,725**	101,173	84.6
Options of all kinds	**140,675**	115,353	22.0	**131,584**	109,537	20.1

* Including forwards, financial swap contracts, future swap and credit derivatives transactions.

See Note 18A and 18F to the Financial Statements for further details.

C. The following table sets out the development of balances of the customers' off-balance sheet financial assets with the Leumi Group:

	Consolidated		
	2007	2006	Change
	NIS millions		%(1)
Securities portfolios of customers	**404,686**	353,729	14.4
Of which: in mutual funds(2)	**44,235**	38,657	14.4
provident funds(2) (3)	**46,747**	41,000	14.0
supplementary training funds(2) (3)	**10,342**	10,706	(3.4)
Total	**461,775**	405,435	13.9

(1) Including increase in market value of securities and the value of securities of mutual and provident funds held on custody, in respect of which operation management and custody services are provided.
(2) On 31 December 2007, the Group in Israel did not have mutual funds, provident funds or supplementary training funds under its management.
(3) Assets of customers in relation to which the Group provides operation management services.

Deposits of the public

Deposits of the public with the Group amounted to NIS 238.0 billion at the end of 2007, compared with NIS 231.8 billion at the end of 2006, an increase of 2.7%.

The shekel's appreciation against most foreign currencies contributed to a 3.3% decrease in the amount of the deposits of the public.

Additionally, the Group raised funds from the public, through issues of debentures, capital notes and subordinated capital notes, the balance of which was some NIS 19.2 billion as at the end of 2007, compared with NIS 15.6 billion at the end of 2006. Deposits of the public, debentures and subordinated capital notes rose in 2007 by 4.0% and together represent 85% of total assets.

The following table sets out the mix of deposits of the public by type and linkage sector:

	31 December 2007				
	Demand	**Term**	**Savings schemes**	**Ear-marked deposits**	**Total**
	%	**%**	**%**	**%**	**NIS millions**
Israeli currency:					
Unlinked	**49**	**41**	**-**	**10**	**96,656**
CPI-linked	**-**	**10**	**95**	**90**	**26,919**
Foreign currency:					
including foreign currency linked	**51**	**49**	**5**	**-**	**113,975**
Non-monetary					**495**
	100	**100**	**100**	**100**	
Total in NIS millions	**33,447**	**197,460**	**7,118**	**20**	**238,045**

	31 December 2006				
	Demand	Term	Savings schemes	Ear-marked Deposits	Total
	%	%	%	%	NIS Millions
Israeli currency:					
Unlinked	44	39	3	60	88,662
CPI-linked	-	12	89	40	31,245
Foreign currency:					
including foreign currency linked	56	49	8	-	111,328
Non-monetary					588
	100	100	100	100	
Total in NIS millions	29,611	192,472	9,737	3	231,823

The increase in the volume of deposits of the public in 2007 was mainly in unlinked shekel deposits, which increased by NIS 8.0 billion and foreign currency deposits, which increased by NIS 2.6 billion. CPI-linked shekel deposits declined by NIS 4.3 billion, the decline being primarily in CPI-linked savings schemes. After neutralizing the effect of changes in the rate of exchange of the shekel, deposits of the public grew by 5.9%.

Developments in the various kinds of deposits were as follows:

– Unlinked shekel deposits of the public increased by 9.0% compared with 31 December 2006, as a result of the public's preference for these types of deposits, against the background of the high real interest rates in this sector.

– Deposits of the public denominated in or linked to foreign currency increased by 2.4% as compared with 31 December 2006, and after neutralizing the effect of changes in the rate of exchange of the shekel, increased by 9.2%.

– CPI-linked deposits declined by 13.8% as against 31 December 2006, primarily in consequence of the expectation of a low inflation rate in 2007 which caused changes in the composition of the financial assets portfolio of the public.

The Bank develops and sells financial investment products of the structured products type. There are various types of structured products including, on the one hand, assurance of the whole or part of the principal, and on the other hand, a chance of a higher yield than that of a risk-free investment. Waiving risk-free interest enables the purchase of financial derivatives based on various underlying assets, such as: options on interest rates, options on shares and share indices, options on exchange rates, credit derivatives and more, which constitute a component of the structured product. The structured deposits offered by the Group offer full assurance of the principal, while the structured debentures often give only partial assurance. The terms of the structured products range between the short-term, on occasions even one month, to long-term of up to 15 years. In 2007, the range of the Group's structured products was expanded both as regards the composition of the underlying assets and also as regards the types of options embedded in the products. This was in accordance with the economic developments in the various markets based on the Bank's analysts' evaluations.

In 2007, the volume of transactions in structured deposits carried out in the Leumi Group amounted to some US$ 322 million, compared with some US$ 396 million in 2006.
The balance of structured deposits totaled NIS 723 million on 31 December 2007, as compared with NIS 675 million at the end of 2006.

The following table sets out the development of the deposits of the public according to principal activity segments:

Segment	**2007**	2006	Change
	NIS millions		%
Households	**115,549**	115,437	0.1
Small businesses	**13,901**	11,795	17.9
Corporate banking	**25,553**	27,860	(8.3)
Commercial banking	**30,742**	27,370	12.3
Construction and real estate	**3,189**	3,136	1.7
Private and international banking	**37,169**	36,664	1.4
Financial management, capital markets and other*	**11,942**	9,561	24.9

* Includes mainly deposits of institutional bodies.

Deposits from Governments amounted to some NIS 1.2 billion at the end of 2007 - these deposits include deposits from government sources that were made available to the banks in prior years mainly for restructuring the debts of the kibbutzim and also deposits for granting housing credit to eligible members of the public.
In 2007 there was a decline of some NIS 1 billion in deposits from governments, of which some NIS 419 million was at Leumi Mortgage Bank, a decline of some NIS 193 million was at the Bank due to the lending of government bonds, and a decline of some NIS 216 million at Leumi USA from the repayment of a government deposit.

Deposits of the government for the granting of credit at its responsibility were offset against the credit, and amount to NIS 0.9 billion.

This item also includes deposits of foreign governments in overseas subsidiaries, which amounted to some NIS 0.2 billion at the end of 2007, as against NIS 0.5 billion at the end of 2006.

Deposits with Banks and from Banks

A. Deposits with Banks:*

	31 December 2007		31 December 2006	
	With central banks	**With banks**	With central banks	With banks
	NIS millions			
Israeli Currency:				
Unlinked	**5,492**	**1,590**	3,370	485
CPI-linked	**-**	**587**	-	440
Foreign currency including foreign currency-linked	**1,299**	**31,971**	1,029	40,824
Total deposits with banks	**6,791**	**34,148**	4,399	41,749

*Central and commercial banks.

Total deposits with banks decreased by 11.3%, mostly as a result of a change in the Bank's asset portfolio and as a result of the shekel's appreciation in relation to foreign currencies in general.

B. Deposits from Banks:

	31 December 2007		31 December 2006	
	From central banks	**From banks**	From central banks	From Banks
	NIS millions			
Israeli Currency:				
Unlinked	**-**	**2,596**	58	1,049
CPI-linked	**-**	**669**	-	1,303
Foreign currency including foreign currency-linked	**10**	**2,864**	16	2,815
Total deposits from banks	**10**	**6,129**	74	5,167

By law, the Bank of Israel is permitted to provide loans to banking corporations against collateral. The Bank uses its deposits with the Bank of Israel for this purpose, as well as a pledge of its securities portfolio.
On 31 December 2007, deposits of the Group with the Bank of Israel totaled NIS 5.5 billion, against which there were no loans from the Bank of Israel.

For further details, see page 85.

As may be seen from these tables, the liquidity situation of the Group is very positive, and the Group has net deposits with banks amounting to NIS 38.4 billion.

Credit to the public

Credit to the public in the Leumi Group at the end of 2007 totaled NIS 198.6 billion, compared with NIS 183.8 billion at the end of 2006, an increase of 8.0% (at the Bank, an increase of 6.6%). Credit to the public comprises 65.7% of total assets (compared with 63.5% at the end of 2006).

The shekel's appreciation against most foreign currencies contributed to a decline of 2.0% in total credit to the public.
Pursuant to directives of the Supervisor of Banks, commitments in respect of credit cards were previously recorded as guarantees. As of 2006, the directive was amended and commitments in respect of credit cards are recorded as part of credit to the public. Excluding these commitments, credit to the public increased by 7.4%. Credit commitments in respect of credit cards amounted to NIS 5,800 million, as compared with NIS 4,386 million at the end of 2006.

As well as granting credit to the public, the Group invests in the securities of companies, in an amount of NIS 12,345 million at the end of 2007, as compared with NIS 10,652 million at the end of 2006. These investments also involve a credit risk.

The following table sets out the mix of credit to the public by type and sector:

	31 December 2007		31 December 2006		Change
	NIS millions	**% of mix**	NIS millions	% of mix	%
Unlinked*	**88,683**	**45**	77,199	42	14.9
CPI-linked	**53,314**	**27**	50,221	27	6.2
Foreign currency including foreign currency-linked	**56,560**	**28**	56,380	31	0.3
Total	**198,557**	**100**	183,800	100	8.0

* Including non-monetary items.

Most of the increase in credit to the public was in unlinked shekel credits amounting to NIS 11,484 million, 14.9%.
Foreign currency and foreign currency-linked credit to the public increased by NIS 180 million, and after neutralizing the effect of the changes in the exchange rate of the shekel, such credit increased by 6.9%.
CPI-linked credit to the public increased by NIS 3,093 million, 6.2%.
Total credit to the public that was offset from deposits according to the extent of collection amounted to NIS 10.6 billion in the Group. Some 80.2% of such credit is granted from government deposits according to the extent of collection for mortgage financing.

The following table sets out the spread of credit in foreign currency, including foreign currency-linked credit, according to principal currencies:

	31 December 2007	31 December 2006
	NIS millions	
US dollar	**36,826**	38,625
Euro	**7,315**	6,594
Other currencies	**12,419**	11,161
Total	**56,560**	56,380

The following table sets out the development of obligations in the construction and real estate segment:

	31 December		
	2007	2006	Change
	NIS millions		%
Balance sheet credit risk	**35,094**	32,814	6.9
Guarantees to apartment purchasers*	**3,315**	2,637	25.7
Other off-balance sheet risk	**16,072**	12,969	23.9
Total	**54,481**	48,420	12.5

* Weighed according to balance sheet value.

The total credit risk of the construction and real estate sector in Israel (according to the report according to sectors of the economy in Exhibit E to the Management Review) increased in 2007 by 11.3%. Credit risk of the construction and real estate sector in Israel constitutes some 19.5% of total credit risk in Israel. However, in accordance with the rules laid down by the Bank of Israel for calculating the rate of financing by sector of the economy, the total obligations in the sector at the Bank amount to some 20.75% of the total obligations in Israel, and therefore there is a sectoral excess of credit of some 0.75%, compared with an excess of 0.98% at the end of 2006.

The following table sets out the development of credit to the public according to principal activity segments:

	31 December		
Segment	**2007**	2006	Change
	NIS millions		%
Households	**57,270**	51,708	10.8
Small businesses	**17,502**	13,936	25.6
Commercial banking	**42,290**	38,367	10.2
Corporate banking	**51,636**	51,478	0.3
Construction and real estate	**23,470**	22,501	4.3
Private and international banking	**5,155**	4,417	16.7

- Credit to households also includes housing loans (mortgages). After neutralizing this credit, credit to households (banking and finance) increased by 15.8%. Housing loans totaled NIS 36.6 billion at the end of 2007, an increase of 9.6%. (The rates of increase in credit in 2006 were 16.7% and 1.6%, respectively.)
- There was a decrease of some NIS 331 billion in the credit activities in Israel of the corporate banking segment.
- There was an increase of some NIS 886 billion in the credit activities in Israel of the construction and real estate sector at the Bank.

See Exhibit E to the Management Review for further details of the development of credit and credit risks according to sectors of the economy.

The following table sets out the development of overall credit to the public risk* according to principal sectors of the economy:

	31 December 2007		31 December 2006		
Sectors of the Economy	**Overall credit to the public risk**	**Percentage of total**	Overall credit to the public risk	Percentage of total	Change
	NIS millions	**%**	NIS millions	%	%
Agriculture	**2,591**	**0.8**	2,370	0.9	9.3
Industry	**47,617**	**15.6**	43,086	15.5	10.5
Construction and real estate	**54,481**	**17.9**	48,420	17.4	12.5
Electricity and water	**2,333**	**0.8**	2,671	1.0	(12.7)
Trade	**32,601**	**10.7**	31,335	11.2	4.0
Hotels, accommodation and food services	**5,757**	**1.9**	5,927	2.1	(2.9)
Transportation and storage	**5,959**	**2.0**	5,910	2.1	0.8
Communications and computer services	**6,602**	**2.2**	7,854	2.8	(15.9)
Financial services	**42,160**	**13.8**	37,788	13.6	11.6
Other business services	**9,161**	**3.0**	8,048	2.9	13.8
Public and community services	**8,326**	**2.7**	8,084	2.9	3.0
Private persons - housing loans	**40,585**	**13.3**	35,992	12.9	12.8
Private persons – other	**46,746**	**15.3**	41,170	14.7	13.5
Total	**304,919**	**100.0**	278,655	100.0	9.4

* Including off-balance sheet credit risk and investments of the public in debentures, and including other assets in respect of derivatives.
See Exhibit E to the Management Review for further details as to the spread of credit to the public according to sectors of the economy.

Part of the information set forth below is "forward-looking information". For the meaning of this term, see the chapter "General Environment and Effect of External Factors on Activities" in the "Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report" section on page 43 above.

Industry Sector:

Following is a review according to industry sub-sectors:

Construction inputs – Activities of the companies in the sector are directly affected by developments in the number of building starts. In recent years, the number of residential building starts has remained relatively stable at a low level, following the recession experienced by the construction sector during the nineties. In the field of non-residential construction, there was a decline in the area of building starts in 2006, and stability at a low level in 2007.

The construction inputs sector includes the non-metallic minerals field (building finish products - glass, ceramic products, cement, plaster and clay and stone-cutting) which are used, *inter alia*, for renovations, and the metals field (basic metals, non-ferrous metals, cast iron and steel and metal piping).

There is a positive atmosphere in the non-metallic minerals sector, and investment in the expansion of production lines. In addition, a moderate improvement in operating profitability of public companies operating in the sector has been recorded in recent years.

Metals sector – The world and local steel markets have continued to experience a growth trend in 2007, expressed in a sharp rise in demand and increases in prices. The price increases have mostly had a positive impact on steel manufacturers in all areas, mainly because of inventory management and properly timed purchases, and the passing on of price increases to the final consumer. Beginning in 2007, growth in the field of infrastructures was also recorded, and in the number of tenders issued in this field, which increased demand for metals by contractors.

Metal products sector – The growth trend in this sector's product, which began in 2003, ceased in the second quarter of 2006, and since that time the sector's product has remained relatively stable. Nevertheless, the amount of imported iron and steel is rising. The increase in imports has been accompanied by a rise in the prices of raw materials, which has caused difficulties for the companies operating in the sector, and which have absorbed part of the price increases. The operating profits of public companies operating in the sector were eroded by 1.2% during the third quarter of 2007, compared with the corresponding quarter in 2006. Steel prices continued to rise in 2007 also, and companies trading in the sector who have carried out a wise inventory policy are expected to experience high profitability this year.

The high-tech company sector – In 2007 the sector maintained stability and the growth trend that began in 2004 indeed continued, with increased investment in "clean tech" ("green technology") companies. There is a flow of funds and holding companies that are purchasing or examining the possibility of the purchase of control or significant holding in high tech companies.

Three central segments are distinguishable in the high-tech company field - equipment for the communications equipment sector, the software services sector, and semi-conductors.

Communications equipment sector – During the first three quarters of 2007, the growth trend in this sector, which began in early 2004 and accelerated in 2006 stabilized at a higher level than it had reached in 2000, when the "high-tech" bubble was at its peak. At the same time, the sector's profitability is being eroded. Nevertheless the public companies in the sector are characterized by a high level of liquidity and financial strength, which has continued to strengthen in 2007. Further, the trend towards deeper penetration of developing markets, such as Russia, India, China and South America, has continued.

Software services sector – This sector has seen the larger companies growing at the expense of the smaller companies, which are focused on a single main product, with continued expansion through purchases of new companies and mergers. In addition, in light of technological development, the large companies have been supplying similar technologies, and therefore an additional level of competition in the area of customer credit days has been added. The public companies in the sector are characterized by a relatively high level of profitability, liquidity and financial strength.

The semi-conductor field - The growth trend in demand continued in this field alongside the erosion of prices. This trend, together with technological changes, resulted in accelerated investment in existing FAVs, in order to adapt them to the new technologies. This is indicated by the increase in the share of long-term liabilities in the sector's overall balance sheet in the third quarter of 2007, as compared to the corresponding period in 2006 (based on the financial statements of the public companies active in the field). Sectoral profitability is low compared with other industry sectors – the sector presented an operating loss during the year ended in September 2007.

Diamonds – Activity in the diamond sector grew in 2007 as compared to 2006, with imports rising by some 10% and exports increasing by some 12% (raw + polished diamonds).

It should be noted that activity in the sector had slowed in 2006, such that this year's growth reflects a level of stability when compared with the activity levels in 2005, a slight improvement in profitability for the large diamond companies that are supplied by De Beers.

The growth in activity this year was mainly supported by increased demand for diamonds in the Far East (primarily in China and in India) and Israeli exports to these destinations increased this year by some 37%, as compared with 2006.

In contrast, there was a decrease of some 6% in polished diamond exports to the United States – a decline which reflects the impact of economic developments in the United States, which still purchases some 52% of the polished diamonds exported from Israel.

Leumi finances the sector's operations in Ramat Gan and New York, and focuses mainly on financing the large companies in the sector. These companies that have a business presence in a number of the diamond centers of the world, and have the financial and logistical ability to exploit the comparative advantages in each center.

The Bank's exposure policy for the diamond industry (in both Israel and the USA) is examined and supervised at the Group level.

The construction and real estate sector is divided into two principal sub-sectors:

The residential sector - The residential construction sector on a national level has been characterized during the past year by a recovery in the traditional areas of residential demand, in accordance with additional indicators that point to a rapid growth trend in the economy.

In traditional areas of demand, there was continued stability in low-cost housing construction, while a positive trend in the exclusive apartment market was noticeable, affected by a large number of purchases by foreign residents.

A slowdown in activity of the construction sector was conspicuous and particularly severe in peripheral areas, in the Galilee and the Negev.

The inventory of unsold new apartments has been steadily decreasing over recent years. As of the end of December 2007, this inventory stood at some 10.2 thousand residential units (a decline of some 23.2% as compared with the corresponding period in 2006). (Data adjusted for seasonal fluctuations).

The collapse of a large company in the residential project field during the year constituted an important event for the real estate sector, and is expected to lead to strengthened control and supervision by the institutions that finance such projects. This has also led to changes in legislation and regulation.

The income - producing property sector – In the income - producing property sector (offices and commercial properties) demand continued, affected by the growth in the economy’s business sector.

Commercial construction has witnessed an expansion of commercial centers in the outlying areas of large cities (power centers) and a trend towards the departure of traditional anchors from shopping malls in urban areas. In this field, there has also been a high number of sale transactions of active income producing properties, at high prices, reflecting a process of reduction in the required rates of return.

Office construction is experiencing increased demand after an extended period of excess supply. There is an obvious trend toward increased occupancy rates and rising rents. There has also been increased involvement of financial entities in the market, both in direct financing of properties and in ownership.

The infrastructure project sector - The moderate growth in carrying out large volume national infrastructure projects continued during the past year. The main activity in this area has been in infrastructure and transportation, energy and electricity. Some of these projects are carried out on a BOT or PFI basis.

The trade sectors

General – All areas within this sector are characterized by strong competition. The companies seek to expand their activities, mainly through mergers and acquisitions of operations synergetic with their existing activities.

Customers of the wood sector were affected by especially high volatility in global wood prices, and therefore acquired larger inventories of wood than had been maintained in the past.

Fluctuations in the exchange rates and in the prices of the raw materials create the need for currency hedging transactions, principally by companies engaged in imports. The margin between the dollar and the euro led to different situations among customers in the same sector, and a search for alternative sources.

The food marketing chain sector - This sector is comprised of the two largest food chains (including sub-chains) - "Supersol" and the "Blue Square", and of private chains - "Tiv Tam", "Kolbo Chetzi Chinam", "Rami Levi" and others. Willifood, a public company engaged in the import, marketing and distribution of food products in Israel is also included within this sector. According to various reports, 2007 was characterized by an increase in market share of the private chains, at the expense of the public chains. In addition, the chains are taking measures to expand in the field of “non-food” items, which they view as a source of growth.

According to various estimations, the global rise in commodity prices which characterized 2007 is expected to lead to an increase in the sale price of products and to the erosion of consumer buying power, and this may affect the food marketing chains. During the first three quarters of 2007, the operating profit margin of the large food market chains were somewhat low at some 4.5%. The financial leverage of these companies is relatively high and amounts to some 75% of the balance sheet, with appropriate liquidity levels.

A slowdown in the economy’s growth is likely to affect the public’s purchasing power and gradually affect the various sub-sectors in the trade sector.

The hotels sector - The continued improvement in the hotels sector derives primarily from the improvement in the security situation and from Israel’s economic growth. Some 2.3 million tourists entered the country during 2007, as compared with some 2.4 million entries during the peak year of 2000, the 2007 figure representing a 24% increase as compared with 2006.

The total number of tourist and Israeli overnight stays in 2007 exceeded, for the first time, the record recorded in 2000 (20.5 million overnight stays in 2007, compared with 19.5 million in 2000). Compared with 2006, the number of overnight stays increased by 6%. However, the percentage of overnight tourist stays out of total overnight stays amounted to 41% in 2007, as compared with 49.5% in 2000.

Average occupancy rates in Israeli hotels amounted to some 61% in 2007, as compared with 58% in 2006 and 60% in the record year of 2000. The improvement in these parameters was reflected in the hotels’ profitability, which increased by 2.3% in third quarter of 2007, as compared with the corresponding period in 2006. As long as the improved security situation continues, and as long as the global economy does not enter into recession, it is expected that there will be an increase in incoming tourism and the forecast for 2008 is for continued growth in the hotels sector.

The communications services sector - The sector is comprised of four principal sub-sectors: fixed line communications (internal and international), cellular communications, multi-channel television and internet access.

Key issues to be noted in this sector in 2007:

Mobility of telephone numbers – The Telephone Number Mobility Law came into force on 1 December 2007, allowing subscribers to change telephone companies without changing their telephone numbers. The law’s commencement is expected to increase competition in the fixed line and cellular communications sectors.

WiMax technology – the Ministry of Communications is currently examining the regulation of WiMax licensing. This is a wireless technology for the provision of fixed line and cellular communications services which enables high broadband communications.

The following is a description of the main sub-sectors:

Fixed line communications - In the domestic fixed line communications field, commercial licenses were granted in the first half of 2007 to the companies in this sector to provide VOB broadband telephony services. This platform was added to the two existing platforms in the sector: traditional fixed lines and cable television. (In November 2003 the cable television companies received a license to provide internal operator (IO) services.) Further, additional companies in the communications sphere (particularly in the international and cellular telephone field) received an IO license and other companies have filed applications for a similar license. Currently, the cellular companies' IO licenses are primarily directed at the business sector.

Cellular communications - The cellular companies continue to present good levels of profitability and cash generation. Despite the negative effect of regulatory directives, such as the reduction of connection fees, the companies have succeeded, by means of increased efficiency and raising prices, in presenting good business results. Thus, in the third quarter of 2007, the cellular companies presented operating profit margins of 22.3%, 3% higher than in the corresponding period in 2006. In addition, there was a significant decline in the cost of the investments required for the transition to advanced technologies, a fact that is likely to contribute to the companies' financial ability. The Gronau Commission is expected to publish its conclusions in the near future. These will relate, *inter alia,* to the granting of an MVNO (virtual operator) license which will allow the entry of additional competitors into the sector, while using the infrastructures of the companies that are currently operating in the sector.

Multi-channel television - In May 2006, an agreement was signed for merging of the activities of the cable companies, and in December 2006 a financing agreement was signed between the merged company and seven banks, including Leumi. On 31 December 2006, the steps required for the merger of the cable companies were completed and the financing agreement took effect (see the paragraph regarding the merger of the cable companies below for further details). It should be noted that there has been a return to and increase in competition levels between the companies active in this sector in the last two years.

Internet access – The provision of broadband internet access services is divided into two parts: the provision of an infrastructure through traditional fixed line communications and the provision of access services through the service providers (most of which currently provide international communications services as well). During the past year, the sector has been characterized by consolidation, such that three large companies operate in the sector, with the market share being equally divided between them. During the last few years, the sector has been characterized by high growth rates. At the same time, the penetration rate of broadband internet among Israeli households reached some 72% by the end of 2007 – of which 95% use high-speed internet. The companies in the sector are now currently expected to focus on increasing the average income per subscriber and less on increasing the number of subscribers.

The local authorities –
The Budgetary Principles (Amendment No. 31 and Temporary Provision) Law, 2004 (the "Amendment to the Law") came into force on 17 June 2004.
The purpose of the Amendment to the Law, as declared by the government, was to enable local authorities in distress to carry out recovery programs under the supervision of an accompanying accountant and to that end to enjoy immunity from creditors for a limited period.
The Amendment to the Law restricts, for the entire period of the recovery program, the use of monies classified within the context of the recovery program as "recovery monies", and prevents the enforcement or creation of a pledge, assignment or attachment of such monies throughout the recovery program period. The definition of "recovery monies" includes, *inter alia*, special allocations for that purpose from the State (which are not current allocations).

Since the Amendment to the Law impaired signed agreements between the Bank and the Israeli government in respect of the debts and the arrangements made in the past with the local authorities sector and, as mentioned above, impaired the collateral that the Bank had received as security for this credit, the Bank's Management decided to freeze the extension of new credit to local authorities.
Following a consensus reached by the banks and the Ministry of Finance and the Ministry of the Interior, the Bank decided to renew the granting of credit at the beginning of 2005 to some of the local authorities on a selective basis.
Since August 2005, the financial supervision of the local authorities has been carried out according to a new system of parameters operated in order to examine, *inter alia*, the Bank's share in the credit of each authority, its debt servicing ability and the period during which it can repay its debts to the Bank.

Private individuals

The private individuals sector relates to households. The acceleration in the growth rate in 2007 and in particular the increase in real terms in per capita private consumption reflect a continuation of the trend that prevailed in 2006, which is also based upon positive expectations for an improvement in the households' position. The improvement in the background conditions, such as the low real interest rate as compared with previous years, the real increase in salaries and the trend towards a decline in the unemployment rate, support the expansion of demand for credit on the part of this sector of the economy.

Mortgages - housing loans

In 2007, an increase was recorded in the granting of housing loans to the public by the mortgage banks, reaching an amount of some NIS 30.1 billion, compared with some NIS 22.3 billion in 2006, an increase of some 35.0%. Building starts decreased by 6.5% in 2007, as compared with 2006. There were some 97,000 transactions executed in 2007.

However, it would appear that recovery was focused on exclusive areas of demand in which the rate of financing by means of own funds is higher than in comparison with the peripheral areas, which are more dependent on external financing and in which a sharp decline in the volume of activity was recorded.

Following is further data on total credit.

The following table sets out the spread of credit to the public* and off-balance sheet credit risk according to the size of the credit to a single borrower:

		31 December 2007		
Credit Ceiling in NIS thousands		**Percentage of total number of borrowers**	**Percentage of total balance sheet credit**	**Percentage of total off-balance sheet credit**
From	To		%	
0	80	**85.5**	**6.0**	**16.5**
80	600	**12.8**	**19.6**	**11.4**
600	1,200	**0.9**	**5.8**	**2.7**
1,200	2,000	**0.3**	**3.1**	**1.4**
2,000	8,000	**0.3**	**9.4**	**5.8**
8,000	20,000	**0.1**	**9.3**	**6.8**
20,000	40,000	**0.05**	**8.3**	**7.4**
40,000	200,000	**0.04**	**19.2**	**21.2**
200,000	800,000	**0.01****	**14.1**	**16.5**
Above 800,000		**0.0*****	**5.2**	**10.3**
Total		**100.0**	**100.0**	**100.0**

		31 December 2006		
Credit Ceiling in NIS thousands		Percentage of total number of borrowers	Percentage of total balance sheet credit	Percentage of total off-balance sheet credit
From	To		%	
0	80	83.4	6.4	14.4
80	600	15.0	20.1	12.7
600	1,200	0.8	4.7	2.3
1,200	2,000	0.2	2.5	1.4
2,000	8,000	0.4	8.9	5.8
8,000	20,000	0.1	9.1	7.2
20,000	40,000	0.05	8.8	9.0
40,000	200,000	0.04	19.1	24.7
200,000	800,000	0.01**	15.9	14.9
Above 800,000		0.0***	4.5	7.6
Total		100.0	100.0	100.0

* After deducting the specific provisions for doubtful debts.
** In 2007 - 121 borrowers and in 2006 - 120 borrowers
*** In 2007 - 14 borrowers and in 2006 - 12 borrowers.
See Note 4 F to the Financial Statements for further details about the spread of credit according to size.

The obligations of the six largest groups of borrowers represented 9.4% of total credit risk at 31 December 2007 and 99.5% of the capital calculated for the limitation on the six largest groups of borrowers (the limit was 135% of the capital until 31 December 2006).

In February 2007, the Supervisor of Banks approved a limit for the total obligations of the six largest borrowers and groups of borrowers, of 150% of the Bank's capital, subject to:

1. The limit of the obligations of a single group of borrowers may not exceed 25% of the Bank's capital.
2. The limits are to be adopted in the Bank's credit policy and approved by the Board of Directors.
3. The Bank may not readopt the previous limits.

Problem Loans

The following table sets out a summary of data on the overall problem credit risk (6) relating to credit to the public at the Group's responsibility, less specific provisions for doubtful debts:

	2007	2006
	(NIS millions)	
Problem Loans(1)		
Non-performing	**1,604**	2,519
Restructured (2)	**929**	1,179
To be restructured (3)	**85**	134
In temporary arrears	**764**	658
Under special supervision*	**9,618**	13,548
Total balance sheet credit to problem borrowers (1)	**13,000**	18,038
Off-balance sheet credit risk to problem borrowers (1) (5)	**2,438**	2,410
Debentures of problem borrowers	**4**	15
Other assets in respect of derivatives of problem borrowers	**32**	23
Total overall credit risk in respect of problem borrowers(1)	**15,474**	20,486
Assets received in respect of repaid credit	**865**	606
*Of which: debts for which there is a specific provision (4)	**4,666**	5,484
*Of which: credit for housing for which there is a provision according to the extent of the arrears	**523**	830

(1) Not including problem loans that are covered by collateral that is permitted to be deducted for the purpose of restrictions on the obligations of a borrower and a group of borrowers (Proper Banking Management Directive No. 313).
(2) Credit that was restructured during the course of the current year and also credit that was restructured in previous years with a waiver of income.
(3) Credit to borrowers in respect of whom there is a decision of the banking corporation's management for a restructure, but the restructure has not yet been implemented.
(4) Apart from credit for housing in respect of which there is a provision in accordance with the extent of the arrears.
(5) As calculated for the purposes of limits on the obligations of a borrower and a group of borrowers, except in respect of guarantees given by a borrower to secure an obligation of a third party.
(6) Credit to problem borrowers as detailed in the disclosure format.

The large amount of problem loans, mainly at the Bank, is the result of the extended slowdown in activity in the economy during the years 2001 to 2003 and its negative impact on borrowers and their repayment ability. As a result, increased monitoring and supervision of these borrowers is required.

There was a 24.5% decrease in 2007 in the scope of problem loans and a decrease of 36.2% in non-performing loans, as compared with 2006.

There was a decrease of 29.0% in loans under special supervision. Classified in this group are loans in respect of which, according to the Bank of Israel's definitions, the Bank's Management considers it necessary to intensify monitoring and supervision, but does not anticipate credit losses in respect thereof, and also the balance of the obligations of a borrower, another part of which has been defined as a problem loan under another classification ("resultant"). The sum of some NIS 3.7 billion out of the debts under special supervision is resultant and some NIS 5.9 billion is in accordance with decisions of Management.

In 2006, Proper Banking Management Directive No. 325 "Management of Current Account Credit Lines" was implemented. Pursuant to the above directive, and to clarifications of the Supervisor of Banks, the Bank is required to classify any excess over approved credit lines (where excesses are above NIS 1,000) as a non-performing loan, if the Bank charges the customer excess interest. The credit within the line and the remainder of the customer's obligations must be classified as a debt under special supervision, without regard to existing collateral or to the customer's repayment ability. The effect of the said directive has been

to increase non-performing loans by NIS 74 million, and loans under special supervision by NIS 1,775 million, and as a result to increase the additional provision by NIS 7 million in 2006, NIS 119 million, 3,460 million and NIS 12 million respectively.
The aggregate balance of the general provision and the additional provision for doubtful debts (according to risk characteristics defined by the Supervisor of Banks) at the Bank and its consolidated companies amounted to some NIS 875 million at the end of 2007 (constituting some 0.29% of total credit risks), compared with NIS 1,024 million at the end of 2006 (some 0.37% of total credit risks.)

See Note 4 to the Financial Statements and Exhibit E to the Management Review for further details on problem loans.

Credit to Governments as at 31 December 2007 totaled NIS 642 million, a decrease of NIS 378 million (37.1%) as compared with 31 December 2006.

Securities

The Group's investment in securities as at 31 December 2007 amounted to NIS 47,169 million, an increase of NIS 794 million, 1.7%, compared with 31 December 2006; this was mainly as a result of the increase in investments in foreign currency denominated securities, which was partially offset by the strengthening of the exchange rate of the shekel.

Securities are classified into three categories: securities for trading, securities available for sale and debentures held to maturity.

Securities for trading are presented in the balance sheet at fair value and the difference between the fair value and the adjusted cost is charged to the profit and loss statement, and available for sale securities are presented at fair value, where the difference between fair value and adjusted cost is presented as a separate item in shareholders' equity less the related tax. Debentures held to maturity are presented at adjusted cost (par value with the addition of accumulated interest and linkage differentials, less/plus disagio or agio).

The following table sets out the classification of the securities item in the consolidated balance sheet as at 31 December 2007 in accordance with the above-mentioned rules:

	31 December 2007				
	Adjusted cost	**Unrealized gains from adjustments to fair value**	**Unrealized losses from adjustments to fair value**	**Fair value**	**Balance sheet value**
	NIS millions				
Debentures					
Held to maturity	**1,581**	**22**	**(4)**	**1,599**	**1,581**
Available for sale	**33,458**	**141**	**(507)**	**33,092**	**33,092**
For trading	**7,110**	**69**	**(38)**	**7,141**	**7,141**
Shares and Mutual Funds					
Available for sale	**3,275**	**1,195**	**(34)**	**4,436**	4,436
For trading	**918**	**28**	**(27)**	**919**	919
Total Securities	**46,342**	**1,455**	**(610)**	**47,187**	47,169

31 December 2006					
	Adjusted cost	Unrealized gains from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair value	Balance sheet value
	NIS millions				
Debentures					
Held to maturity	2,528	48	(10)	2,566	2,528
Available for sale	32,628	282	(259)	32,651	32,651
For trading	6,875	98	(9)	6,964	6,964
Shares and Mutual Funds					
Available for sale	3,220	981	(2)	4,199	4,199
For trading	34	-	(1)	33	33
Total Securities	45,285	1,409	(281)	46,413	46,375

As at 31 December 2007, some 79.6% of the Group's nostro portfolio was classified as securities available for sale and some 17.1% as securities for trading. This classification allows for flexibility in management of the securities portfolio. Some 2.1% of the value of the securities represents investments in shares of companies that are not presented on the equity basis, but according to cost or to the market value of the shares traded on the Stock Exchange.

Commencing on 4 September 2006, the Bank began operating as a market maker in the "Shahar" debenture market. The trading portfolio as at 31 December 2007 included a balance of NIS 493 million, arising from the Bank's activities as a market maker. The volume of transactions during 2007 amounted to some NIS 114.9 billion, as compared with some NIS 23 million during the fourth quarter of 2006.

In respect of the available for sale portfolio, adjustments for a decrease in value amounting to NIS 210 million were charged to the capital fund in 2007, mainly from the decline in value of debentures, in the amount of some NIS 389 million, of which NIS 175 million is from government debentures, compared with an increase in value amounting to NIS 876 million in 2006. In 2007, a decline in value of some NIS 28 million (US$ 7.2 million) was recorded in the profit and loss statement, as described below. The accumulated capital fund totaled NIS 765 million, gross. In respect of debentures for trading, realized and unrealized losses amounting to a loss of NIS 22 million were recorded in the profit and loss statement in 2007, compared with a profit of NIS 73 million in 2006. Furthermore, net profits were recorded from the sale of debentures available for sale in the amount of NIS 108 million, compared with NIS 29 million in 2006 and profits in the amount of NIS 67 million from the sale of mutual funds were also recorded.

	2007	2006
	NIS millions	
Profits in respect of securities recorded in the profit and loss statement	**1,214**	647
Adjustments to the capital fund for increase (decrease) in the securities' value	**(210)**	876

The following table sets out details of the composition of investments in debentures according to linkage basis:

	31 December 2007			31 December 2006		
	Govt. of Israel	**Foreign govts.**	**Other companies**	Govt. of Israel	Foreign govts.	Other Companies
	NIS millions					
Israeli Currency:						
Unlinked	**8,040**	**-**	**41**	10,704	-	-
CPI-linked	**4,993**	**-**	**1,462**	4,116	-	1,215
Foreign currency including foreign currency-linked	**1,760**	**1,973**	**23,545**	1,960	3,720	20,428
Total debentures	**14,793**	**1,973**	**25,048**	16,780	3,720	21,643

In 2007 there was an increase of some NIS 3,405 million, some 15.7%, in the Group's investments in corporate debentures, mainly in foreign currency debentures abroad. Some 40% of debentures are invested in government debentures, mainly of the Israeli government.

See Note 3 to the Financial Statements for further details.

The securities portfolio includes investments of some NIS 27.3 billion in foreign currency, mainly in foreign securities. Currently, the Bank has not yet securitized its assets and does not bear any underwriting obligation for such securities in Israel or abroad. Most of the Bank’s investments in its overall portfolio are in Israeli government securities (some 31.4% of said portfolio) and securities of banks rated higher than A.

Investments in Foreign Asset-Backed Securities

The Group’s securities portfolio includes some NIS 6.7 billion (some US$ 1.7 billion) of asset-backed securities (both mortgage-backed and non-mortgage-backed), all of which are investment grade securities, some 90% being rated 'AAA' and some 8% rated 'AA'. Of said portfolio, NIS 6.3 billion (some US$ 1.6 billion) is classified in the available for sale securities portfolio, and the balance in the securities for trading portfolio.

The revaluation of the portfolio is based on revaluation data received from external sources. Most of the portfolio is revalued each month by a recognized international institution, which carries on business as a valuer and is independent of both the issuing entities and the marketing entities. Internal models are not used for the purpose of revaluing these securities.

The test for determining whether a decline in value is of a non-temporary nature is based primarily on the following criteria:

- A change in the security’s rating by the international rating agencies.
- The length of time during which the security’s value is less than its cost.
- The assets and the collateral backing the security.
- The rate of the decline in value as a percentage of the value of the security.

The Management’s decision in this regard is made after an examination of all these criteria and an estimation of the accumulated significance.

The Management of the Bank estimates that the decline in the value of the asset-backed securities portfolio (both mortgage-backed and non-mortgage-backed) is mostly temporary in nature. From the time the investments were made, the Bank’s intention was to hold them until redemption. The investments were classified as belonging to the available for sale portfolio, in order to allow for flexibility in management of the portfolio. The Bank intends, and is able, to continue to hold the investments until the expected return of the full cost of the assets. Therefore, most of the decline in value was charged to capital fund. The total decline charged to the capital fund in respect of the above-mentioned securities amounts to some NIS 170 million (some NIS 107 million after taxes). The decline in the market value of these securities arises primarily from the widening of margins, the source of which is the reduction of liquidity and the sharp fluctuations in the global capital markets since July 2007, and not from the lowering of the credit rating of the securities.

In addition to the temporary decline in value which was charged to the capital fund, some NIS 28 million was recorded in the profit and loss account, as explained below.

The Group's available for sale securities portfolio as at 31 December 2007 includes investments in mortgage-backed securities in the total amount of some NIS 4.1 billion. Of this amount, 99% is rated 'AAA' by the world's leading rating agencies (S&P, Moody's, Fitch). The portfolio includes Sub-Prime debentures in the amount of NIS 4.0 billion (US$ 10 million), which are rated 'AAA'. Of the mortgage-backed securities, 97% are guaranteed or issued by United States federal agencies (GNMA, FHLMC, FNMA – see below for definitions). The total of the mortgage-backed securities that are not (U.S.) government guaranteed and are not backed by American federal entities amounts to some NIS 146 million.

The projected term to maturity for the mortgage-backed securities portfolio is slightly less than four years on average.

Most of the decline in the portfolio's value was recorded in previous years at the US subsidiary due to the rise in interest rates in the United States three years ago. Since interest rates began to fall, the margin between the adjusted value and the fair value has narrowed. Consequently, and on the basis of the criteria mentioned above, the Bank estimates that the decline in value is temporary in nature. Recently, due to fluctuations in the markets, a decline in value was recorded, following the widening of margins.

As at 31 December 2007, the decline in value charged to capital fund resulting from the mortgage-backed securities portfolio was some NIS 45 million (some NIS 29 million after taxes).

In addition to the mortgage-backed securities, the Group's available for sale securities portfolio includes other securities that are backed by assets other than mortgages (obligations in respect of credit cards, car financing credit and other types of credit), in the amount of some NIS 2.1 billion. More than 71% of these debentures are rated 'AAA' by the world's leading rating agencies, and the others are rated A- and above. This portfolio includes, *inter alia*, SCDO's in the amount of some NIS 430 million, and CLO's in the amount of some NIS 1,226 million. The projected term to maturity of the portfolio of securities that are backed by assets other than mortgages is less than five and a half years on average.

The Bank estimates, and on the basis of examination of the above criteria, that the decline in the value of the portfolio of securities that are backed by assets other than mortgages is mostly temporary in nature, and most of the decline in value was therefore charged to the capital fund. As at 31 December 2007, the decline in value charged to the capital fund attributed to the portfolio of securities back by assets other than mortgages came to some NIS 123 million shekels (some NIS 78 million after tax).

In addition to the temporary decline in value which was charged to the capital fund, some NIS 28 million was charged to the profit and loss statement in respect of asset-backed securities in the available for sale portfolio. The provision in this amount was made in respect of the SCDO portfolio. The provision was made as a measure of prudence, even though not a single event of failure had been recorded with respect to the portfolio, and the ratings of none of the securities had been lowered. Most of the decline in market value occurred commencing from the second half of 2007. Moreover, the portfolio has been rated 'AAA' or 'AA' by the world's leading rating agencies. Additionally the credit risk in the portfolio is widely spread among more than five hundred borrowers (all of which are companies and not mortgage portfolios), and the weight of the largest borrower is less than 2% of the portfolio (some NIS 7 million).

The decision to classify the above decline in value in the amount of some NIS 28 million as a non-temporary decline in value was based primarily on the decline in value of the SCDO's which took place commencing from the second half of 2007, and on a detailed examination of the ratings of the borrowers in CDS that back the SCDO's in the portfolio.

There was an additional decline in the value of the asset-backed securities portfolio (both mortgage-backed and non-mortgage-backed securities) since the end of the year, through the end of February 2008, in the amount of some NIS 99 million (some NIS 63 million after tax). This decline is not included in the results as at the end of 2007.

The following table presents the investments in asset-backed securities in the available for sale portfolio as at 31 December 2007:

	Cost	Unrealized Gains	Unrealized Losses	Balance Sheet Value (Fair Value)
	NIS millions			
MBS (mortgage-backed securities)	4,199	3	50	4,152
ABS (asset-backed securities)				
Of these, the non-mortgage backed securities:	2,241	6	129	2,118
CLO	1,287	-	61	1,226
SCDO	491	5	66	430
Total	6,440	9	179	6,270

For further details, see Note 3 to the Financial Statements.

The Bank manages two additional portfolios in addition to the available for sale portfolio. The Group's held for redemption portfolio includes no investments of this type. The securities for trading portfolio includes investments through portfolio managers in foreign currency securities in the amount of some NIS 390 million (US$ 101 million), of which some NIS 344 million are invested in mortgage-backed securities and some NIS 46 million are invested in other asset-backed securities. This portfolio includes securities that are backed by sub-prime mortgages in the amount of some NIS 23 million (US$ 6 million), of which NIS 18 million are rated 'AAA'.

The difference between fair value and the reduced cost, to the extent that such exists, was credited to the profit and loss statement.

The Bank has an off-balance sheet investment in CDS securities in the amount of NIS 975 million. A revaluation of these instruments, based on their fair value, was recorded in the profit and loss statement. Income in the amount of NIS 64 million was recorded in the profit and loss statement with respect to the portfolio of securities for trading and the investment in CDS securities in 2007.

Definitions

MBS - Mortgage-Backed Security
Debentures backed by mortgages for which the payments of interest and principal are based on cash flows resulting from the repayment of loans secured by mortgages.

Sub-Prime – a particular type of MBS
Debentures for which the interest and principal payments are based on a cash flow from a portfolio of mortgages given to borrowers with low credit ratings who have not provided appropriate collateral.

CDO - Collateralized Debt Obligation
A debenture backed by a portfolio of debentures and/or loans with varying levels of seniority and ratings.

SCDO - Synthetic Collateralised Debt Obligation
An agreement backed by a portfolio of CDS (which are derivatives) with varying levels of seniority.

CLO - Collateralized Loan Obligation

A debenture backed by a portfolio of loans.

FNMA - Fannie Mae: A public company backed by the United States government which purchases mortgages, securitizes them and sells them on the open market. (This company's securities do not have U.S. government guarantees).

FHLMC - Freddie Mac: A United States government sponsored enterprise which purchases mortgages, securitizes them and sells them on the open market. (This company's securities do not have U.S. government guarantees).

GNMA (Government National Mortgage Association) - Ginnie Mae: A federal mortgage company which guarantees the securities it issues.

CDS – Credit Default Swap – a financial product that transfers the issuer's credit exposure among the parties to the transaction.

The following table sets out details of the Group's activities in debentures:

	2007	2006
	NIS millions	
Debentures which reached maturity and/or were sold (held to maturity and available for sale)	**36,362**	27,138
Purchases of debentures for redemption and available for sale	**35,880**	23,397
Profit, net, from investments in debentures:		
- Interest income on an accumulative basis	**667**	417
- Profit from the sale of debentures available for sale	**108**	29
- Profit realized and/or unrealized from adjustment to fair value of debentures for trading	**(22)**	73

The Bank is a member of the Stock Exchange Clearing House Ltd. and the Maof Clearing House Ltd.
The Bank (like all other Maof Clearing House members) pledges securities from the nostro to secure its customers' activities, the nostro activities and its part of the risks fund. The pledge also secures amounts due in respect of obligations of the other members of the risks fund, if the pledge provided by another member is not sufficient to cover all his obligations and in proportion with the relevant share of each of the members of the fund, up to the lower of the amount of the collateral provided or the amount of the sums due to the Maof Clearing House. As at 31 December 2007, the Bank had pledged debentures having a value of NIS 2.5 billion to the Maof Clearing House.

A similar collateral arrangement exists with the Stock Exchange Clearing House. The total value of debentures pledged by the Bank to the Stock Exchange Clearing House as at 31 December 2007 was NIS 2.5 million.

On 23 July 2007, the Bank signed a debenture in favor of the Bank of Israel as security for sums due or to be due from the Bank to the Bank of Israel. As collateral for the debenture, the Bank created a floating charge in favor of the Bank of Israel, unlimited in amount, on debentures deposited in a specific account maintained at the Stock Exchange Clearing House in the name of the Bank of Israel. The balance in the account as at 31 December 2007 is NIS 3.2 billion.

As at 31 December 2007, there was no credit to the Bank from the Bank of Israel, while the balance of the Bank's deposits with the Bank of Israel amounted to NIS 5,773 billion.

The following table sets out the principal investments in shares and mutual funds recorded in the securities item (available for sale portfolio)[(1)]:

	The Bank's share on consolidated basis in the paid up capital giving the right to receive profits		Value of the investment in the consolidated balance sheet	
	31 December	31 December	**31 December**	31 December
	2007	2006	**2007**	2006
	%		NIS millions	
Migdal Insurance and Financial Holdings Ltd.	**9.89**	9.89	**619**	619
Gibor Sport Ltd.	**4.3**	4.32	**3**	3
Africa Israel Properties Ltd.	**4.3**	5.0	**120**	107
Cellcom Israel Ltd[(2)]	**2.23**	5.0	**267**	312
Super-Pharm (Israel) Ltd.[(6)]	**18.0**	-	**182**	-
Hot – Cable Communciations Systems Ltd. [(3)]	**14.96**	15.3	**637**	407
Otzar Hityashvuth Hayehudim B.M.	**8.64**	8.64	**95**	88
Bezeq – Israel Communications Company Ltd. [(4)]	**4.23**	4.23	**754**	761
Union Bank of Israel Ltd. [(5)]	**6.46**	6.46	**99**	116
Spring Mountain Fund	-	-	**289**	-

(1) See page 132 for details of non-banking investments presented on the equity basis.

The following table sets out investments (positions) in shares and mutual funds included in the securities item (available for sale portfolio and tradable portfolio) (in NIS millions)

	Balance Sheet Amount	
	2007	2006
Shares with quoted prices	**4,383**	3,400
Shares without quoted prices	**972**	742
Total	**5,355**	4,232

(2) In May 2006, Leumi & Co. Investment House Ltd. (a wholly owned subsidiary of the Bank – "Leumi & Co.") purchased 5% of the share capital of Cellcom Israel Ltd. from Discount Investment Corporation Ltd. for an aggregate consideration of NIS 328 million. In December 2007, Leumi & Co. sold some 2.8% of the share capital of Cellcom Israel Ltd. for a total consideration of NIS 331 million.

(3) Hot - Cable Communications Systems Ltd.
In the context of the completion of the merger of the activities of the cable companies in 2006, the Bank, as well as other banks, received shares in the merged company. The Bank holds 14.96% of the shares in the merged company.

(4) Pursuant to a July 2003 directive of the Supervisor of Banks, the classification of the credit of a certain customer, granted to finance the acquisition of shares in the communications sector, was changed from credit to the public to the securities item. The market value of the said shares as recorded in the shares available for sale item as at 31 December 2007 was NIS 754 million, compared with the actual market value of the shares of NIS 789 million. The shares were not recorded at their full market value since the Bank is not entitled to increases in value in excess of the balance of the debt. Adjustments to market value in the sum of NIS (7) million were recorded in the capital fund in 2007 in respect of these shares and the aggregate balance as at the end of 2007 amounted to NIS 251 million. Total dividends received in reduction of the debt amounted to NIS 120 million.

(5) Union Bank

On 17 November 2003, an agreement was signed between the Bank, Sherodar Assets Ltd. and Yishayahu Landau Holdings (1993) Ltd. for the extension of the put option and of the call option that were granted in an agreement dated 18 November 1999, in respect of the balance of the shares in Union Bank that are held by the Bank, for a period ending on 17 November 2010.

As at 31 December 2007, the Bank held 6.46% of Union Bank’s shares.

For further details in respect of the abovementioned agreement see Note 18 N to the Financial Statements.

(6) Super-Pharm

On 17 July 2007, the allotment of 18% of the shares of Super-Pharm (Israel) Ltd. ("Super-Pharm") to Leumi & Co. Investment House Ltd. was completed, pursuant to an agreement signed on 1 May 2007 between Leumi & Co. and Super-Pharm and GRI Global Retail Investment B.V. – the controlling shareholder of Super-Pharm – providing for the allotment of the said percentage of the share capital of Super-Pharm to Leumi & Co. for a consideration of some NIS 180 million, subject to adjustments laid down in the agreement. In addition, Leumi & Co. was granted an option for the allotment of a further 2% of the share capital of Super-Pharm. Leumi & Co. was granted standard minority protection rights.

Psagot - Leumi & Co. Underwriting Ltd.

Following new legislation regarding the underwriting of securities issues, which imposes significant restrictions on an underwriting company controlled by a bank, the Bank decided that the Group’s securities underwriting activity would be concentrated in a new company in which the Bank would hold a 19.99% interest. For this purpose, Leumi & Co. Investment House Ltd. entered into an agreement with Psagot Investment House Ltd., according to which Leumi & Co. and Psagot will cooperate in the area of underwriting, within the framework of a new company, called Psagot - Leumi & Co. Underwriting Ltd. The new company began operations during the third quarter of 2007.

Fixed Assets and Installations

Buildings and Equipment - the cost after depreciation of buildings and equipment as at 31 December 2007 amounted to NIS 3,276 million, compared with NIS 3,056 million as at 31 December 2006.

The investments in buildings and equipment as at 31 December 2007 are as follows:

	Cost	Accumulated Depreciation	Balance for Depreciation	
			31 December 2007	31 December 2006
	NIS millions			
Buildings and land	3,137	1,560	**1,577**	1,548
Equipment, furniture and vehicles	5,731	4,032	**1,699**	1,508
Total	8,868	5,592	**3,276**	3,056

The land and equipment are used mainly for the activities of the Group. Buildings that are not used by the Group and are leased to non-Group parties are included in the consolidated balance sheet and amounted to NIS 31 million as at 31 December 2007.

The majority of the structures in which the business of the Group is conducted in Israel are owned by the Bank or by subsidiaries. Most of the properties in which the business of the Group is conducted abroad are leased.

Real estate assets of the Bank are owned by the Bank, Binyanei Bank Ltd. and Lyn City Center Ltd. (wholly-owned subsidiaries of the Bank). 241 properties are owned by the Group, of which 125 are branches and archives and 21 are head office buildings. Total property under ownership, of an area of some 257,000 sq.m., is divided into branches - some 85,141 sq.m., head office buildings - some 41,220 sq.m. and the balance is divided amongst offices in use by subsidiaries, a logistical center, plots, vacant properties etc. Vacant properties designated for sale constituted 1,275 sq.m. and are presented according to the lower of depreciated cost or realization value.

Investment in buildings in 2007 totaled NIS 124 million compared with NIS 69 million in 2006.
In addition to property owned by the Bank, the Bank leases 173 properties under unprotected leases and 10 properties under protected leases. Total property leased constitutes some 60,059 sq.m.

The Bank is planning the construction of a computer site with anti-missile protection to protect the computer center and an energy center. The structure will be built to withstand a direct hit by “small” rockets and a nearby hit by surface to surface missiles.

"Keshev" – "The Yitzhak Rabin Bank Leumi Service Center". "Matam" – the computer, information systems and administration service center of the Bank is located in Lod, within a facility comprising a total area of 78.8 dunams. The facility was purchased by Binyanei Bank Ltd. The Bank leases the property from Binyanei Bank and pays a monthly rental of NIS 1.8 million including VAT (as at 31 December 2007).

Leumi's mainframe computers are products of IBM, part of the Z Series range. The power measurement unit for these computers is "mips", the meaning of which is the number of instructions (in millions) that the computer is capable of performing per second. Two model Z Series computers operate at Keshev for use by the production systems: a primary computer with an operating power of some 5,105 mips and a second computer with an operating power of some 429 mips. The secondary production computer is expandable to a capacity of some 3,806 mips for internal back-up purposes in the Keshev facility.
One computer, with an operating power of some 2,158 mips, operates at the Tel Aviv facility, and serves as the development and testing environment. This computer is expandable to a capacity of some 6,213 mips in emergency situations in which the Keshev facility ceases to operate.
The storage network of the Bank for use with the decentralized systems is based on central storage packages of IBM and XIV. The switching units are products of Cisco. The storage volume is some 294 TB. The storage volume of the mainframe computer environment is some 34 TB.
The tapes cartridge system layout is based on IBM automatic libraries – two at the Keshev facility and two at the Tel Aviv facility.
The server layout is made up of products of IBM, Sun and HP. There are some 1,400 servers in the production layout. The vast majority are based on the Windows operating system, with a minor portion being based on the Unix operating system.

In December 2007, there were 1,432 employees at Matam, of whom 337 are managerial staff and 1,095 are clerical staff. In addition, there are 795 personnel employed through outsourcing, of whom 136 are included in Matam's workforce and the rest are outside consultants.

The Bank has a database of historical data stored on disks and tapes manufactured by XIV, IBM and HDS, with a capacity for tens of TB at the main Keshev computer facility and at the Tel Aviv backup facility. A third copy of the data is held in a different location in Israel.

Leumi has a very advanced communications network for data and voice communication, with high-speed data transfer. The communications network is highly resilient, as is the whole of the Bank's computer network.
Leumi's branches are computerized and connected on-line to the Bank’s computer center at Keshev. Some 310 servers and some 7,170 work-stations, mostly PC-based, have been installed in the branches. There

are 297 innovative automatic teller machines and some 521 self-service “Leumi Information” stations (317 stations in the branches and 204 external information stations in the walls of branches) available for customers’ use. At head office and district management units there are 8,000 personal computers connected in local area networks, with the capability of communicating directly with the computer center and separate external internet connection.

Information security at Leumi is based on the principle of banking secrecy and various laws and directives, namely the provisions of the Protection of Privacy Law and related regulations, the provisions of the Computers Law, directives of the Bank of Israel, including Information Technology Management Directive 357, and accepted standards of information security.

Matam operates a computer services system for the Arab Israel Bank and for Union Bank. (See page 204 below of the Report regarding the agreement with Union Bank). There is an agreement concerning the computer services that Matam provides to the Arab Israel Bank, including operational services, computer systems development, consultancy services, organization and methods services, back-ups, training and additional services.

Based on these directives, extensive activity is undertaken in defining organizational information security policy, structuring work programs for the implementation of supervision and information security mechanisms, establishing systems and integration of information security management, and planning and execution of information security controls, including the preparation of guidelines.

The operations and computer layout of the subsidiaries in Israel and abroad are based on independent systems, with the managements and boards of directors of those companies having professional and administrative responsibility. Within the context of a multi-year program, the Bank is upgrading the systems at the overseas subsidiaries to a uniform computerized banking system.

The computer systems of the Israeli subsidiaries are connected by communications systems to the Bank’s central computer in Israel.

The computer center of Leumi Mortgage Bank is located outside of its offices, and is operated by means of outsourcing by IBM. This center has a backup facility located separately from the computer center, which is operated and maintained by IBM. The computer center is connected by communication systems to Leumi Mortgage Bank head office and to the Bank's computer center at Keshev.

The overseas subsidiaries are connected to each other and to the Bank in Israel via a private communication network. This system is used for voice messages as well as for transmitting encrypted data in a secured manner. The Bank invests in maintaining and developing internet sites for the Bank’s overseas subsidiaries based on the infrastructure which serves the Bank’s central site. A project is planned for 2008, involving the upgrading of the Bank’s international communications network for the Bank’s European subsidiaries and its representative offices. In addition, the technological infrastructure was upgraded to improve management information and customer service.

Bank Leumi USA has outsourcing agreements with a number of US companies regarding the information systems used for the management of its banking business, including the management of various kinds of accounts for customers, granting credit, various investment related services and more. Most of these information systems are situated at the premises of the said companies, and managed pursuant to the SAS-70 reporting directive. At the beginning of 2008, Bank Leumi USA decided to replace its infrastructure and accompanying systems.

In 2007, the Group invested some NIS 591 million in equipment, as compared with NIS 562 million in 2006. The budget was adapted to support the strategic goals as defined by the Bank's Management and also for the operating requirements for the banking of the future. The projects that were carried out in 2007 were designed for the benefit of the customers, to increase their satisfaction, reinforce their loyalty and to prevent their leaving. The major investment in 2007 (as in 2006) was focused on the following spheres: distribution network (with the aim of increasing the shift to direct channels), Leumi Call, the renewal of infrastructure systems dealing with collateral and the customer database, improving the "customer experience" and compliance with regulatory directives. Furthermore, the development of three projects continued: upgrading and improving the internet system (Kochav project), the upgrading and improvement of the content management system and a dealing room project for the replacement of the core of the foreign currency transaction systems, large parts of which are already in operation (the project is being developed in stages.)

Against the background of various requirements of the authorities (Bank of Israel, Ministry of Finance etc.) for execution of various directives, the Bank incurred computer–related expenses estimated at some NIS 108.7 million in 2007 (some NIS 104.3 million in 2006). The principal subjects were tax reform, payments and clearing systems (RTGS) and the information technology directives. In 2007, the preparation for implementation of the Bank of Israel's directives on Basel II continued, the upgrading of the support systems for the provision of credit and for the ongoing management of the credit portfolio, the preparation for CLS (see above at pages 40-41 of the Report), upgrading of compliance, and the upgrading of the operating systems for provident funds in accordance with the statutory provisions. Additionally, a pension counseling system in regard to supplementary training funds was put into operation in 2007, along with the preparation for all the legislation in the field pensions and finance.

The increase in investments in buildings and equipment is intended to adapt the logistical infrastructure and deployment of the Bank's branches to the expansion that has occurred in business activity, and to the operational needs of modern banking.

Matam has been certified as being in compliance with the ISO 9001 quality control standard for software. According to data of the Standards Institute of Israel, Matam was the first information systems entity in the Israeli banking system to be certified, and one of the largest software entities in Israel operating under the standard, a fact that contributes to the development of high quality systems and products for customers. The certification of Matam includes development, the running of the operations centers, the communications infrastructure, production management and service and the real property and procurement section.

The real property and procurement section has been certified as being in compliance with the ISO 9001 quality control standard. In 2007, it was also certified as being in compliance with the ISO 18001 work safety standard and with the ISO 14001 environmental management standard. The three standard certifications together provide the real property and procurement section with a "golden label."

The Bank and its subsidiaries implement Standard No. 15 of the Accounting Standards Board, which prescribes the treatment of a decline in the value of assets. The implementation of the Standard has had no material impact on the Financial Statements.

Since 1 January 2007, the Bank has implemented Accounting Standard No. 16 – "Real Estate for Investment" and Accounting Standard No. 27 – "Fixed Property." Implementation of these Standards has had no impact on the Financial Statements.

See Note 7 to the Financial Statements for further details.

Intangible Assets

1. The Bank is the sole proprietor of the "Leumi" mark, and accompanying design logo, in the banking and finance services field in Israel.

   In addition, the Group makes use of the names of its companies and their logos for the purposes of its activities, and the names of services and products, some of which are registered as trademarks and service marks.

2. The Group has registered data bases in which information is stored, *inter alia*, regarding customers, suppliers and employees of Leumi. Advanced technological means designed to secure customer

transactions and business transactions of the Bank are used, while reducing the risks arising from the use of the information systems.

3. The Group holds various intellectual property rights and user rights in various computer programs and information systems for the purposes of managing its business, including for the provision of services to customers.

Since 1 January 2007, the Bank has been implementing Accounting Standard No. 30 – "Intangible Assets." Implementation of this Standard has had no impact on the Financial Statements.

Operational Segments in the Group

This chapter describes the business development according to operational segments.

See above pages 15-16 for a description of the methodology of the operational segments.

Following are principal data according to operational segments of the principal balance-sheet items as at December 31:

	Credit to the Public			Deposits of the Public			Total Assets		
	2007	2006	Change	**2007**	2006	Change	**2007**	2006	Change
Segments	NIS millions		%	NIS millions		%	NIS millions		%
Households	**57,270**	51,708	10.8	**115,549**	115,437	0.1	**57,934**	52,148	11.1
Small businesses	**17,502**	13,936	25.6	**13,901**	11,795	17.9	**18,363**	14,545	26.2
Corporate banking	**51,636**	51,478	0.3	**25,553**	27,860	(8.3)	**55,649**	54,663	1.8
Commercial banking	**42,290**	38,367	10.2	**30,742**	27,370	12.3	**46,214**	43,001	7.5
Construction and real estate	**23,470**	22,501	4.3	**3,189**	3,136	1.7	**23,725**	22,705	4.5
Private banking	**5,155**	4,417	16.7	**37,169**	36,664	1.4	**8,807**	7,867	11.9
Financial management – capital markets and others	**1,234**	1,393	(11.4)	**11,942**	9,561	24.9	**91,459**	94,412	(3.1)
Total	**198,557**	183,800	8.0	**238,045**	231,823	2.7	**302,151**	289,341	4.4

Following are principal data according to operational segments of the off-balance-sheet items and data regarding customers' balances in the capital market:

	Guarantees and Documentary Credit			Securities Portfolio, including Mutual Funds		
	2007	2006	Change	**2007**	2006	Change
Segments	NIS millions		%	NIS millions		%
Households	**1,412**	594	137.7	**79,349**	69,625	14.0
Small businesses	**1,138**	977	16.5	**6,582**	4,388	50.0
Corporate banking	**10,497**	9,793	7.2	**70,163**	60,250	16.5
Commercial banking	**5,274**	5,521	(4.5)	**82,914**	69,258	19.7
Construction and real estate	**11,044**	8,933	23.6	**14,897**	13,531	10.1
Private banking	**932**	750	24.3	**71,616**	65,127	10.0
Financial management – capital markets and others	**540**	560	(3.2)	**79,165**	71,551	10.6
Total	**30,837**	27,128	13.7	**404,686**	353,730	14.4

Following are details of the net profit and the net operating profit according to operational segments:

	Net profit, after neutralizing special salary expenses			Net operating profit, after neutralizing special salary expenses*		
	2007	2006	Change	**2007**	2006	Change
Segment	NIS millions		%	NIS millions		%
Households**	**938**	1,505	(37.7)	**660**	378	74.5
Small businesses	**201**	217	(7.2)	**172**	163	5.8
Corporate banking	**816**	624	30.9	**799**	592	35.1
Commercial banking	**543**	493	10.0	**527**	419	25.6
Construction and real estate	**379**	226	67.9	**378**	225	68.2
Private banking	**148**	180	(17.8)	**142**	104	36.5
Financial management capital markets and others**	**486**	911	(46.7)	**460**	195	135.9
Total	**3,511**	4,156	(15.5)	**3,138**	2,076	51.1

* After neutralizing special salary expenses, as detailed above on page 58.

** The profit from extraordinary items during the years 2006-2007, which derives from the sale of the activities of Psagot-Ofek, Leumi-Pia and the provident funds, has been attributed to each operational segment according to the segment's share of the income from mutual funds and/or provident funds. In 2006, some 54.2 % of the profit, NIS 1,127 million, was attributed to the household segment, while in 2007, about 79%, some NIS 278 million. In 2006, the profit from extraordinary items from the sale of Africa-Israel and Migdal Holdings in the sum of NIS 718 million was attributed to the financial management – capital markets segment.

See Note 28 to the Financial Statements for additional details.

Return on Equity According to Operational Segments

In accordance with the directives of the Bank of Israel, it was determined that the return on the equity allocated to each operational segment must be calculated.

Tier 1 capital has been allocated among the segments according to each segment's relative share of the Group's total risk assets.

The operational segments have been credited with income in respect of the capital allocated to the segment according to its share of the risk assets, and at a price that reflects a risk-free return.

The calculations of the return on equity include the ratio between the net profit of each of the segments and the shareholders' equity allocated to the segment. The shareholders’ equity allocated to the segment includes the segment’s relative share of the Tier 1 capital according to the segment’s share of the risk assets.

The following table presents the return of the net profit on equity according to operational segments, calculated as stated above:

	Return on equity as a % of the net profit				Return on equity as a % of the net operating profit			
	2007	2006	**2007***	2006*	**2007**	2006	**2007***	2006*
Segment								
Households	**22.0**	36.2	**24.3**	43.7	**14.8**	3.6	**17.1**	11.0
Small businesses	**16.6**	19.5	**18.6**	26.1	**13.9**	13.0	**15.9**	19.6
Corporate banking	**16.1**	12.3	**16.3**	12.9	**15.8**	11.6	**16.0**	12.2
Commercial banking	**15.6**	15.8	**16.1**	17.6	**15.1**	13.1	**15.7**	15.0
Construction and real estate	**16.1**	9.0	**16.2**	9.3	**16.1**	8.9	**16.2**	9.2
Private banking	**32.0**	41.0	**33.5**	46.2	**30.6**	21.5	**32.2**	26.7
Financial management – capital markets	**10.2**	31.6	**10.4**	40.2	**10.2**	1.0	**10.4**	9.6
Others	**43.2**	(7.7)	**43.0**	(7.4)	**37.5**	(7.3)	**37.2**	(6.9)

* After neutralizing special salary expenses

The principal characteristics of the operational segments and their business activities as detailed above are as follows:

(For the criteria for categorizing customers according to operational segments, see page 16.)
For further details regarding activities of the principal subsidiaries and affiliates, see page 145 below.
A breakdown of the results of the operational segments is presented in Note 28 to the Financial Statements.

1. The Household Segment

General

The Bank provides a range of financial services and products to private customers in the household segment, according to their varying needs, while segmenting customers according to demographics, place of residence, occupation, financial characteristics and stages of life, from which the customers' financial needs are deduced.

Objectives and Strategy

The following information is "forward-looking information." For the meaning of this term, see page 43

The strategic objectives for banking in the household segment are to increase profitability by broadening the customer base and expanding the activities of existing customers, while placing emphasis on the provision of efficient service that is adapted to their needs.

The business line emphases in the household segment are:

- Systematic and constant focus on improving the **level of service** to the customer by upgrading the employees' skills, and measuring and controlling the work procedures and customer interface.
- **Increasing the availability of service to customers** by increasing the number of branches and adapting them to future banking needs, while integrating advanced automatic instruments, and adapting them to various customer needs.
- **Expanding the direct marketing channels**: advanced telephone and internet services and instruments for self-service performance of financial operations.

- **Developing financial products and services:** the provision of professional and objective counseling services in all investment fields and the expansion thereof, after receiving the necessary approvals (also in the pension field), adapted to the needs of customers, while using data mining (CRM, DWH) and analytical models to analyze and forecast the customer's financial activities and needs.
- Systematic, information-based **initiative** *vis-à-vis* customers in every operational segment: investments, consumer and commercial credit and current account services; improving the level of service in order to increase customer satisfaction and loyalty by means of creating advantages for groups of customers by providing differential service.
- **Cooperation with companies in the Group** such as Leumi Mortgage Bank and Leumi Card, in order to exploit the Group's ability to provide all-inclusive banking solutions to the customer.

Pension Counseling

Following legislation passed in August 2005 implementing the reform in the capital market, the Bank has been making preparations for the receipt of a license to engage in pension counseling from the Supervisor of the Capital Market, Insurance and Savings.

The Bank intends to commence pension counseling activities in 2008, subject to the receipt of the said license.

The Bank is in the midst of preparations to enter the pension counseling field. These preparations include developing computerized tools, as well as training and recruiting employees. The Bank has filed an application with the Supervisor of the Capital Market, Insurance and Savings for a pension counseling license, and the receipt thereof is expected upon completing the preparations with regard to the employee funds, following a format agreed to between the chairman of the Knesset Finance Committee and the Supervisor of the Capital Market, Insurance and Savings, which enables the major banks (Leumi and Hapoalim) to engage in pension counseling, as described above on pages 32-33.

Structure of the Segment

Household banking categorizes customers into segments according to their characteristics, needs, preferences and contribution to profitability, and develops services, products and distribution channels for them according to this segmentation. Service is provided through various distribution channels: 205 branches (including the branches of the Arab Israel Bank Ltd.), spread throughout the country and organized into eight districts on a geographical basis, and by means of technological/direct distribution channels, such as the Leumi Call center, the internet, Leumi information terminals and more.

In-branch service to customers is provided by banking teams divided into customer segments. These teams centralize all aspects of service to the customer, and specialize in providing banking service according to the customer's characteristics and needs.

Service to these customers is multi-channel and is provided both by means of the wide distribution of branches, the Leumi Call center and advanced internet solutions adapted to meet customers' needs.

Legislative Restrictions, Regulations and Special Constraints that Apply to Banking in the Household Segment

The Bank, and the household segment in particular, operate within the context of laws, regulations and directives of authorities imposed on the banks by the Banking Supervision Department, the Israel Securities Authority, the Supervisor of the Capital Market, Insurance and Savings and by the Antitrust General Director:

- The reform in the capital market required the household banking segment to make preparations for the provision of integrated counseling – both with regard to the capital market and in the field of pensions and insurance, while developing analytical systems and advanced models for adapting financial products to specific customers.

These changes require the bank to undertake massive recruitment and training of counselors for the pension field and to invest in the development of supporting information systems and new working procedures at the branches and headquarters.

- The Bank has been implementing the principles of the package deal for households since December 2005. For details regarding the amendment to the Banking (Service to Customers) Law on the subject of commissions, see pages 36-37 above.

For further details see pages 31-41.

Changes in Markets of the Household Segment or in Customer Characteristics

There were no material changes in the household segment in Israel during the past year. At the same time, the household segment is affected from time to time by changes in the demographic and economic data for the population of the State, by changes in personal consumption and by customers' saving characteristics.

Technological Changes that Have an Impact on Banking in the Household Segment

The majority of the technological changes that affect household banking are in the area of distribution channels. The trend that began in recent years of a transition to automatic direct channels is expected to continue in 2008, with an emphasis on telephone, cellular telephone and the internet, and adaptation of the services to the different customer characteristics. The segment is focused on improving and expanding the telephone service provided by the Leumi Call center, to which hundreds of thousands of customers, who perform most of their day-to-day activities in their accounts via the center, are connected.

An increase is also expected in internet activity, through which thousands of transactions are executed every day, due to technological improvements, while adapting Leumi's websites to the different customer segments. Developments in the field of computers enable the collection of information on customer activity. Advanced tools enable data mining and data analysis for the development of products and services, and for the adaptation of service to customers.

Critical Success Factors in the Household Banking Segment

Critical success factors for banking in the segment are:

- The distribution and availability of points of sale and service: expanding the distribution of the branches and adapting the opening hours to the region and type of population.
- Broadening the exposure and availability to customers of direct technological channels (internet and telephone) and broadening the geographical distribution (ATM machines).
- Quality: abiding by the rules of consistent and methodical documentation, in light of the increasingly stringent rules of compliance with consumer laws and regulations in recent years.
- Efficiency: a constant examination of retail operating costs against the benefits derived from them, and reducing cross subsidization between the various activities and populations.
- Maintaining pro-active service according to the needs and wishes of the customer.
- Preparations for the provision of pension and investment counseling services by making available appropriate manpower and technological support.

Entry and Exit Barriers in Banking in the Household Segment

- The technological and physical infrastructure (branch distribution) and the quality of the manpower are relative advantages of banking in the household segment, and constitute entry barriers for competitors. The importance of the technological infrastructure increases as the regulatory requirements increase.

- The investment required in physical and technological infrastructure constitutes a barrier to both entry and exit.
- The training of skilled human resources in the light of increasingly strict and frequently changing regulations.
- The development of analytical capabilities to effectively adapt solutions for customers based on historical data on customer activity and market behavior.

Alternatives to Banking Products and Services in the Household Segment

Following the reform in the capital market, the banks constitute the main entity providing objective counseling to customers – both in the capital market and in the pension field.
Current accounts can only be managed at banks. Other products and services can be purchased outside of the banks as well. The following are the main alternatives:

Consumer credit	- Credit card companies, retail food chains, insurance companies
Capital market	- Brokers, insurance companies, fund managers
Pensions	- Brokers, insurance companies, fund managers
Mortgages	- Contractors, construction companies, insurance companies

Structure of the Competition

The competition in this segment permeates the entire banking system. In the household segment, the competition is over the fundamental principles of success: the availability and correct usage of distribution channels, segmentation and understanding customer needs, and efficiency.

Some of the banks are taking aggressive marketing action, while making use of price strategy. Other banks have merged with their mortgage activities and are leveraging synergetic activities in order to expand potential customer bases for mortgages and opening of current accounts as well.
In addition, competition in retail banking has been developing in recent years from financial and other bodies, primarily from credit card companies – while in the fields of consumer credit, competition is developing from mortgage banks, insurance companies and retail marketing chains.
The competition is from bodies not subject to audit by the Bank of Israel or that are not audited at all, and which do not operate under the restrictions that apply to the banks. The directives issued by the Supervisor of Banks, which make it easier for customers to move from bank to bank, are expected to increase the competition between the banks in this segment.

Products and Services of the Segment

As part of its overall service concept, Leumi has invested considerable resources in development, and has reached a high degree of availability through multiple channels: telephone, internet and branches, in order to provide customers with an interface with the Bank for executing transactions and receiving information any time and anywhere.
In the credit field, Leumi leads with a product that enables customers to enjoy pre-approved loans via all the self-service channels, according to their characteristics and needs. Customers are offered various credit products, which are appropriate for their needs and the various stages of their lives.
In the investments field, Leumi offers a variety of both single deposit and installment-based deposits, and savings schemes, with various linkage bases, for periods that suit the customer, as well as a variety of investment products, including structured deposits in Israeli and foreign currency, savings schemes, provident funds and mutual funds.

Customers

Leumi is able to offer its services, which have been tailored to suit the various sectors, to the following population groups: households with medium to low levels of wealth, customers with growth potential: young people, soldiers, students and new immigrants, pensioners and wealthy private customers whose main activities relate to investments.

For further details, see page 16.

Marketing and Distribution

The following information is "forward-looking information." For the meaning of this term, see page 43.

Household banking is based on a countrywide distribution network, professional and skilled manpower and technological systems that enable the provision of efficient service to customers, as well as measurement and control tools to the Management. Leumi sees strategic importance in a broad distribution network. Three new branches were opened during 2007, and new branches are planned to be opened during the course of 2008 to service customers in this segment.
In addition, emphasis is placed on offering service via a multitude of channels, in an attempt to maintain a uniform customer experience and level of service. The principal distribution channel for the segment is the branch channel, while the direct channels (internet, Leumi Call and ATMs) are experiencing a continuing growth trend, both for carrying out transactions and for informational purposes. Use is also made of targeted direct mailing, advertising on websites in general and on the Bank’s website in particular, as well as other media, including newspapers and television.
Marketing activity is based on advanced analytical information systems, enabling customers' needs and behavior to be characterized, with a view to offering customers products and services that are tailored to their needs.

Competition

The changes occurring in the structure of the banking groups and their ownerships will affect the retail markets and competition in general. These changes affect the distribution of the branches, strategic cooperation between banking groups and external bodies, and changes in their ability to invest in infrastructure.
The Bank faces competition by exploiting its advantages of expansive distribution, professional and skilled manpower in the various banking fields and its data processing ability, which enable Leumi to initiate and to offer customers quality products and services.

Human Capital

In 2007, the average number of positions assigned to the household segment totaled 6,678, of which 1,511 were management staff, compared with 6,429 positions in 2006, of which 1,392 were management staff.
Tenured employees, who have been trained for various positions according to banking needs, are employed in the branches. In addition, external staff is employed in basic positions, also after having received appropriate training.

Credit Cards

See pages 137-138 below.

Mortgages - housing loans – are centralized in Leumi Mortgage Bank Ltd. ("Leumi Mortgage Bank"), through its representative offices throughout the country, operating in Leumi branches (80 counters) and in 9 separate branches.

During 2007, Leumi Mortgage Bank launched a number of campaigns, the aim being to promote new products and services. During the fourth quarter of 2007, "the new speak" was launched, with campaigns being modified according to this new motto – "it's simple to take out a mortgage."

The launching of new products in 2007, such as "Safe Mortgage," "the Tender on Interest," and others, led to a significant increase in the volume of people showing an interest in obtaining a mortgage at the Bank.

The launching of new services, such as "Running for You," "Time Out from the Mortgage," expressed the Bank's new service concept – turning the ordeal of taking out a mortgage into a simple process.
The volume of refinancing at Leumi Mortgage Bank rose in 2007 and reached NIS 1,361 million, compared with NIS 780 million in 2006, which constituted some 15.7% of Leumi Mortgage Bank's performance.
The policy of the management of Leumi Mortgage Bank is to continue focusing activity in the loans for residential apartment purchases segment and in the residential apartment collateral loan segment.
During 2007, Leumi Mortgage Bank granted new loans (excluding refinancing) in the amount of some NIS 7.3 billion, compared with NIS 5.3 billion in 2006, a growth rate of some 38.9%.
In addition, included in these amounts is the amount of NIS 349 million in credit, which was granted from designated deposits, the payment of which is conditional upon the degree of collection, compared with NIS 367 million in 2006.
Leumi Mortgage Bank's inclusive share of the credit portfolio in the system as at 31 December 2007, according to the Bank of Israel's activity report, was 25.9%, similar to its share in 2006.

The net profit in the mortgage sector totalled NIS 248 million in 2007, compared with NIS 71 million in 2006, an increase of NIS 177 million.

The net interest income and operating income increased by NIS 85 million, from NIS 539 million in 2006, to NIS 624 million in 2007.

The provision for doubtful debts decreased from NIS 190 million in 2006 to NIS 39 million in 2007. Since 1 January 2006, Leumi Mortgage Bank has been implementing the Bank of Israel circular regarding all matters pertaining to the method of calculating the provision for doubtful debts in respect of housing credit.

For additional details, see page 148 below in the Report.

The effect of the implementation of the circular on the provision for doubtful debs at Leumi Mortgage Bank was a non-recurring addition in the amount of NIS 64 million, in respect of adjustment of the opening balance for the year 2006.

Operating expenses increased, from a total of NIS 208 million in 2006 to NIS 239 million in 2007, primarily as a result of increased salary expenses and marketing expenses. Tax provision expenses increased and totaled NIS 98 million, compared with NIS 70 million in 2006.

For additional details on Leumi Mortgage Bank, see page 147 of the Report.

Following is the volume of mortgages executed in the household segment:

	2007	2006	
	Annual Total	Annual Total	Change
	NIS millions		%
From Bank funds	**6,946**	4,811	44.4
From Ministry of Finance funds:			
Directed loans	**349**	367	(4.9)
Non-recourse loans	**8**	7	14.3
Total new loans	**7,303**	5,185	40.8
Refinanced loans	**1,361**	780	74.5
Total performance	**8,664**	5,965	45.2

Following are condensed operating results of the household segment:

	Banking and finance	Credit cards	Capital market	Mortgages	Total
	2007				
	NIS millions				
Profit (loss) from net interest income:					
From external sources	**(2,376)**	**103**	**3**	**1,642**	**(628)**
Intersegmental	**4,387**	**(28)**	**(3)**	**(1,156)**	**3,200**
Operating and other income:					
From external sources	**667**	**381**	**505**	**126**	**1,679**
Intersegmental	**1**	**213**	**-**	**12**	**226**
Total income	**2,679**	**669**	**505**	**624**	**4,477**
Provisions for doubtful debts	**125**	**13**	**-**	**39**	**177**
Operating and other expenses:					
To external sources	**2,360**	**461**	**392**	**225**	**3,438**
Intersegmental	**1**	**3**	**-**	**14**	**18**
Operating profit before taxes	**193**	**192**	**113**	**346**	**844**
Provision for taxes	**76**	**56**	**43**	**98**	**273**
Operating profit after taxes	**117**	**136**	**70**	**248**	**571**
Profit from extraordinary items after taxes	**-**	**-**	**278**	**-**	**278**
Net profit	**117**	**136**	**348**	**248**	**849**
% Return on equity					**22.0%**
Average balance of assets	**14,174**	**5,461**	**70**	**34,915**	**54,620**
Average balance of liabilities	**108,663**	**257**	**-**	**12,696**	**121,616**
Average balance of risk assets	**12,302**	**5,373**	**69**	**29,028**	**46,772**
Average balance of mutual fund assets	**-**	**-**	**34,497**	**-**	**34,497**
Average balance of securities	**-**	**-**	**42,895**	**-**	**42,895**
Average balance of other assets under management	**279**	**-**	**-**	**8,102**	**8,381**
Margin from credit-granting activities*	**583**	**84**	**-**	**274**	**941**
Margin from taking of deposits *	**1,280**	**-**	**-**	**80**	**1,360**
Other	**148**	**(9)**	**-**	**132**	**271**
Total profit from net interest income	**2,011**	**75**	**-**	**486**	**2,572**
Balance of credit to the public	**15,047**	**5,558**	**75**	**36,590**	**57,270**
Balance of deposits of the public	**107,962**	**11**	**-**	**7,576**	**115,549**

* The margin is, in effect, the interest gap between the interest received from granting credit and the interest paid on raising deposit, and the transfer prices set by the Finance Division.
This comment relates to all of the operational segments.

Main Changes in the Volume of Activity

Total credit to the public in the segment increased by 10.8%, with the growth in banking credit and financing increasing by some NIS 2.1 billion, 15.8%, and some NIS 3.2 billion in mortgages, 9.6%.
Total deposits of the public increased by 0.1%, primarily in banking and finance, which rose by NIS 0.6 billion.
With regard to the segment's securities portfolios, there was an increase of some NIS 9.7 billion (14.0%).

Household Segment (continued)

	Banking and finance	Credit cards	Capital market	Mortgages	Total
	2006				
	NIS millions				
Profit (loss) from net interest income:					
From external sources	(2,454)	75	6	1,096	(1,277)
Intersegmental	4,314	(15)	(5)	(693)	3,601
Operating and other income:					
From external sources	607	410	325	128	1,470
Intersegmental	2	183	187	8	380
Total income	2,469	653	513	539	4,174
Provisions for doubtful debts	134	5	-	190	329
Operating and other expenses:					
To external sources	2,502	495	371	198	3,566
Intersegmental	1	3	-	10	14
Operating profit (loss) before taxes	(168)	150	142	141	265
Provision for taxes (benefit)	(36)	50	58	70	142
Operating profit (loss) after taxes	(132)	100	84	71	123
Profit from extraordinary items after taxes	-	-	1,127	-	1,127
Net profit (loss)	(132)	100	1,211	71	1,250
% Return on equity					36.2%
Average balance of assets	12,027	5,198	104	33,362	50,691
Average balance of liabilities	107,634	42	-	12,998	120,674
Average balance of risk assets	10,331	5,205	106	27,395	43,037
Average balance of provident fund, mutual fund and supplementary training fund assets	-	-	60,471	-	60,471
Average balance of securities	-	-	35,918	-	35,918
Average balance of other assets under management	309	-	-	8,443	8,752
Margin from credit-granting activities	480	74	-	223	777
Margin from taking of deposits	1,275	-	-	77	1,352
Other	105	(14)	1	103	195
Total profit from net interest income	1,860	60	1	403	2,324
Balance of credit to the public	12,994	5,245	96	33,373	51,708
Balance of deposits of the public	107,324	6	-	8,107	115,437

Main Changes in the Net Profit

Net profit from the household sector totaled NIS 849 million in 2007, compared with NIS 1,250 million in the corresponding period in 2006, a decrease of 32.1%. The decrease in net profit derives from the sector’s share of profits from extraordinary items from the sale of the capital market activities, including Psagot-Ofek, Pia and some of the provident funds, in the amount of some NIS 1,127 million in 2006, compared with profit from extraordinary items totaling NIS 278 million in 2007. Operating profit after taxes amounted to NIS 571 million, compared with NIS 123 million, and after neutralizing special salary expenses, an increase in the amount of NIS 342 million. The increase in operating profit after taxes derives from an increase in net interest income of NIS 248 million, from a decrease in provisions for doubtful debts, mainly in the mortgage sector, by some NIS 152 million, and from an increase in operating and other income of NIS 55 million, mainly in net interest income, which was partially offset by a rise in operating expenses.

2. The Small Business Segment

General

Banking in the small business segment provides a variety of financial services and products to small and medium-sized business customers according to their varying needs, while segmenting customers according to their business activity turnovers, the extent of their credit needs and the sector in which their businesses operate.
This segment also includes the activities of Bank Leumi Romania, which operates through 35 branches and offices.
The Bank also handles the personal accounts of the proprietors of the businesses in the segment, so that they receive all their services in one place.

Objectives and Strategy

The following information is "forward-looking" information. For the meaning of this term, see pages 43.

The strategic objectives of banking in the small business segment are to increase profitability by broadening the customer base and expanding the activities of the existing customers, while placing emphasis on the provision of efficient service that is adapted to their needs.

The business line emphases in the small business sector are:

- Systematic and constant focus on improving the level of service to the customer by upgrading the employees' skills, and measuring and controlling the work procedures and customer interface.
- **Expanding the direct marketing channels**: advanced telephone and fax response and internet services.
- Developing financial products and services that are adapted to the needs of customers, while using data and analytical models to analyze and forecast the customer’s financial activities and needs.
- Systematic, information-based **initiative** *vis-à-vis* customers in every operational segment: commercial credit, consumer credit, investments and current account services; improving the level of service in order to increase customer satisfaction and loyalty, by creating advantages for groups of customers by providing differential service.
- **Cooperation with companies in the Group,** such as Leumi Mortgage Bank and Leumi Card, in order to exploit the Group’s capability to provide all-inclusive banking solutions to the customer.

Structure of the Segment

The small business segment provides a variety of services to small to medium-sized business customers. These customers receive services from business teams in the branches, who specialize in the needs of the segment, and from an internet channel designated for the segment’s customers.

The segment specializes in the provision of banking solutions, including counseling with regard to commercial credit, investment counseling and routine business activities, while determining subsegments according to the level of activity and risk.
The main products that the segment provides are credit and investment products, unique financial products and credit cards.

Legislative Restrictions, Regulations and Special Constraints that Apply to the Segment

The small business segment in particular operates within the context of laws, regulations and directives issued by the authorities, which are imposed on the banks by the Banking Supervision Department, the Israel Securities Authority, the Supervisor of the Capital Market, Insurance and Savings and by the Antitrust General Director.

For details regarding the amendment to the Banking (Service to Customers) Law on the subject of commissions, see pages 36-37 above.

Developments in the Markets of the Segment, or Changes in its Customers' Characteristics

There were no significant changes in the small business segment during the past year.

Critical Success Factors in Banking in the Small Business Segment:

Critical success factors in the segment are:
- The distribution and availability of points of sale and service: expanding the distribution of the branches and adapting the opening hours to the region and type of businesses.
- Staff possessing high levels of management and interpersonal capabilities (both *vis-à-vis* customers and within the organization).
- Familiarity with the customers, including their financial position, and the prospects/risks inherent in working with them.
- Ongoing monitoring of the changes occurring in the market in order to identify potential and to avoid risk; credit risk management and control.
- Quality: abiding by the rules of consistent and methodical documentation, in light of the increasingly stringent rules of compliance with consumer laws and regulations in recent years.
- Increasing the exposure and availability to customers of direct channels (internet and fax).
- Focusing on the provision of pro-active service and initiatives according to the needs and wishes of the customer.

Main Entry and Exit Barriers in the Small Business Segment

- The technological and physical infrastructure (branch distribution) and the quality of the manpower are relative advantages of the small business segment, and constitute entry barriers for competitors. The importance of the infrastructure increases as the regulatory requirements increase.
- The investments required in physical and technological infrastructure constitute a barrier to both entry and exit.
- The training of high-quality human resources with a high level of skill and familiarity with the customers' fields of activity.
- The development of analytical capabilities to effectively adapt solutions for customers based on historical data on customer activity and market behavior.

Alternatives to the Products and Services

In recent years, the competition in the small business segment has become increasingly intense. The direct competitors are all commercial banks in Israel and, recently, the insurance companies as well.

Business credit	- Insurance companies, credit card companies, suppliers
The capital market	- Brokers, insurance companies, fund managers
Pensions	- Brokers, insurance companies, fund managers

Structure of the Competition

The main competition is between the major banks. In recent years, the smaller banks have been expanding their activities in this segment by means of aggressive marketing activities and the use of price strategy.

In addition, competition has been developing recently from financial and other bodies, primarily from credit card companies, by means of supplier cards and from insurance companies, which have shown an interest in financing small businesses.

Directives issued by the Supervisor of Banks, which make it easier for customers to move from bank to bank, are expected to increase the competition between the banks in this segment.

The Segment's Products and Services

The services provided include, *inter alia*, current financing according to the customers' needs, financing investments to maintain and expand activity, providing solutions in the field of financing and international trade. In addition, the service includes banking services for companies' employees and management.

In the investments field, Leumi offers a variety of both single deposit and installment-based deposits, and savings schemes, with various bases of linkage, for periods that suit the customer, as well as a variety of investment products, including structured deposits in Israeli and foreign currency, savings schemes, provident funds and mutual funds.

In addition, Leumi has invested considerable resources in development and has reached a high level of multi-channel availability (telephone, fax and the internet), in order to provide customers with an efficient interface with the Bank for executing transactions and receiving information any time and anywhere.

Customers

The customers attributed to this segment are characterized by varied business activities (small to medium sized) and a great number and variety of sectors and fields.

For additional details, see page 16 above.

Marketing and Distribution

The small business segment is based on a nationwide distribution network, professional and skilled manpower, technological systems that enable the provision of efficient service to customers, as well as measurement and control tools for Management. Leumi sees strategic importance in a broad distribution network; consequently, business segments exist in most of the branches in the Banking Division that deal with customers, while placing an emphasis on increasing the level of familiarity with the customers and their needs and on finding appropriate solutions for them. Marketing activity is based on advanced information systems that enable activities to be initiated *vis-à-vis* existing customers and potential customers. The preparations undertaken at the regional management level enables the focus to be placed on developing business with customers.

Competition

The competition that the Bank has been facing in the small to medium-sized business segment has been increasing in recent years. The competitors that the Bank faces include all commercial banks in Israel, and recently credit card companies and insurance companies have joined the competition.

The Bank faces competition by exploiting its advantages, namely expansive distribution, professional and skilled manpower in the various banking fields and its data processing ability, which enable Leumi to initiate and to offer customers quality products and services.

Human Capital

In 2007, the average number of positions assigned to the small business segment totaled 1,680, of which, 418 were management staff, compared with 1,562 positions in 2006, of which, 380 were management staff.
The employees working in this segment are mainly employees with academic educations. In addition to their educational qualifications, the employees undergo professional training on an ongoing basis in various fields of banking, as part of their training within the Bank.

Following are condensed operating results of the small business segment:

	Banking and finance in Israel	Credit cards	Capital market	Mortgages	Overseas companies	Total
	2007					
	NIS millions					
Profit from net interest income:						
From external sources	**920**	**12**	**6**	**8**	**70**	**1,016**
Intersegmental	**(134)**	**(4)**	**(4)**	**(6)**	**(22)**	**(170)**
Operating and other income:						
From external sources	**342**	**46**	**21**	**-**	**27**	**436**
Intersegmental	**1**	**(28)**	**-**	**-**	**-**	**(27)**
Total income	**1,129**	**26**	**23**	**2**	**75**	**1,255**
Provisions for doubtful debts	**105**	**-**	**-**	**-**	**12**	**117**
Operating and other expenses:						
To external sources	**738**	**20**	**11**	**-**	**114**	**883**
Intersegmental	**-**	**-**	**-**	**-**	**-**	**-**
Operating profit (loss) before taxes	**286**	**6**	**12**	**2**	**(51)**	**255**
Provision for taxes (benefit)	**110**	**2**	**4**	**1**	**(12)**	**105**
Operating profit (loss) after taxes	**176**	**4**	**8**	**1**	**(39)**	**150**
Profit from extraordinary items after taxes	**-**	**-**	**26**	**-**	**3**	**29**
Net profit (loss)	**176**	**4**	**34**	**1**	**(36)**	**179**
% Return on equity						**16.6%**
Average balance of assets	**14,440**	**369**	**141**	**108**	**1,451**	**16,509**
Average balance of liabilities	**11,958**	**723**	**-**	**-**	**1,071**	**13,752**
Average balance of risk assets	**11,483**	**319**	**131**	**104**	**1,041**	**13,078**
Average balance of mutual fund assets	**-**	**-**	**1,208**	**-**	**-**	**1,208**
Average balance of securities	**-**	**-**	**4,646**	**-**	**94**	**4,740**
Average balance of other assets under management	**475**	**-**	**-**	**-**	**-**	**475**
Margin from credit-granting activities	**536**	**2**	**2**	**2**	**15**	**557**
Margin from taking of deposits	**147**	**-**	**-**	**-**	**21**	**168**
Other	**103**	**6**	**-**	**-**	**12**	**121**
Total profit from net interest income	**786**	**8**	**2**	**2**	**48**	**846**
Balance of credit to the public	**15,723**	**529**	**182**	**126**	**942**	**17,502**
Balance of deposits of the public	**12,753**	**-**	**-**	**-**	**1,148**	**13,901**

Main Changes in the Volume of Activity

The growth in credit reached a rate of some 25.6%. Total deposits by the public increased by 17.9%. The activity of this segment at the Bank increased by some 22.9%, and at Arab Israel Bank there was an increase of some 19.8%.
The securities portfolios recorded growth at the rate of some 50.0% (an increase of NIS 2.2 billion).

Small Business Segment (continued)

	Banking and finance in Israel	Credit cards	Capital market	Mortgages	Overseas activities	Total
	2006					
	NIS millions					
Profit from net interest income:						
From external sources	816	11	7	5	24	863
Intersegmental	(119)	(6)	(6)	(4)	(4)	(139)
Operating and other income:						
From external sources	288	31	14	-	13	346
Intersegmental	1	(25)	10	-	-	(14)
Total income	986	11	25	1	33	1,056
Provisions for doubtful debts	110	-	-	-	3	113
Operating and other expenses:						
To external sources	655	10	13	-	53	731
Intersegmental	-	-	-	-	-	-
Operating profit (loss) before taxes	221	1	12	1	(23)	212
Provision for taxes	99	1	4	-	-	104
Operating profit (loss) after taxes	122	-	8	1	(23)	108
Profit from extraordinary items after taxes	-	-	54	-	-	54
Net profit (loss)	122	-	62	1	(23)	162
% Return on equity						19.5%
Average balance of assets	12,203	135	164	69	391	12,962
Average balance of liabilities	9,676	641	-	-	280	10,597
Average balance of risk assets	9,603	343	153	63	192	10,354
Average balance of provident fund, mutual fund and supplementary training fund assets	-	-	4,343	-	-	4,343
Average balance of securities	-	-	2,661	-	1	2,662
Average balance of other assets under management	418	-	-	-	-	418
Margin from credit-granting activities	464	-	1	1	7	473
Margin from taking of deposits	137	-	-	-	9	146
Other	96	5	-	-	4	105
Total profit from net interest income	697	5	1	1	20	724
Balance of credit to the public	13,057	136	209	91	443	13,936
Balance of deposits of the public	11,060	-	-	-	735	11,795

Main Changes in the Net Profit

Net profit in the small business segment totaled NIS 179 million in 2007, compared with NIS 162 million during the corresponding period in 2006, a rise of 10.5%. The operating profit after taxes totaled NIS 150 million, compared with NIS 108 million during the corresponding period in 2006, a rise of 38.9%.

The rise in profit derives mainly from an increase in net interest income of NIS 122 million, and in operating income in the amount of NIS 77 million, which was partially offset by an increase in operating expenses in the amount of NIS 152 million. The profit from extraordinary operations totaled NIS 29 million from the sale of the activities of the capital market companies, compared with NIS 54 million in 2006.

3. The Corporate Banking Segment

General

Corporate banking specializes in providing banking and financial services to large corporations, including corporations with multi-national activities. The customers belonging to this segment are characterized by their leading position in the market and dominance in their sphere of business. The services provided are based on the provision of an overall solution for all of the customer's needs, with a view to the entire range of their business activity, *inter alia*, international financing and trade, investment and counseling services, capital market activities, financial instruments designed to hedge against market risks, the initiation of banking services for the employees, management and owners of these companies, etc. Services outside of Israel are provided to the business sector primarily by Bank Leumi USA, Bank Leumi (UK) and other overseas offices of the Bank.

The Structure of the Segment

The corporate banking segment is managed in Israel by the Corporate Division, which is comprised of five sectors. Service is provided to customers by customer relations managers, who coordinate the Group's services to the customer and specialize in the sector of the economy in which the customer operates. The customers' accounts are managed at commercial branches of the Bank spread throughout the country, mainly at corporate departments in branches specializing in handling large customers and customers with a wide range of activities, as well as through the Bank's overseas offices. Transactions involving the acquisition of means of control are handled by a designated unit having expertise in handling transactions of this kind, due to the complexity and level of risk involved. In addition, a special unit operates in the area of management of complex transactions involving financing of investments in infrastructure projects (power stations, desalinization plants, toll roads, BOT projects, etc.), which examines the transactions and builds the financing packages, including possible involvement of capital market entities in the financing of such transactions.

With the objective of tightening credit controls, improving the quality of the Banks' credit portfolio and improving service to customers, the Credit Risk Management Unit was established in the Credit Department during 2006. The unit engages in in-depth analyses of the Corporate Division's customers' credit applications, examines and approves them or submits them for deliberation by the appropriate credit committee. The unit is also responsible for validating the risk rating assigned to each customer, for recommending methods for handling problem debts, for developing methodologies and work plans, as well as for developing control processes and assimilating work procedures at the Bank level.

Bank Leumi USA and Bank Leumi (UK) enable Israeli and local companies belonging to the segment to receive banking services as well as credit for financing activities in international trade, real-estate, mergers and acquisitions. The subsidiary in the United States, the headquarters of which are in New York, and the subsidiary in the United Kingdom, the headquarters of which are in London, view the servicing of Israeli companies as a direct extension of their activities in Israel.

Business Objectives and Strategy, and Expectations for Development in the Coming Year

The following information is "forward-looking information." For the meaning of this term, see pages 43.

Corporate banking operates in the large business customer segment. Its strategic objective is to expand its customers' activities with the Group, to increase the variety of products and services offered and to leverage its ongoing connections with the customers in order to develop business with various units in the Leumi Group in Israel and abroad.

The economic recovery in Israel that began in recent years, and the expectation for positive growth in 2008 also, while the Bank of Israel's restrictions and the Bank's own internal restrictions that reduce the Bank's options for granting additional banking credit to groups of large borrowers, will continue to force many companies to seek alternative financing solutions, and to raise money by means of the sale of short-term marketable securities or some other form of financing in the long-term. This trend will make it difficult for the Bank to grow in the credit section of the corporate banking segment.

The process characterizing the corporate banking segment in recent years is the development of business activities outside of Israel. One can expect that this process will continue and expand in the coming years. As a consequence of the Bank's above-mentioned policy, and the trend among customers belonging to the corporate customers segment, an increase is expected in the volume of overseas banking activities by the segment's customers.

Restrictions, Legislation, Regulations and Special Constraints that Apply to the Segment

The Bank, and the corporate banking segment in particular, operate within the context of laws, regulations and regulatory directives imposed on the banking system in Israel by entities such as the Banking Supervision Department, the Supervisor of the Capital Market, Insurance and Savings, the Antitrust General Director, the Israel Securities Authority and additional bodies. The Bank's overseas subsidiaries and representative offices operate under permits from the Banking Supervision Department, and are also subject to local regulations.

The restrictions that are especially relevant for the corporate banking segment are the restrictions prescribed in Proper Banking Management Directive No. 313 on the extent of the indebtedness of large borrowers and of the six largest groups of borrowers in the Group. The Bank operates in conformance with a restriction, whereby the Group's total exposure to a group of borrowers shall not exceed 25% of the Bank's capital, while the total exposure to the six largest groups of borrowers shall not exceed 150% of the Bank's capital. As at 31 December 2007, the indebtedness of the largest group of borrowers reached 19.9% of the Bank's capital. The indebtedness of the largest single borrower reached 10.0% of the Bank's capital, and the indebtedness of the six largest groups of borrowers reached 99.5% of the Bank's capital.

Furthermore, there is a regulatory restriction relating to the credit balance for all transactions for the acquisition of control/means of control, pursuant to the provisions of Proper Banking Management Directive No. 323. Pursuant to this Directive, the total credit for all transactions for the purchase of a means of control in corporations fulfilling the conditions as defined in the Directive, when the ratio between the financing rate and the purchase cost of the corporation being acquired is higher than 50% – shall not exceed 70% of the Bank's capital. The Directive prescribes an additional restriction on the financing of an acquisition of a means of control in a banking corporation. The total credit for each financing transaction for the acquisition of a means of control in a banking corporation, when the financing rate for this acquisition exceeds 30% of the purchase cost – shall not exceed the lower of: 5% of the capital of the bank providing the credit, or 5% of the capital of the bank being acquired. As at 31 December 2007, the liability of all transactions for the acquisition of a means of control totaled NIS 4,571 billion, 15.9% of the Bank's capital. The liability of transactions for the acquisition of a means of control in a banking corporation, which meet the requirements of the Directive, totaled NIS 624 million, 2.2% of the Bank's capital.

As of 2007, corporate banking has been making preparations to analyze and examine the potential implications of the changes deriving from the international financial reporting standards (IFRS), in all planes of reference, such as: mapping of the economic sectors having horizontal characteristics; mapping and examination of key subjects and potential customers which, in light of the sensitivity and the potential impact on the financial statements, an in-depth examination of the implications must be carried out; the establishment of a professional work team and a support unit for the purpose of providing solutions and assistance in this regard; the distribution of procedures and guidelines for modes of operation and dealing with issues; and also many steps are being taken in order to inform business entities in the Bank.

Developments in the Markets of the Segment or Changes in its Customers' Characteristics

The largest customers and the largest groups of borrowers in the economy constitute a significant share of the Bank's corporate customers. Within the context of merger and acquisition activities that have taken place in recent years, the proportion of large borrowers and large groups in the banking activities has grown, and they constitute a significant share of the Bank's corporate customers. The largest groups of borrowers have a significant share of the activities of the business sector of the economy, and therefore it is expected that a significant part of the expected growth will also be reflected in the growth of the banking needs of these groups.

In recent years, the corporate sector has obtained part of the financing that it requires outside of the banking system, primarily from the capital market, from insurance companies and from institutional bodies.

Regarding the developments in each of the sectors that comprise the segment, see pages 72-78 above.

Technological Changes that Could Have a Material Impact on the Segment

The information systems that serve the corporate banking segment are intended to assist in analyzing the customers' needs and in the day-to-day work with them, in the analysis and measurement of credit risks and in the monitoring and control of customers' activities. The various technological systems are updated and upgraded on an ongoing basis for the benefit of the segment.

Critical Success Factors in the Segment

Critical success factors in the segment are: staff possessing high management and interpersonal capabilities (both *vis-à-vis* the customers and within the organization), familiarity with the customers, including their financial position, and the prospects/risks inherent in working with them, ongoing monitoring of the changes occurring in the market in order to identify potential and to avoid risk, credit risk management and control, a high degree of skill in planning complex financing packages, constant investment in technological aids, and diligence in providing a response to customers' needs within appropriate response times.

The Main Entry and Exit Barriers in the Segment

In order to provide service to the customers in the corporate banking sector, high quality human resources are required, possessing a high level of skill in familiarizing themselves with the customers in the segment, the diversity of their activities and in analyzing their needs. Managing customers in the segment requires an in-depth familiarity with the customers, their financial data, their spheres of activity, and adaptation of the Bank's products to these data. Moreover, appropriate preparation is required in order to comply with the regulatory restrictions and to monitor and control various risks and exposures.

Alternatives to the Products and Services of the Segment, and the Changes that have Occurred Therein

Since the sources that are available to the Bank in order to make long-term financing available are restricted, in comparison with the sources available for short to medium-term financing, it is expected that, in the sphere of financing of long-term projects (primarily infrastructure projects and income-generating assets), institutional investors will continue to participate in the financing of such projects, through their participation in financing consortia or by means of the sale of portions of the long-term bank credit.

Structure of the Competition in the Segment and the Changes that have Occurred Therein

Competition in the corporate banking segment has been intensifying in recent years. The direct competitors are the major commercial banks in Israel and the foreign banks abroad. In addition, insurance companies, institutional bodies and the capital market compete in the corporate sector in the credit field.

The Segment's Products and Services

The services provided include, *inter alia*, ongoing financing according to the customers' needs, the financing of investments to maintain and expand the operations, the provision of solutions in the sphere of international trade and financing (including the financing of projects abroad), the financing and guidance of national and international projects, the financing of mergers and acquisitions, financial instruments to hedge against currency risks, interest risks and changes in commodity prices, activities in the capital market, as well as counseling services in the field of investments. The service also includes the initiation and promoting of banking services to the companies' employees and management.

Customers

Customers belonging to this sector are characterized by their leading position in the market and dominance in their sphere of activity, by operating turnovers in the amount of NIS 250 million and more, by high financing needs and an *obligo* of over NIS 80 million.

(For additional details, see page 16).

These companies are, for the most part, public companies, from a variety of different sectors of the economy, with a complex organizational structure comprised of numerous tiers of management and a broad span of control.

Marketing and Distribution

The service and marketing to customers are provided by customer relations managers who specialize in the sector of the economy in which the customer operates, and who coordinate the Group's services to the customer.

Competition

The competition that the Bank has been facing in the corporate banking segment has been intensifying in recent years. The competitors that the Bank is facing include the major commercial banks in Israel, as well as foreign banks abroad. In the field of credit to customers of the segment, the Bank is also facing competition from insurance companies, institutional bodies and the capital market. In light of the stiffening of the credit underwriting criteria in recent years, the corporate sector finds the financing that it needs, mainly long-term credit, at terms more favorable to it outside of the banking system.

Human Capital

In 2007, the average number of positions assigned to the segment totaled 1,059 positions, of which, 447 were management positions, compared with 955 positions in 2006, 404 of which were management staff.
Most of the employees have academic educations. In addition to their educational qualifications, the employees undergo professional training on an ongoing basis, in various fields of banking, as well as management courses, as part of their training within the Bank.

Within the scope of their work, the employees must possess the ability to analyze complex credit applications, to lead complicated transactions, and the ability to provide service at the highest level.

Following are condensed operating results of the corporate banking segment:

				Activities abroad		
	Banking and finance in Israel	Credit cards	Capital market	Capital market	Banking and Finance	Total
	2007					
	NIS millions					
Profit from net interest income:						
From external sources	**1,982**	**27**	**-**	**-**	**403**	**2,412**
Intersegmental	**(948)**	**(11)**	**-**	**-**	**31**	**(928)**
Operating and other income:						
From external sources	**258**	**196**	**25**	**6**	**30**	**515**
Intersegmental	**1**	**(153)**	**-**	**-**	**-**	**(152)**
Total income	**1,293**	**59**	**25**	**6**	**464**	**1,847**
Provisions for doubtful debts	**(30)**	**2**		**-**	**-**	**(28)**
Operating and other expenses:						
To external sources	**316**	**68**	**17**	**1**	**137**	**539**
Intersegmental	**-**	**-**	**-**	**-**	**107**	**107**
Operating profit (loss) before taxes	**1,007**	**(11)**	**8**	**5**	**220**	**1,229**
Provision for taxes (benefit)	**373**	**(3)**	**3**	**1**	**66**	**440**
Operating profit (loss) after taxes	**634**	**(8)**	**5**	**4**	**154**	**789**
Profit from extraordinary items after taxes	**-**	**-**	**17**	**-**	**-**	**17**
Net profit (loss)	**634**	**(8)**	**22**	**4**	**154**	**806**
% Return on equity						**16.1%**
Average balance of assets	**43,569**	**320**	**4**	**-**	**11,997**	**55,890**
Average balance of liabilities	**20,552**	**2,915**	**-**	**-**	**9,290**	**32,757**
Average balance of risk assets	**47,384**	**309**	**5**	**-**	**12,794**	**60,492**
Average balance of mutual fund assets	**-**	**-**	**384**	**91**	**-**	**475**
Average balance of securities	**-**	**-**	**63,236**	**1,375**	**-**	**64,611**
Average balance of other assets under management	**422**	**-**	**-**	**-**	**-**	**422**
Margin from credit-granting activities	**709**	**(11)**	**-**	**-**	**85**	**783**
Margin from taking of deposits	**63**	**-**	**-**	**-**	**44**	**107**
Other	**262**	**27**	**-**	**-**	**305**	**594**
Total profit from net interest income	**1,034**	**16**	**-**	**-**	**434**	**1,484**
Balance of credit to the public	**40,007**	**337**	**-**	**-**	**11,292**	**51,636**
Balance of deposits of the public	**19,386**	**-**	**-**	**-**	**6,167**	**25,553**

Main Changes in the Volumes of Activity

In the corporate banking segment, there was an increase in credit to the public of some NIS 158 million (0.3%). This increase occurred mainly in the subsidiary in the United States. There was a reduction in deposits by the public of some NIS 2.3 billion, 8.3%, which mainly derives from the effect of exchange rate differentials, due to the appreciation of the shekel relative to the dollar, in the activity of the subsidiary in the United States. On the other hand, the increase in activity in Israel partially offset this decrease.

There was an increase in activity in securities of some NIS 9.9 billion (16.5%), which derives primarily from an increase in the market value. There was an increase of 7.2% in the segment in off-balance-sheet activity, guarantees and documentary credit.

Corporate Banking Segment (continued)

	Banking and finance in Israel	Credit cards	Capital market	Overseas activities	Total
	2006				
	NIS millions				
Profit from net interest income:					
From external sources	2,226	24	1	272	2,523
Intersegmental	(1,186)	(10)	(1)	135	(1,062)
Operating and other income:					
From external sources	231	122	21	39	413
Intersegmental	1	(131)	6	-	(124)
Total income	1,272	5	27	446	1,750
Provisions for doubtful debts	176	-	-	6	182
Operating and other expenses:					
To external sources	333	19	15	155	522
Intersegmental	3	-	-	124	127
Operating profit (loss) before taxes	760	(14)	12	161	919
Provision for taxes (benefit)	309	(3)	5	45	356
Operating profit (loss) after taxes	451	(11)	7	116	563
Profit from extraordinary items after taxes	3	-	29	-	32
Net profit (loss)	454	(11)	36	116	595
% Return on equity					12.3%
Average balance of assets	45,755	258	21	11,040	57,074
Average balance of liabilities	19,445	2,916	-	12,388	34,749
Average balance of risk assets	48,636	128	24	11,663	60,451
Average balance of mutual fund and supplementary training fund assets	-	-	3,145	57	3,202
Average balance of securities	-	-	49,979	1,080	51,059
Average balance of other assets under management	627	-	-	-	627
Margin from credit-granting activities	813	(7)	-	88	894
Margin from taking of deposits	58	-	-	81	139
Other	169	21	-	238	428
Total profit from net interest income	1,040	14	-	407	1,461
Balance of credit to the public	40,339	249	8	10,882	51,478
Balance of deposits of the public	17,682	-	-	10,178	27,860

Main Changes in the Net Profit

Net profit in the corporate banking segment totaled NIS 806 million in 2007, compared with NIS 595 million in the corresponding period in 2006, an increase of 35.5%. Operating profit after taxes totaled NIS 789 million, compared with NIS 563 million in the corresponding period in 2006, an increase of 40.1%.

The increase in profits derives mainly from a reduction of NIS 210 million in provisions for doubtful debts, of which a decrease of NIS 204 million was from the segment's activities in Israel. Total income rose by NIS 97 million, 5.5%, and the operating expenses decreased by NIS 3 million. In addition, profits in the amount of NIS 17 million were recorded in respect of the sale of the capital market companies, compared with NIS 32 million in 2006.
The majority of the increase in the net profit was in the activity of the segment in Israel, some 80% which derived from the reduction of the provisions for doubtful debts, while about 20% was contributed by the U.S. subsidiary's activity in the segment.

4. The Commercial Banking Segment

General

Commercial banking engages in the provision of the entire spectrum of financial services to middle-market business companies in all sectors of the economy for whom credit facilities of from NIS 10 million to NIS 80 million or more have been approved (until 31 December 2006 – up to NIS 100 million), subject to the decision of the relevant division heads and the customers' characteristics, as well as to the interested parties of the business companies, including shareholders and senior officeholders, and to subcustody customers.

The segment is managed by the Commercial Banking Division. The principal contact with customers is through designated commercial branches located throughout the country. The Commercial Banking Division has a main branch in Tel Aviv and 24 business branches located in industrial zones and in the major cities, which are geographically attributed to four commercial districts. The branches specialise in the management of business activities characteristic of the Division's customers, giving it a competitive advantage.

Service and marketing to these customers is carried out on an individual basis, and include mainly the financing of transactions with credit instruments tailor-made to the customers' unique requirements, the adaptation of investment products and financial instruments for hedging risks, the financing of international trade transactions and the financing of start-up companies.

The commercial banking segment also includes activities outside of Israel through the Bank's subsidiaries abroad. Companies that are served by the Commercial Banking Division take advantage of their relations with the Bank in Israel for the purpose of their activities abroad. Bank Leumi (UK) enables Israeli companies to receive banking services and enjoy credit lines for financing international trade, real-estate purchases, acquisitions of and mergers with companies across Europe. The subsidiary in London – the European financial center – views the continuing servicing of these companies as a direct continuation of the banking activities in Israel.
An additional service provided by Bank Leumi (UK) is the financing of Israeli companies for importing products from leading European suppliers. The familiarity with Israeli companies on the one hand, together with the strength of the supplier, enable Bank Leumi (UK) to bridge the financing gaps.

In addition, Bank Leumi (UK) specializes in the granting of credit to medium-sized local customers, with a special emphasis on international trade.

For additional details regarding Bank Leumi (UK), see pages 155-156.

The Structure of the Segment

The commercial banking segment has an organizational structure that is unique in the Israeli banking system, which enables it to provide all-inclusive and comprehensive service (a one-stop shop) to its customers, and give the Division a competitive advantage.

The segment operates through 24 business branches spread across the country, and a main branch in Tel Aviv, most of which have also been physically adapted to meet the segment's unique characteristics.

The business branches provide service to business companies and to interested persons. The main branch in Tel Aviv combines the commercial line with additional activity centers at the Bank level.

Bank Leumi (UK) has a main branch in London, a branch in Manchester and a subsidiary company in Isle of Jersey.

For additional details, see pages 15-17.

Strategy

The following information is "forward-looking information". For the meaning of this term, see pages 43.

Commercial banking serves middle-market business customers. These customers have potential for profitability that is relatively higher than those of other segments. The strategic objective of commercial banking is to continue to strengthen its competitive advantage by expanding the activities with existing customers and recruiting new customers, while providing comprehensive solutions for the benefit of its customers operating in Israel and abroad.

Restrictions, Legislation, Regulations and Special Constraints that Apply to the Segment

See details on pages 31-41 of the Report.

Developments in the Markets of the Segment, and in its Customers' Characteristics

The main activities of the segment's customers are in the local market, in the industrial, trade and services and real-estate sectors of the economy. Nonetheless, in recent years, there has been a trend towards increased activity in markets abroad, directly by customers or through subsidiaries of some of the customers in the segment.
The year 2007 was characterized by the expansion of the businesses of a significant portion of the segment's customers in most sectors of the economy.
Existing or planned activities abroad are affected both by the aspiration to develop and expand business activities and by the customers' forecasts regarding the economic and security implications in Israel and abroad.

For details on the sectors of the economy, see pages 72-77 of the Report.

Technological Changes

- The segment's employees are assisted by computerized systems that support various processes being carried out in the segment, such as control, definition of targets and the measurement thereof, marketing and business development.
- The segment makes technological tools available to its customers, similar to those used by all of the Bank's customers. At the same time, the Bank strives to develop these systems in order to respond to the changing and developing needs of the segment's customers.

Critical Success Factors in the Segment

- Identifying the customer's needs and adapting appropriate inclusive solutions, while reducing the response time and raising the level of service.

- Cultivating human capital and constantly raising its professional level at the required pace, in light of the changes in the capital market and in the business environment.
- Maintaining a control system to reduce the credit risks and tighten compliance by the employees of the segment.

The Main Entry and Exit Barriers in the Segment

- The establishment of a network of distribution channels whose spread corresponds to the business potential.
- Training professional manpower with diverse skills.
- Maintaining a range of products tailored to the customers' needs.
- The establishment and development of technological means to service customers and employees.

Competition

The competitive factors in this segment of operations, in both the credit and investments spheres, are all banks operating in Israel (domestic and foreign), banks abroad, entities that operate in the capital market, and insurance companies. The insurance companies are competitors in both the credit and investment services spheres for customers in the segment, while private investment houses are competitors in the investments sphere.

The Bank expects that the competition in this segment will increase, due to the regulatory restrictions on a single borrower and on a group of borrowers, the expanding possibilities for raising capital in Israel and abroad, and the wider-scale relationships of customers with banks abroad. In addition, following the improvement in the state of the economy and of most of the firms that occurred in 2007, and, to the extent that this will continue in 2008, the competition in the segment will become even more intense.

Human Capital

- The average number of positions assigned to the segment in 2007 totaled 1,358, of which 488 were management positions, compared with 1,485 positions in 2006, 529 of which were management staff positions.
- The branches and the headquarters are staffed by employees and managers who have undergone appropriate training, commensurate with the commercial customers' needs, which created specialization in the management of the business operations that are characteristic of the Division's customers.

Following are condensed operating results of the commercial banking segment:

	Banking and finance in Israel	Credit cards	Capital market	Mortgages	Activities abroad: Capital market	Activities abroad: Banking and finance	Total
	2007						
	NIS millions						
Profit from net interest income:							
From external sources	**1,413**	**7**	**2**	**20**	**-**	**297**	**1,739**
Intersegmental	**(354)**	**(3)**	**(2)**	**(14)**	**-**	**(46)**	**(419)**
Operating and other income:							
From external sources	**266**	**46**	**121**	**1**	**10**	**41**	**485**
Intersegmental	**-**	**(31)**	**-**	**-**	**-**	**2**	**(29)**
Total income	**1,325**	**19**	**121**	**7**	**10**	**294**	**1,776**
Provisions for doubtful debts	**173**	**-**	**-**	**(1)**	**-**	**21**	**193**
Operating and other expenses:							
To external sources	**564**	**17**	**45**	**2**	**5**	**156**	**789**
Intersegmental	**-**	**(1)**	**-**	**-**	**-**	**-**	**(1)**
Operating profit before taxes	**588**	**3**	**76**	**6**	**5**	**117**	**795**
Provision for taxes	**227**	**1**	**29**	**1**	**1**	**32**	**291**
Operating profit after tax	**361**	**2**	**47**	**5**	**4**	**85**	**504**
Minority interests in profits of consolidated companies	**-**	**5**	**-**	**-**	**-**	**-**	**5**
Operating profit after taxes	**361**	**7**	**47**	**5**	**4**	**85**	**509**
Profit from extraordinary items after taxes	**-**	**-**	**16**	**-**	**-**	**-**	**16**
Net profit	**361**	**7**	**63**	**5**	**4**	**85**	**525**
% Return on equity							**15.6%**
Average balance of assets	**33,602**	**204**	**36**	**292**	**-**	**10,948**	**45,082**
Average balance of liabilities	**21,693**	**653**	**-**	**98**	**-**	**9,210**	**31,654**
Average balance of risk assets	**32,690**	**174**	**42**	**246**	**-**	**7,611**	**40,763**
Average balance of mutual fund assets	**-**	**-**	**2,691**	**-**	**281**	**-**	**2,972**
Average balance of securities	**-**	**-**	**72,909**	**-**	**2,729**	**-**	**75,638**
Average balance of other assets under management	**1,222**	**-**	**-**	**-**	**-**	**-**	**1,222**
Margin from credit-granting activities	**708**	**12**	**-**	**(1)**	**-**	**83**	**802**
Margin from taking of deposits	**157**	**-**	**-**	**-**	**-**	**84**	**241**
Other	**194**	**(8)**	**-**	**7**	**-**	**84**	**277**
Total profit from net interest income	**1,059**	**4**	**-**	**6**	**-**	**251**	**1,320**
Balance of credit to the public	**33,841**	**273**	**14**	**294**	**-**	**7,868**	**42,290**
Balance of deposits of the public	**21,655**	**-**	**-**	**54**	**-**	**9,033**	**30,742**

Main Changes in the Volumes of Activity

Credit to the public increased by some NIS 3.9 billion (10.2%), of which an increase of NIS 2.7 billion was in the segment’s operations in Israel and an increase of NIS 1.2 billion was in activities abroad.

Deposits by the public increased by some NIS 3.4 billion (12.3%), of which some NIS 2.9 billion was in the domestic segment and NIS 0.5 billion was in activities abroad.

The activities in securities recorded an increase of some NIS 13.7 billion, at the rate of 19.7%, which derives primarily from a rise in the market value and from an increase in activity in Israel, including subcustody activity. In off-balance-sheet activities, guarantees and documentary credit facilities there was a decrease of 4.5%.

Commercial Banking Segment (continued)

	Banking and finance in Israel	Credit cards	Capital market	Mortgages	Activities abroad	Total
	2006					
	NIS millions					
Profit from net interest income:						
From external sources	1,222	7	3	15	273	1,520
Intersegmental	(292)	(1)	(3)	(10)	(37)	(343)
Operating and other income:						
From external sources	252	29	83	1	40	405
Intersegmental	-	(26)	12	-	2	(12)
Total income	1,182	9	95	6	278	1,570
Provisions for doubtful debts	182	-	-	(1)	2	183
Operating and other expenses:						
To external sources	568	8	40	1	151	768
Intersegmental	12	(1)	-	-	-	11
Operating profit before taxes	420	2	55	6	125	608
Provision for taxes	177	-	22	4	37	240
Operating profit after taxes	243	2	33	2	88	368
Profit from extraordinary items after taxes	-	-	74	-	-	74
Net profit	243	2	107	2	88	442
% Return on equity						15.8%
Average balance of assets	28,684	93	68	336	9,393	38,574
Average balance of liabilities	18,116	645	-	115	7,964	26,840
Average balance of risk assets	28,449	188	69	340	5,877	34,923
Average balance of provident funds, mutual fund and supplementary training fund assets	-	-	4,236	-	181	4,417
Average balance of securities	-	-	52,738	-	2,153	54,891
Average balance of other assets under management	1,271	-	-	-	-	1,271
Margin from credit-granting activities	623	3	-	1	54	681
Margin from taking of deposits	138	-	-	-	68	206
Other	169	3	-	4	114	290
Total profit from net interest income	930	6	-	5	236	1,177
Balance of credit to the public	31,320	91	66	294	6,596	38,367
Balance of deposits of the public	18,805	-	-	64	8,501	27,370

Main Changes in the Net Profit

Net profit in the commercial banking segment totaled NIS 525 million in 2007, compared with NIS 442 million in the corresponding period in 2006, an increase of 18.8%. The growth in the net profit derives from an increase in the net operating profit, which totaled NIS 504 million, compared with NIS 368 million during the corresponding period in 2006, an increase of 37.0%. The increase was partially offset by a decrease in the profit from extraordinary items, which amounted to NIS 16 million, compared with NIS 74 million in 2006, and derived from the sale of the operations of the capital market companies. The increase in the net operating profit derives from an increase in the net interest income in the amount of NIS 143 million and an increase in operating income in the amount of NIS 63 million. On the other hand, provisions for doubtful debts rose by some NIS 10 million as a result of an increase in provisions for doubtful debts in the United Kingdom, and partially offset the increase in profit. Most of the increase was in activities in the segment in Israel and arose from an increase in income in the amount of NIS 164 million, 12.9%. Net operating profit, after neutralizing special salary expenses, increased by some NIS 120 million, 29.6%.

5. The Construction and Real-Estate Segment

General

The segment specializes in providing financial services to customers of the corporate and commercial banking segments, which engage mainly in the fields of construction and real estate and in the field of infrastructure projects. The construction sector is financed through the use of analytical tools and instruments that are unique to the segment, while applying a considered policy. A material portion of project financing is provided using the closed construction lending format, with close supervision and monitoring, and emphasis on the meticulous examination of each project.

The Credit Risk Management Unit in the Credit Department is responsible for examining transactions and approving them, or submitting them for deliberation by the appropriate credit committee.

The Structure of the Segment

Most of the business activities in the construction and real-estate segment are carried out through the Construction and Real-Estate Division. This Division supplies a comprehensive range of banking services, both to major construction and real estate companies in the economy, and to middle-market business companies engaging in construction and real estate.

The Division is divided into two sectors, each with three senior customer relations managers, possessing specific expertise in the real-estate sector. The senior customer relations managers coordinate all banking aspects of the customers assigned to them.

The sectors in the Division are: the building contractors sector, which specializes in the provision of services to middle-market business customers, with the majority of the activity being the financing of the residential sector, using the closed construction lending method; and the construction companies sector, which supplies a broad range of banking services to major customers in the economy in the construction and real-estate sphere.
An additional department operates within the scope of the Division, which specializes in financing wide-scale infrastructure projects, including projects using a BOT or PFI format. Heading this sector is a senior customer relations manager, who is responsible for coordinating the organization of the financing for these projects.

Customers of the Bank in this segment operating in the United States or Europe avail themselves of the services of the construction and real-estate financing divisions at Bank Leumi USA, Bank Leumi (UK) and Bank Leumi Romania, while leveraging their relations with the Bank in Israel.
Bank Leumi USA operates in this segment primarily through its main branch in New York.

Objectives and Business Strategy and Expectations for Development in the Coming Year

The following information is "forward-looking information." For the meaning of this term, see pages 43.

Banking in the real-estate segment handles the large and medium-sized segment of business clients in the field of real-estate. Its strategic objective is to magnify its relative advantage and continue to improve its contribution to the Group's profit. The objective of banking in the segment is to expand its customers' activities with the Group, to increase the range of products and services offered to customers and to leverage its ongoing relations with the customers to develop business with the various units in the Leumi Group in Israel and abroad.

Restrictions, Legislation, Regulations and Special Constraints that Apply to the Segment

The Bank, and the construction and real-estate segment in particular, operate within the context of laws, regulations and regulatory directives imposed on the banking system in Israel by entities such as the Banking Supervision Division, the Supervisor of the Capital Market, Insurance and Savings, the Antitrust General Director, the Israel Securities Authority and additional bodies. The Bank's overseas subsidiaries and representative offices operate under permits from the Banking Supervision Division, and are also subject to local regulations.

For details, see pages 31-41 above.

According to Bank of Israel regulations, when the total indebtedness of a certain sector to a banking corporation exceeds 20% of the total indebtedness of the public to the banking corporation (the bank on a non-consolidated basis), this surplus is considered to be an excess, for the purpose of the concentration of segmental indebtedness. In such instance, an additional provision for doubtful debts is required in respect of the excess amount. The segmental excess in this segment totaled 0.75% at the end of 2007, compared with the excess of 0.98% at the end of 2006.

Developments in the Markets of the Segment, or Changes in its Customers' Characteristics

The activities of this segment's customers during 2007 were characterized by a continuing positive trend in all segments of this activity in Israel – residential construction, non-residential construction and infrastructure projects.
Residential construction was characterized by a rally in the traditional high-demand localities for housing, *inter alia,* under the influence of high volumes of purchases by foreign residents and an increase in rents charged in the center of the country.
Price levels for housing units in the high-demand localities are characterized by stability in low-cost construction and by a significant rise in the high-priced residential segment. On the other hand, the market also absorbed a significant rise in the construction input prices.
The demand has continued for income-generating properties (offices and commerce), under the influence of the growth in the business segment of the economy. Regarding commercial construction, commercial centers (power centers) have considerably expanded at the outskirts of the major cities, coupled with the trend of the traditional anchors leaving the malls in the urban areas.
During the past year, the moderate uptrend in the execution of wide-scale national infrastructure projects has continued, with the main participating segments being infrastructure, transportation, energy and electricity.
The growing tendency of real-estate companies to increase their investments abroad by initiating residential and commercial projects, and by acquiring hotels, is evident. The principal centers of activity outside of Israel are in Eastern Europe, North America and Eastern Asia.

The collapse of a major company in the field of residential projects during the year constituted a material event for the real-estate segment, which is expected to lead to the financing institutions tightening the control and supervision of financing projects, and possibility even to statutory and regulatory amendments.

Technological Changes that Could Have a Material Impact on the Segment

The information systems that serve the construction and real-estate segment are intended to assist in analyzing the needs of the customers and in the ongoing work with them, in analyzing and measuring credit risks and in the monitoring and control of customers' activities. The various technological systems are updated and upgraded on an ongoing basis for the benefit of the segment.

Critical Success Factors in the Segment

Critical success factors in the segment are: staff possessing high levels of management, professional and interpersonal capabilities (both *vis-à-vis* the customers and within the organization), specialization, familiarity with the customers, including their financial position and the prospects/risks inherent in working with them, proper management and control of the financing for projects, reading the market correctly in order to identify potential and to avoid risk, credit risk management and control, continual investment in technological aids, and diligence in customer relations, in providing service and responding to the customers' banking needs.

The Main Entry and Exit Barriers in the Segment

In order to provide service to customers in this segment, high-quality human resources are required, possessing a high level of skill in familiarizing themselves with the customers in the segment and the range of their activities, and in analyzing their needs. The management of customers in the segment requires an in-depth familiarity with its customers, their financial data, spheres of activity, and adaptation of the Bank's products to these data. Appropriate preparations are also required in order to comply with the regulatory restrictions and the internal restrictions prescribed by the Bank's Board of Directors, as well as monitoring and control of the various exposures and risks.

Alternatives to the Products and Services in the Segment, and Changes that have Occurred Therein

Alternative sources have been developed as a substitute for banking credit, which are offered by non-banking financial bodies, in particular, by institutional bodies. The alternative products being offered are public and private issues of shares, debentures and other securities in the capital markets in Israel and abroad, and the granting of credit and guarantees under the Sale Law by these bodies.

Structure of the Competition in the Segment and Changes that have Occurred Therein

The competition for financing the real-estate segment is intense, both on the part of the four major banking groups in Israel, and on the part of the small banks in the system, including the mortgage banks. In recent years, there has been a marked and growing involvement of institutional bodies, such as insurance companies and pension funds, and even foreign banks are seen entering the field of long-term financing for income-generating properties. During recent years, there has been a marked upward trend in raising capital through company debentures, and this trend is expected to continue to rise. As opposed to the rise in the percentage of non-bank credit, the percentage of bank credit is in a decreasing.

Since the real-estate segment is the largest consumer of credit abroad, Israeli real-estate companies operating abroad are the main casualties of the sub-prime crisis, which reduced the companies' ability to recruit non-bank credit on the local capital market and abroad, mainly companies that are not rated. For these companies, the risk margins in the off-balance-sheet market rose. The major, well established companies with high ratings were not affected, and accordingly, not only did the competition arising from non-bank credit not diminish, it intensified.

The Segment's Products and Services

The construction and real-estate sector is financed using specific analytical tools and monitoring tools that assist in the decision-making process and in controlling the financial support that is provided for various projects. Financing in the segment is carried out with the intention of diversifying the credit portfolio and differentiating between the various segments – residential, income-generating properties designated for commerce and offices, construction for industry and trade. The financing policy of the Construction and Real-Estate Division for 2008 focuses on giving preference to residential projects in typical areas of demand. Residential projects will, as a rule, be financed using the closed construction lending method, which enables frequent close supervision of the financed projects. In addition, the Construction and Real-Estate Division continues to integrate financing for national projects using the various PPP (Public-Private Partnership) methods. These transactions are analyzed in collaboration with a special unit that examines the transactions and structures the financing package, while taking into account the nature of the customer, the analysis of its ability to service the debt, the right of recourse to the customer, restrictions in the operating contract, technical limitations, etc.

Customers

The customers in this segment are the major companies in the economy in the real-estate sphere and select middle-ranking business companies engaging in construction and real estate.

Marketing and Distribution

The real-estate segment’s activity *vis-à-vis* its customers is coordinated by senior customer relations managers, who maintain regular continuous contact with the customers and provide solutions to all their banking needs.

Competition

The year 2007 was characterized by stiff competition in the financing of all segments of the real-estate sector. The competition is evident in the provision of service, in response times and in prices. The competition is from all players in the Israeli banking market and in the foreign banking market, as well as from institutional bodies, such as insurance companies and pension funds.

Human Capital

In 2007, the average number of positions assigned to the segment totaled some 217, of which, 101 were management positions, compared with 183 positions in 2006, of which, 85 were management staff positions. Most employees have academic qualifications. In addition to their educational qualifications, the employees undergo professional training on an ongoing basis in various fields of banking and management courses, as part of their training within the Bank. Within the scope of their work, the employees must have the ability to analyze complex credit applications, to lead complicated transactions and the ability to provide service at the highest level.

Following are condensed operating results of the construction and real-estate segment:

	Banking and finance in Israel	Capital market	Activities abroad	Total
	2007			
	NIS millions			
Profit from net interest income:				
From external sources	**1,456**	**-**	**63**	**1,519**
Intersegmental	**(853)**	**-**	**(24)**	**(877)**
Operating and other income:				
From external sources	**39**	**4**	**-**	**43**
Intersegmental	**-**	**-**	**-**	**-**
Total income	**642**	**4**	**39**	**685**
Provisions for doubtful debts	**(37)**	**-**	**4**	**(33)**
Operating and other expenses:				
To external sources	**93**	**2**	**7**	**102**
Intersegmental	**-**	**-**	**8**	**8**
Operating profit before taxes	**586**	**2**	**20**	**608**
Provision for taxes	**226**	**1**	**6**	**233**
Operating profit after tax	**360**	**1**	**14**	**375**
Profit from extraordinary items after taxes	**-**	**1**	**-**	**1**
Net profit	**360**	**2**	**14**	**376**
% Return on equity				**16.1%**
Average balance of assets	**22,010**	**1**	**796**	**22,807**
Average balance of liabilities	**3,108**	**-**	**247**	**3,355**
Average balance of risk assets	**27,443**	**1**	**847**	**28,291**
Average balance of mutual fund assets	**-**	**76**	**1**	**77**
Average balance of securities	**-**	**15,127**	**20**	**15,147**
Average balance of other assets under management	**136**	**-**	**-**	**136**
Margin from credit-granting activities	**426**	**-**	**(7)**	**419**
Margin from taking of deposits	**14**	**-**	**(2)**	**12**
Other	**163**	**-**	**48**	**211**
Total profit from net interest income	**603**	**-**	**39**	**642**
Balance of credit to the public	**22,623**	**1**	**846**	**23,470**
Balance of deposits of the public	**2,992**	**-**	**197**	**3,189**

Main Changes in the Volumes of Activity

Credit to the public in this segment rose by some NIS 1.0 billion (4.3%), which derives mainly from an increase in activity in Israel. Activities in securities increased, by some NIS 1.4 billion, 10.1%. There was an increase of 23.6% in off-balance-sheet activity, guarantees and documentary credits.

Construction and Real-Estate Segment (continued)

	Banking and finance in Israel	Capital market	Activities abroad	Total
	2006			
	NIS millions			
Profit from net interest income:				
From external sources	1,390	-	70	1,460
Intersegmental	(854)	-	(26)	(880)
Operating and other income:				
From external sources	43	4	-	47
Intersegmental	-	-	-	-
Total income	579	4	44	627
Provisions for doubtful debts	150	-	5	155
Operating and other expenses:				
To external sources	91	1	6	98
Intersegmental	-	-	9	9
Operating profit before taxes	338	3	24	365
Provision for taxes	138	1	9	148
Operating profit after tax	200	2	15	217
Profit from extraordinary items after taxes	-	1	-	1
Net profit	200	3	15	218
% Return on equity				9.0%
Average balance of assets	23,051	1	897	23,949
Average balance of liabilities	2,848	-	291	3,139
Average balance of risk assets	29,323	-	995	30,318
Average balance of provident fund, mutual fund and supplementary training fund assets	-	161	-	161
Average balance of securities	-	11,665	6	11,671
Average balance of other assets under management	131	-	-	131
Margin from credit-granting activities	421	-	(13)	408
Margin from taking of deposits	13	-	(4)	9
Other	102	-	61	163
Total profit from net interest income	536	-	44	580
Balance of credit to the public	21,737	2	762	22,501
Balance of deposits of the public	2,876	-	260	3,136

Main Changes in the Net Profit

Net profit of the construction and real-estate segment totaled NIS 376 million in 2007, compared with NIS 218 million in the corresponding period in 2006, an increase of 72.5%. The majority of the increase in the net profit in this segment derives from a decrease in provisions for doubtful debts in the operational segment in Israel of NIS 187 million and from an increase in total income of NIS 58 million, mainly in the activity of the segment in Israel.

6. The International and Private Banking Segment

General

International and private banking engages in business and commercial activities, and is also responsible for wealthy customers in Israel and all over the world. The activities are carried out through designated centers in Israel for foreign and Israeli residents, as well as through the Bank's subsidiaries in the United States, Great Britain, Switzerland, Luxembourg, and representative offices in Europe, Latin America, Canada and Australia. Its strategic objective is to expand its customer base, to increase the volume of activity of private banking customers in Israel and globally, as well as to develop business and commercial activity in special fields by providing professional, high-quality service by the Bank's subsidiaries.

The Structure of the Segment

The private banking line is operated in Israel by way of the provision of prestigious and personal service by professional teams in eight unique centres around the country, who serve local residents and foreign residents in their own language, and who are familiar with the customers' needs, preferences and spheres of interest.

Outside of Israel, private banking services are provided mainly through the subsidiaries Leumi (Switzerland) and Leumi (Luxembourg) and through Leumi (UK) and Leumi USA. The Bank also has representative offices in a number of countries in Europe, Latin America, Canada and Australia. Concurrently, the organization of representative offices of Leumi (Switzerland) and Leumi (Luxembourg) in Israel has recently been completed, for the provision of services to their customers in Israel.

For additional details regarding overseas subsidiaries, see pages 151-159.

Objectives and Business Strategy

The vision of private banking is to be "the private banking choice of customers in the leading private banker in Israel." This vision emphasizes a number of core values: focus on and attention to each existing and potential customer, to the profitability of his or her asset portfolio, to the level of professionalism and excellence in service, and all while developing professional and competitive teams possessing initiative, with the highest level of service orientation.

This strategy is also supported by the Bank's overseas units, which present this business line to potential customers in Europe, Latin America, Canada and Australia, and thus, assist in increasing activity with new and existing customers.

At the end of 2006, the international operations were centralized in the International and Private Banking Division. Within this framework, the Bank's subsidiaries in the United States, the United Kingdom and Uruguay, the branches in Georgetown, Panama and the Bank's agency in New York were made the responsibility of the Division which was already responsible for the subsidiaries in Switzerland and Luxembourg and for all of the Group's representative offices throughout the world. The consolidation of all of the Bank's international activities under one roof supports Leumi's strategy in the international arena.

Restrictions, Legislation, Regulations and Special Constraints that Apply to the Segment

The private banking segment in Israel operates within the context of laws, directives and regulations, which are imposed on the banking system in Israel by entities, such as the Banking Supervision Department, the Supervisor of the Capital Market, Insurance and Savings, the Antitrust General Director, the Israel Securities Authority and other bodies. The Bank's overseas subsidiaries and representative offices operate pursuant to permits from the Banking Supervision Department in the Bank of Israel, and are also subject to local regulation.

For details regarding the amendment to the Banking (Service to Customers) Law on the subject of commissions, see pages 36-37 above.

Developments in the Markets of the Segment of Activity, or Changes in its Customers' Characteristics

On 1 January 2005, the tax rate payable by residents of Israel on investments in Israel and abroad were equalized, a move that caused a significant increase in the activities of Israeli resident customers in foreign securities and in investments abroad. The year 2007 was characterized by rises in the indices in the emerging markets and in Asia, which also led to a significant increase in the investment activities in shares and debentures in those markets, and to a rise in the interest rates in Israel and around the world, which helped in obtaining improved terms for the structured products that are offered to our customers.

Technological Changes

The private banking segment in Israel implemented two advanced technological systems during 2005, adapted to the needs of the segment's customers and which improve the service provided to them: the Odyssey system, which provides detailed reports to customers regarding their investments and assets, and the Profiler system, which helps counselors adapt an investment policy to the customers' asset portfolios that suits their needs.

The assimilation of these two systems continued during 2006. In addition, the Division temporarily made use of a CRM system (Customer Relations Management) for strengthening relations with the Bank's customers.

During 2007, the integration of an advanced CRM system continued, which strengthened relations between the counselors and customers, with the objective of providing improved service and increasing customer satisfaction. In addition, use is made of the Reuters and Bloomberg systems as decision-making support information.

Critical Success Factors in the Private Banking Segment

- The expansive international spread of the Group's subsidiaries and representative offices.
- A range of comprehensive and advanced solutions and products for managing customers' assets and responding to their needs.
- Counseling customers by a professional team supported by analysts and information systems.
- The provision of personal and tailored VIP services, over and above routine financial services.

The Main Entry and Exit Barriers in the Segment

- The training of skilled, qualified manpower possessing high levels of professionalism and service capabilities.
- An international spread of centers of activity throughout the world.
- The implementation of means of control over the entire range of activities.
- The establishment, maintenance and upgrading of advanced technological information systems.
- The offering of a broad range of financial products and services.

Products and Services

Private banking customers are offered a range of investment products, including deposits, investments in Israeli and foreign securities, mutual funds, structured products, hedge funds and more. In addition, customers are offered credit facilities and investment banking services, including private offerings, trust services in Israel and off-shore, and more.

New Products

A broad spectrum of innovative and sophisticated investment products was built and offered to customers of the segment in Israel and abroad during the course of 2007, taking into account the variable market conditions and the customers' needs. Among the new products is a wide variety of short and long-term structured products, mutual funds, hedge funds, and more.

Alternatives to the Products and Services of the Segment

Among the range of products, the private banking segment offers products in cooperation with international bodies within the framework of open architecture. Every product has various alternatives, according to the varying market conditions and the customer's needs. The segment continually strives to expand its range of products and services for its customers.

Customers

The customers are financially wealthy individuals, who are defined as being high net worth customers, and are divided into two main groups of customers – foreign residents and residents of Israel – based on parameters of financial wealth and types of activity. Customers of the segment receive service from professional teams of counselors at centers across Israel, with the teams being assigned according to the customer's language requirements.

For additional details, see page 16.

Marketing and Distribution

The marketing objective is to increase the customer base in the segment and the Bank's share of the customer's asset portfolio, while creating image differentiation, both within the Group and *vis-à-vis* the competition. In addition to the activities undertaken face-to-face and via telephone at the private banking centers, the products and ancillary services are also marketed through advertising campaigns in the press aimed at an affluent target audience, direct mailing, the internet, e-mail, professional conferences, and more.

Competition

In the private banking segment, Leumi competes in Israel with Israeli banks and with local representative offices of foreign banks, which have the same target audience. Overseas, the Bank competes with local banks and investment houses that offer private banking and investment services, as well as with branches and representative offices of Israeli banks.

Seasonality

There is no significant seasonality in the segment. Nonetheless, the periods of the religious holidays are characterized by vigorous financial activity among foreign residents as a result of tourists visiting Israel from abroad, some of whom are existing customers while others are new customers.

Intangible Assets

Private banking has two significant intangible assets. The first is the segment's logo, which was designed by an international advertising agency on the basis of Leumi's logo, and includes the words "Private Banking." The logo appears on all private banking's advertising and on all communications with customers and with the media. In addition, a trademark has been registered in Israel and abroad for the name of the "Leumi Global Managers" series of funds and for its abbreviation, "LGM."

Human Capital

In 2007, the average number of positions assigned to the segment totaled some 741 positions, of which 324 were management positions, compared with 778 positions in 2006, of which 329 were management staff positions.
Private banking's employees undergo comprehensive training, including professional courses and managerial workshops in Israel and abroad. Particular attention is paid to recruitment and training of employees as investment counselors, including training aimed towards obtaining an investment counselor's license from the Israel Securities Authority.

Cooperation Agreements

The private banking segment offers customers a broad range of products in cooperation with international bodies, within the framework of open architecture. Through this cooperation, Leumi offers a range of advanced investment products, which constitute the principal attraction for foreign resident investors – both existing and new investors – and increases the volume of assets that they hold in the Group.

Since 2004, there has been significant cooperation in the segment with the SEI Investments Company, which serves as a sub-investment manager for the Leumi Global Managers' series of funds that are distributed abroad.

For additional details, see pages 160-161 below.

Following are condensed operating results of the private banking segment:

				Activity abroad		
	Banking and finance in Israel	Credit cards	Capital market	Capital market	Banking and finance	Total
	2007					
	NIS millions					
Profit from net interest income:						
From external sources	**(1,097)**	**-**	**-**	**-**	**(141)**	**(1,238)**
Intersegmental	**1,264**	**-**	**-**	**-**	**346**	**1,610**
Operating and other income:						
From external sources	**42**	**1**	**123**	**160**	**118**	**444**
Intersegmental	**2**	**1**	**-**	**-**	**13**	**16**
Total income	**211**	**2**	**123**	**160**	**336**	**832**
Provisions for doubtful debts	**-**	**-**	**-**	**-**	**-**	**-**
Operating and other expenses:						
To external sources	**178**	**2**	**69**	**103**	**218**	**570**
Intersegmental	**-**	**-**	**-**	**1**	**66**	**67**
Operating profit before taxes	**33**	**-**	**54**	**56**	**52**	**195**
Provision for taxes	**11**	**-**	**21**	**11**	**12**	**55**
Operating profit after tax	**22**	**-**	**33**	**45**	**40**	**140**
Minority interests in profits of consolidated companies	**-**	**-**	**-**	**-**	**(5)**	**(5)**
Operating profit after taxes	**22**	**-**	**33**	**45**	**35**	**135**
Profit from extraordinary items after taxes	**-**	**-**	**6**	**-**	**-**	**6**
Net profit	**22**	**-**	**39**	**45**	**35**	**141**
% Return on equity						**32.0%**
Average balance of assets	**1,632**	**32**	**-**	**-**	**6,626**	**8,290**
Average balance of liabilities	**25,557**	**-**	**-**	**-**	**13,319**	**38,876**
Average balance of risk assets	**1,207**	**28**	**-**	**-**	**4,113**	**5,348**
Average balance of mutual fund assets	**-**	**-**	**3,347**	**2,008**	**-**	**5,355**
Average balance of securities	**-**	**-**	**28,782**	**35,541**	**-**	**64,323**
Average balance of other assets under management	**417**	**-**	**-**	**-**	**-**	**417**
Margin from credit-granting activities	**19**	**-**	**-**	**-**	**23**	**42**
Margin from taking of deposits	**136**	**-**	**-**	**-**	**252**	**388**
Other	**12**	**-**	**-**	**-**	**(70)**	**(58)**
Total profit from net interest income	**167**	**-**	**-**	**-**	**205**	**372**
Balance of credit to the public	**1,600**	**48**	**-**	**-**	**3,507**	**5,155**
Balance of deposits of the public	**24,548**	**-**	**-**	**-**	**12,621**	**37,169**

Main Changes in the Volume of Activity in the Segment

The total monetary assets of customers under management of the private banking segment totaled NIS 109 billion as at 31 December 2007, compared with NIS 102 billion at the end of 2006, an increase of 6.9%.
During 2007, the volume of incoming tourism increased, which caused an increase in the volume of activities.
Deposits of the public in this segment increased by some NIS 505 million (1.4%), which derives from an increase of some NIS 1.4 billion in the segment's activities abroad, and from a decrease of some NIS 0.9 billion in the segment's activities in Israel. Credit to the public in this sector increased by some NIS 738 million, (16.7%). The relatively minor increase in the activities of the segment arises

mainly from appreciation of the shekel against most other currencies. There was an increase in securities activities, including mutual funds, of some NIS 6.5 billion (10.0%), of which, NIS 5.2 billion were generated by the activities in Israel.

	Banking and finance in Israel	Credit cards	Capital market	Activities abroad	Total
	2006				
	NIS millions				
Profit (loss) from net interest income:					
From external sources	(1,017)	-	-	(134)	(1,151)
Intersegmental	1,184	-	-	321	1,505
Operating and other income:					
From external sources	41	1	95	251	388
Intersegmental	1	1	12	12	26
Total income	209	2	107	450	768
Provisions for doubtful debts	-	-	-	2	2
Operating and other expenses:					
To external sources	177	3	66	313	559
Intersegmental	(1)	-	-	70	69
Operating profit (loss) before taxes	33	(1)	41	65	138
Provision for taxes	14	-	17	21	52
Operating profit (loss) after tax	19	(1)	24	44	86
Minority interests in profits of consolidated companies	-	-	-	(2)	(2)
Operating profit (loss) after taxes	19	(1)	24	42	84
Profit from extraordinary items after taxes	-	-	75	1	76
Net profit (loss)	19	(1)	99	43	160
% Return on equity					41.0%
Average balance of assets	1,656	6	-	6,450	8,112
Average balance of liabilities	25,159	-	-	12,783	37,942
Average balance of risk assets	942	39	-	3,885	4,866
Average balance of mutual fund and supplementary training fund assets	-	-	3,304	1,763	5,067
Average balance of securities	-	-	25,877	35,330	61,207
Average balance of other assets under management	453	-	-	-	453
Margin from credit-granting activities	18	-	-	26	44
Margin from taking of deposits	136	-	-	255	391
Other	13	-	-	(94)	(81)
Total profit from net interest income	167	-	-	187	354
Balance of credit to the public	1,478	6	-	2,933	4,417
Balance of deposits of the public	25,419	-	-	11,245	36,664

Changes in the Net Profit

Net profit of the private banking segment in 2007 amounted to NIS 141 million, compared with some NIS 160 million in the corresponding period in 2006, a decrease of NIS 19 million (11.9%). The decrease in the net profit derives from the decrease in the profit from extraordinary items, which derived in 2006 from the sale of the operations of Psagot-Ofek, Leumi-Pia and some of the provident funds, in the amount of NIS 76 million, compared with NIS 6 million in 2007. Operating profit after tax amounted to NIS 135 million, compared with some NIS 84 million in the corresponding period in 2006, an increase of 60.7%. The segment's total income increased by NIS 64 million (8.3%). The increase in operating profit arose both from the segment's activity in Israel and the overseas subsidiaries.

7. The Financial Management Segment – Capital Markets

General

This segment coordinates the financial management of the Bank and of the Group. Following are the segment's spheres of activity.

- Capital management, including public and private offerings of subordinated capital notes and debentures.
- Management of the *nostro*, meaning – the investment of the Bank's independent financial means in tradable investment instruments (primarily debentures and derivatives) and in non-tradable investments (primarily deposits with banks).
- Management of market risk exposures – including the management of basis, interest and liquidity exposures.
- Management of the dealing rooms, which provide trading services to the customers of the other segments, primarily in currencies, securities and derivatives.
- Price management – by setting transfer prices and costing special financial transactions.
- Development of financial instruments.
- Inter-bank activity in Israel and abroad.
- Coordination of banking activity of customers who are institutional investors.

The Structure and Business Strategy of the Segment

The activity of the segment is carried out by the Capital Markets Division, and abroad by the market risk managers in the subsidiaries. The activities include the operation of the Bank's dealing rooms and management of the *nostro*, and the provision of service to customers active in the capital and money markets, including institutional customers.

The segment's business strategy relates to capital management and capital adequacy requirements policies, policies for managing market risks and the *nostro*, while devoting attention to management of current liquidity, and interest and financial margins policies. The business objectives of the financial management segment are to meet profit targets (while the activities are conducted within the framework of restrictions on risk exposure set by the Board of Directors), to develop advanced financial instruments, including structured products, as well as to support and cooperate with the Bank's other operational segments.

Legislative Restrictions, Regulations and Special Constraints that Apply to the Segment

The Bank's activities are subject to laws, regulations and regulatory directives imposed on the banking system in Israel. The Bank is subject to the supervision of various authorities, such as: the Bank of Israel and the Banking Supervision Department, the Supervisor of the Capital Market, Insurance and Savings, the Antitrust General Director and the Israel Securities Authority. The Bank's overseas subsidiaries and representative offices operate under permits from the Banking Supervision Department, and are also subject to local regulations.

The Segment's Profit

The segment's profit is affected mainly by the *nostro* activities in the dealing rooms. Following are the principal components of the net interest income:

– The results of market risk management, including the changes that occurred in transfer prices. Income and expenses resulting from changes in transfer prices are attributed in full to the financial segment, to which all the market risks from the other operational segments are also transferred.
– The results of capital management, including public capital raising and offerings.
– Profits/losses on the realization of debentures, and unrealized profits/losses on market value adjustments of debentures for trading.
– Market value adjustments of derivative instruments
– Effects of foreign currency/shekel exchange rate and CPI differentials, including adjustments from the translation of the investments abroad, including the effects of related taxes.
– Income deriving from the investment of pension, jubilee and regular holiday reserves.
– Certain expenses pertaining to pension liabilities.
– Profits of companies included in the equity basis.

The operating expenses of the segment include mainly the direct operating expenses, as well as indirect expenses involved in the management of market risks, management of independent securities portfolios (*nostro*), and the management of the dealing rooms.
In 2007, the segment's net profit amounted to NIS 286 million, compared with NIS 742 million in 2006, a decrease of 61.5%. The entire decrease in the net profit derives from a decrease in profits from extraordinary items in the amount of NIS 718 million in 2006, from the sale of the holdings in Africa Israel and Migdal Insurance and Financial Holdings, while in 2007, there were no profits from extraordinary items. Net operating profit totalled NIS 286 million, compared with NIS 24 million in 2006. This segment includes the Group's share of the profits of companies included on the equity basis, as detailed below on page 132.

The increase of NIS 262 million in net operating profit in 2007 is explained by the following factors:
- An increase in the net interest income in the amount of NIS 154 million, deriving mainly from adjustments of financial derivatives to fair value.
- An increase in operating income in the amount of NIS 179 million, deriving from an increase in income from dividends and from the sale of shares available for sale.
- A decrease in operating expenses in the amount of NIS 195 million, deriving from a decrease in operating expenses not attributed to the other operational segments, such as: the adopting of new mortality tables, a provision in respect of holiday gifts, and an increase in the provision for pensions made in 2006.

The Main Developments in the Business Environment

In line with the trend that has developed in recent years, the financial management – capital market segment continued to develop a variety of structured investment products in 2007. These products are usually characterized by the assurance of the investment principal, together with the possibility of a high yield, which is dependent upon the development of certain market variables. This activity of the financial management segment contributed mainly to profitability recorded in the Bank's other segments.

A liquidity crisis began to develop in the global markets during the last three months of the year. This crisis, which is still continuing, is expressed by high volatility, by declines in most of the stock indices worldwide, and by material intervention by central banks around the world.

Companies Included on the Equity Basis (Non-Banking) (Presented in the "Financial Management" Segment).

The operating results of the Group's real investments are presented in the financial management segment.

Total investment of the Leumi Group in companies included on the equity basis totaled some NIS 1,873 million as at 31 December 2007, compared with NIS 1,251 million on 31 December 2006.

Following are the main changes:

	Balance Sheet Value (in NIS millions)			Market Value (in NIS millions)	
Name of Company	**31 December 2007**	31 December 2006	% change	**31 December 2007**	31 December 2006
The Israel Corporation Ltd.	**1,138**	1,101	3.4	**5,613**	2,915
Paz Oil Company Ltd.*	**560**	-	-	**920**	-
Others	**175**	150	16.7	**-**	-
Total	**1,873**	1,251	49.7	**6,533**	2,915

* On 31 December 2006, recorded in the "securities" item.

The contribution of the companies included on the equity basis companies to the Group's profit in 2007 amounted to NIS 184 million, compared with NIS 171 million in the corresponding period in 2006.

The increase in the contribution to profit derives primarily from the recording of the profit of Paz Oil Company (until the end of 2006, included in the available for sale portfolio) in 2007, and from an increase in the Israel Corporation's profit.

Following are the contributions of the companies to the Group's net profit (in NIS millions):

	2007	2006	% change
The Israel Corporation Ltd.	**110**	129	(14.7)
Migdal Insurance and Financial Holdings Ltd.(1)	**-**	23	-
Africa Israel Investments Ltd. (2)	**-**	12	-
Paz Oil Company Ltd.	**65**	-	-
Others	**9**	7	28.5
Total	**184**	171	7.6

(1) On March 15, 2006, the Bank sold 10% of the share capital of Migdal Insurance and Financial Holdings Ltd., and, as of 31 March 2006, the balance of the investment is presented under the "securities" item, under "shares available for sale."
(2) On 27 March 2006, the Bank sold its entire holdings in Africa Israel Investments Ltd.

The Israel Corporation Ltd. – Restrictions in the Permit for Control of Oil Refineries Ltd. (ORL)

The control permit for ORL, which was granted to the Israel Corporation Ltd. (the "Israel Corporation"), prescribed certain restrictions on the Bank with respect to directors serving on behalf of the Bank in the Israel Corporation. The purpose of the restrictions is to maintain "Chinese walls" between ORL and the Oil Refinery – Ashdod Ltd. ("ORA"), for so long as: the Israel Corporation is the controlling shareholder in ORL, and the Paz Oil Company Ltd. ("Paz") is the controlling shareholder in ORA, and the Bank has the right or the ability to appoint, to recommend or to otherwise influence the appointment of a director of the Israel Corporation and in Paz.

Paz Oil Company Ltd.

Leumi Real Holdings Ltd. holds 15.63% of Paz. In January 2007, Leumi appointed two directors in

Paz, constituting 20% of its Board of Directors. As of 1 January 2007, the investment has been presented on the equity basis (until that date, the investment had been presented as part of “securities available for sale”).
The recording of the investment on the equity basis was done on the basis of the cost paid. Surplus costs will be attributed partially to real-estate assets and partially to goodwill, which will be written-off over ten years, in accordance with directives of the Supervisor of Banks. In a letter dated 3 July 2007, the Bank of Israel notified the Bank that Paz is considered to be a conglomerate, as detailed below.
Following the Israel Corporation’s acquisition of the control of ORL, the Government Companies Authority considered amending the control permit for ORA, which was granted to Paz’s controlling shareholders.
In a letter dated 16 September 2007, the Government Companies Authority announced that:
"In light of the Immediate Reports filed by Bank Leumi le-Israel on 5 July 2007 and 22 August 2007 regarding its intention to attempt to sell its holdings in the Paz Oil Company Ltd. ("Paz"), pursuant to the Bank of Israel’s notice of 3 July 2007 and the timetables prescribed therein, the Government Companies Authority has decided to suspend, at this stage, the amendment of the control permit for ORA granted to Paz on 27 September 2006."

Holdings in Non-banking Holding Corporations (Conglomerates)

The Bank's holdings in non-banking corporations are subject to restrictions determined in the Banking (Licensing) Law, 1981 (the "Banking Law"). The Banking Law determines, *inter alia*, in section 24A that a banking corporation is entitled to hold means of control in one conglomerate (a "Non-banking Holding Corporation") only (a corporation whose capital exceeds some NIS 1,831 million and operates in more than three branches of the economy). The Bank has holdings in one conglomerate - The Israel Corporation Ltd.

The financial statements of Paz for the first quarter of 2007, in which new accounting standards were implemented, indicate that the shareholders' equity of Paz exceeds the minimal amount of capital for the definition of a conglomerate (a non-banking holding corporation).

Prior to the publication of the said financial statements, discussions had already been held between the Bank and the Bank of Israel with regard to the interpretation of the Banking Law relating to the definition of Paz as a conglomerate. Further to these discussions, the Bank of Israel notified the Bank, in its letter of 3 July 2007, that it does not accept the Bank's interpretation that the energy sector constitutes one sector of the economy. Therefore, according to the Bank of Israel's position, Paz is a conglomerate under the Banking Law.

As a result, and in accordance with the Bank of Israel's notification of 3 July 2007, the Bank is required to sell its holdings in one of the conglomerates, Paz or the Israel Corporation Ltd., by 30 June 2009. Following discussions in August 2007 regarding the holdings of the Bank in non-banking holding companies, and in light of the Bank of Israel's position (and subject to the continuance of the current discussions with the Bank of Israel in this regard, wherein the Bank disagrees with the Bank of Israel's position), the Bank intends to attempt to sell its holdings in Paz (15.63% of the share capital and voting rights – 15.24% on a fully-diluted basis); this being subject to the conditions, the circumstances and additional examinations and taking into account the timetables set by the Bank of Israel (namely, by 30 June 2009), and subject to there being no change in the dates set or position of the Bank of Israel.

Migdal Financial and Insurance Holdings Ltd. ("Migdal Insurance Holdings")

According to Migdal's notice to the Bank at the end of June 2005, and the examination conducted by the Bank pursuant thereto (based on data and information provided by the Migdal Group), the Bank notified the Bank of Israel during July 2005 that pursuant to the Bank of Israel's interpretation of section 24A of the Banking Law (an interpretation with which the Bank disagrees), as of the end of

March 2005, Migdal Insurance Holdings (the company in which the Bank has holdings), operates in more than three branches of the economy and as such is also defined as a "Non-banking Holding Corporation" ("conglomerate"). Therefore, the Bank requested a reasonable transition period for complying with the requirements of the Banking Law in this regard. The Bank further requested the Bank of Israel's assistance in amending the legislation approved following the Bachar Committee's recommendations so that the recommendations regarding the banks' holdings in insurance companies would also apply to the Bank's holdings in Migdal Insurance Holdings and that the Bank would be able to continue to hold part of its holdings in Migdal Insurance Holdings.

Following the enactment of legislation regarding the capital market reform (see Note 31 to the Financial Statements) and without prejudice to the above, and in addition thereto, the Bank must sell part of its holdings in Migdal Insurance Holdings so that it will no longer hold more than 10% of any type of means of control therein. The Bank has carried out the sale as detailed below.

On 5 March 2006, an agreement was signed between the Bank and Leumi Holdings Ltd., a wholly owned subsidiary of the Bank (“Leumi Holdings”) and between Participatie Maatschappij Graafschap Holland N.V. (the “Purchaser”), a wholly owned subsidiary of Assicurazioni Generali S.p.A., for the sale of shares in Migdal Insurance Holdings owned by the Bank and Leumi Holdings, constituting 10% of the issued and fully paid share capital of Migdal Insurance Holdings, for the consideration of the aggregate amount of some US$ 142 million.

On 15 March 2006, the transaction was completed, following receipt of the approval of the Supervisor of Insurance. The net profit from the transaction was some NIS 237 million.

Following completion of the transaction, the Bank holds 9.98% of the issued and fully paid share capital of Migdal Insurance Holdings. The Bank is required to sell this holding, pursuant to the extension granted by the Bank of Israel, by no later than 30 June 2008, this, if until then, the Banking Law has not been amended to expressly exclude insurance companies from the provisions of section 24A of the Law.

8. "Others" Segment – This Segment Includes Activities Not Attributed To Other Segments

This segment includes the other activities of the Group, each of which does not meet the criteria to be considered a profit segment, pursuant to the directives of the Bank of Israel.

This activity includes mainly: part of the activities of the capital market companies that is not allocated to other segments.

In 2007, the net profit of the Others Segment totaled NIS 195 million, compared with a loss of NIS 35 million in 2006, an increase of NIS 230 million. Following are details of the main changes, in NIS millions:

	2007	2006	Difference
Profit from extraordinary items	**26**	(3)	29
Operating activity at the Bank	**35**	25	10
Leumi Securities and Investments (formerly Psagot-Ofek)	**(9)**	31	(40)
Leumi & Co.(1)	**120**	-	120
Leumi Capital Market Services (formerly Leumi Gemel)	**6**	35	(29)
Leumi-Pia	**(10)**	23	(33)
Other companies in Israel	**(4)**	(3)	(1)
Companies abroad	**20**	15	5
Tax adjustments(2)	**11**	(158)	169
Total	**195**	(35)	230

(1) Mainly from the sale of part of the shares in Cellcom.

(2) Tax differentials between the tax calculations in the segments and the effective tax in the consolidated financial statements.

Profit from Extraordinary Items – (allocated to the various segments)

On 31 January 2007, the sale of additional provident fund activities was completed, the largest of which are Sion, a Central Severance Pay Fund, Tzur and Sagi, to Prisma Provident Funds Ltd. at the price of some NIS 418 million, following a price reduction, due to adjustments agreed upon between the parties. The Bank’s net profit, after adjustments and provisions for tax, is some NIS 257 million.

On 15 July 2007, the sale of the activities of Kahal Employees Supplementary Training Fund Ltd. (“Kahal”) – and of Kahal Paths Supplementary Training Fund (managed by Kahal Study Funds Management (1996) Ltd.) ("Kahal Management") was completed, pursuant to an agreement signed on 26 May 2006 between the Bank, Israel Discount Bank Ltd., Kahal and Kahal Management, and between Migdal Capital Markets (1965) Ltd. on behalf of a company under its control and Migdal Insurance and Financial Holdings Ltd. on behalf of a company under its control (the "Purchaser"), for the sale of the goodwill, management rights, additional rights and means of control of the banks in Kahal, and for the sale of the goodwill, activities, assets and liabilities relating to the supplementary training funds managed by Kahal Management, for consideration of NIS 264 million. The Bank's share of the consideration amount is NIS 150 million. The Bank’s net profit, after adjustments and tax provisions, is some NIS 93 million.

In 2006, the Leumi Group sold the following holdings and activities:

a. 10% of its holdings of fully paid share capital of Migdal Insurance Holdings.
b. All its holdings in Africa Israel Investments.
c. The activity of Psagot-Ofek, Leumi-Pia, and some of the activities of the provident funds.

The net profit in respect of the aforesaid sale transactions amounted to NIS 2,078 million.

The profit from extraordinary items from the sale of the mutual funds and provident funds were allocated to the various operational segments, according to their proportionate share in the income from this activity.

For additional details regarding the aforesaid sale transactions, see page 160.

Activities in Products

A. Capital market activities

The Group’s activities in the capital market include investment counseling activity, including counseling in relation to supplementary training funds, brokerage in the securities and financial instruments market, including activity carried out through the foreign currency and Israeli and foreign securities dealing rooms, brokerage and custody services, and banking and financial services to entities active in the capital market. A company included on the equity basis of Leumi & Co. Investment House Ltd. engages in underwriting and the distribution of private and public offerings.

The legislation of the reform in the capital market has had a material effect on the Group’s activity in the capital market, which had engaged not only in asset management in the capital market for the public, but also in counseling and distribution, underwriting and the provision of additional services in the capital market. Following this legislation, the Bank sold its holdings in the companies managing provident funds and mutual funds. The sales were completed in July 2007, with the completion of the transaction for the sale of the supplementary training funds.

For additional details regarding the impact of the capital market reform legislation on the Group’s activities, and the steps taken subsequently, see pages 31-36 of these Financial Statements.

The net profit from the capital market activities amounted to NIS 563 million, compared with NIS 1,625 million in the corresponding period in 2006, a decrease of NIS 1,061 million. The decrease in the net profit derives from:

1. A decrease in the operating profit after tax, from NIS 262 million in 2006 to NIS 217 million in 2007, this as a result of the sale of the activities, as explained above.
2. A decrease in the net profit from extraordinary items, from NIS 1,363 million in 2006 to NIS 347 million in 2007, as a result of the execution of the majority of the sales in 2006.

The following table sets out data on the activities in the capital market as presented in the various operational segments, including the activities of customers in the capital market, and the results of Leumi & Co., Psagot-Ofek and Leumi Pia:

	House-holds	Private banking	Small businesses	Commercial banking	Corporate banking	Real Estate	Financial management and Others	Activities abroad	Total
	2007								
	In NIS millions								
Profit from net interest income	-	-	**2**	-	-	-	-	-	**2**
Operating and other income	**505**	**123**	**21**	**121**	**25**	**4**	**91**	**176**	**1,066**
Total income	**505**	**123**	**23**	**121**	**25**	**4**	**91**	**176**	**1,068**
Operating and other expenses	**392**	**69**	**11**	**45**	**17**	**2**	**93**	**110**	**739**
Operating profit (loss) before tax	**113**	**54**	**12**	**76**	**8**	**2**	**(2)**	**66**	**329**
Operating profit (loss) after tax	**70**	**33**	**8**	**47**	**5**	**1**	**(2)**	**53**	**215**
Profit from extraordinary items after tax	**278**	**6**	**26**	**16**	**17**	**1**	**4**	**-**	**348**
Net profit	**348**	**39**	**34**	**63**	**22**	**2**	**2**	**53**	**563**

	House-holds	Private banking	Small businesses	Commercial banking	Corporate banking	Real Estate	Financial Management and Other	Total
	2006							
	In NIS millions							
Profit from financing operations	1	-	1	-	-	-	-	2
Operating and other income	512	107	24	95	27	4	426	1,195
Total income	513	107	25	95	27	4	426	1,197
Operating and other expenses	371	66	13	40	15	1	250	756
Operating profit before tax	142	41	12	55	12	3	176	441
Operating profit after tax	84	24	8	33	7	2	104	262
Profit from extraordinary items after tax	1,127	75	54	74	29	1	3	1,363
Net profit	1,211	99	62	107	36	3	107	1,625

For additional details regarding the aforesaid activities, see the chapter on the Capital Market and Financial Services Activities of the Bank and the Group on page 160.

B. Credit Cards - Leumi Card

This activity includes mainly the activity of issuing credit cards to private customers and providing acquiring services for businesses.

The principal credit card activities are carried out by the subsidiary, Leumi Card, which engages in the issuance of credit cards, the provision of acquiring services, and the development of payment solutions.

Leumi Card was established at the beginning of 2000 and has licensing agreements with the international Visa and MasterCard organizations, under which Leumi Card received licenses for the issuance and acquiring of Visa cards and MasterCard cards.

As from January 2001, Leumi Card has acted as the issuer of Leumi Visa credit cards jointly with the Bank. In September 2001, the Bank and Leumi Card began issuing MasterCard credit cards to the Bank’s customers.

In addition, Leumi Card issues credit cards independently to customers of all the banks, the majority of these customers being members of various clubs who, as mentioned, are not customers of the Bank. Since May 2000, Leumi Card has been operating in the field of Visa acquiring for businesses. Leumi Card commenced acquiring transactions for MasterCard credit cards during April 2002.

In the card-issuing sphere, the number of valid cards held by customers continued to rise in 2007, at the rate of 14% relative to 2006. The cards’ activity turnover increased in 2007 by 16% relative to 2006, compared with an increase of 11% in the system as a whole, according to data published by the Central Bureau of Statistics. The acquiring turnover rose during this period by 13%.

During the course of 2007, Leumi Card continued to expand the services being offered to its customers.
Leumi Card continued to offer prepaid, private label cards – cards that replace vouchers, both as gift cards and as loyalty cards in chain stores. Within this framework, the company issued over a million cards.

In addition, Leumi Card continued to lead the market in the issuance of revolving credit "Multi" cards. The number of valid Multi cards held by Leumi Card customers at the end of 2007 reached 282 thousand.

For business customers, the company offered services in the B 2 B (business to business) payments sphere, such as supplier cards, whereby the financial activity between a supplier and its customers is conducted through Leumi Card's system, and purchase cards, which provide a monetary refund to a business in respect of its purchases.

Profitability

Leumi Card's income, before operating, marketing, administrative and general expenses, amounted to some NIS 560 million in 2007, compared with some NIS 486 million in 2006.
Leumi Card closed 2007 with a net profit of NIS 104 million, compared with NIS 82 million in 2006, an increase of 27%.

The following table sets out a summary of income from credit card activity (in NIS millions):

	2007	2006
Net profit of Leumi Card Ltd. (after payment of interchange fees)	**104**	82
The Bank's share in interchange fees, before tax	**68**	64
Fees for membership and limitation of responsibility, before tax, collected by the Bank	**52**	51

In addition, the Bank collected interest totaling NIS 68 million in 2007 in respect of credit granted for the financing of credit card purchases (NIS 67 million in 2006).

The following table sets out data on credit card activities as presented in the various operational segments:

	House-holds	Private banking	Small businesses	Commercial banking	Corporate banking	Total
	2007					
	In NIS millions					
Profit from net interest income	**75**	**-**	**8**	**4**	**16**	**103**
Operating and other income	**594**	**2**	**18**	**15**	**43**	**672**
Total income	**669**	**2**	**26**	**19**	**59**	**775**
Provisions for doubtful debts	**13**	**-**	**-**	**-**	**2**	**15**
Operating and other expenses	**464**	**2**	**20**	**16**	**68**	**570**
Operating profit (loss) before taxes	**192**	**-**	**6**	**3**	**(11)**	**190**
The Group's share in the profits of companies included on the equity basis, net	**-**	**-**	**-**	**5**	**-**	**5**
Net profit (loss)	**136**	**-**	**4**	**7**	**(8)**	**139**

	House-holds	Private banking	Small businesses	Commercial banking	Corporate banking	Total
	2006					
	In NIS millions					
Profit from net interest income	60	-	5	6	14	85
Operating and other income	593	2	6	3	(9)	595
Total income	653	2	11	9	5	680
Provisions for doubtful debts	5	-	-	-	-	5
Operating and other expenses	498	3	10	7	19	537
Operating profit (loss) before taxes	150	(1)	1	2	(14)	138
Net profit (loss)	100	(1)	-	2	(11)	90

New Products

During 2007, Leumi Card began marketing a number of new products:
"Free" card – a card with no commissions (periodic and service commissions). The exemption from periodic commissions is conditional, *inter alia*, on the receipt of monthly credit card statements via the internet.
"Cash Card" card – a prepaid, re-loadable Visa card, for use in businesses and for withdrawing cash, which enables the execution of transactions up to the loaded sum, and is a local and international card.
"Gift Card" card – an electronic gift card which may be loaded with any sum needed. The card is sold at significant discounts, especially to committees, organizations and companies.

Interchange fees

On 30 October 2006, an arrangement was signed between Leumi Card, the credit card companies Isracard Ltd., Israel Credit Cards Ltd. and the banks that control them, which regulates the cross acquiring of Visa and MasterCard cards.

The arrangement is for a period of six and a half years and enables, for the first time, the cross acquiring of Visa and MasterCard brands by all three major credit card companies in Israel, this, as opposed to the cross acquiring arrangements that were customary up until then, which contained arrangements solely for Visa cards.

The arrangement includes, *inter alia*, determinations in respect of the rates of the interchange fees (the fees payable by the party acquiring a credit card transaction for the issuer of the credit card used to execute the transaction), which outlines a gradual reduction of the interchange fee over the period of the arrangement and the gradual downsizing of the range of categories that is customary today in relation to the rate of the interchange fee.

In addition, the arrangement contains guidelines that the parties will be obligated to comply with at the end of the period of the arrangement, should they wish to continue the cross acquiring amongst themselves, as well as various rules that will apply to the credit card companies, which are designed to ensure that fair competition is safeguarded and to prevent cross-subsidizing in the competition between the credit card companies.

The credit card companies, and the banks that control them, including the Bank, filed an application for the approval of the arrangement (the "Application") with the Antitrust Tribunal on 30 October

2006, as well as an application for the granting of a temporary permit to act in accordance with the arrangement during the interim period until its final approval. Concurrently, an urgent application was filed with the Antitrust Tribunal, with the consent of the Antitrust General Director, for the granting of a temporary permit, according to which, cross acquiring may be carried out in accordance with the principles of the arrangement.

On 31 October 2006, the tribunal granted temporary approval for the arrangement until a ruling on the temporary permit is issued. In addition, the tribunal announced that, in light of the parties' consent, it intended to grant a temporary permit for the arrangement until 31 May 2008 or until the ruling in the case itself is given, whichever is earlier.

On 31 October 2006, the tribunal decided to grant a temporary permit for the agreement. Recently, an application was filed by some of the parties objecting thereto to rescind the decision in favor of a temporary permit, alleging a lack to jurisdiction. After the responses of the applicants were filed, the tribunal rejected the application.

From December 2006 until February 2007 a number of objections to the application for approval of a restrictive agreement were filed on behalf of five companies.

MasterCard International also joined the proceeding, and notified the tribunal that it supports approval of the arrangement, while stipulating and restricting its modes of operation should it be requested to intervene in relation to determination of the interchange fee. The tribunal refused to approve Visa International's joining the proceeding.

Pursuant to a communication from the tribunal in this regard, the applicants expressed their consent to the joining of additional acquirers to the cross acquiring agreement, provided that the same conditions would apply to those acquirers, and provided that they participate in the costs for setting up the shared interface.

Following a preliminary hearing convened by the tribunal, which was held on 2 November 2007, and after hearing the parties' pleadings, the tribunal decided, on 11 November 2007, to appoint an expert who is to report directly to the Antitrust Authority. The tribunal decided that the expert would be required to present to the tribunal and to all parties to the case his detailed methodology for implementing the ruling on the methodology, prescribed in antitrust case 4630/01. Following the questioning of the expert in relation to his opinion, he will be required to continue carrying out his examination, until the interchange fee obtained from implementing the methodology is examined. It was further determined that the expert must complete his examination within eight months. Recently, an expert was appointed in this regard. An appeal on the tribunal's decision of 11 November 2007 was filed with the Supreme Court by Bank Hapoalim and Isracard Ltd., along with an application for a stay of execution of the tribunal's decision of 11 November 2007.

In the assessment of the Bank's Management, the new arrangement will not have a material impact on the Group.

Gamma Management and Clearing Ltd.

On 28 December 2005, Leumi Card purchased 20% of the shares of Gamma Management and Clearing, which is a leader in the field of the discounting of credit card transactions. Within the framework of the transaction, Leumi Card was granted an option to purchase an additional 67% of the company's shares and at a later stage all of the shares in the company, subject to the receipt of approval from the Antitrust General Director and the terms set in the sale agreement.

On 10 March 2008, an agreement was signed between the shareholders of Gamma and Leumi Card inclusively, and Phoenix Holdings Ltd., pursuant whereto, the Phoenix would purchase 49% of the issued and fully paid share capital of Gamma from the shareholders (20% of which constitutes Leumi

Card’s entire holding of Gamma) for the consideration of the aggregate amount of some NIS 64 million. It was further agreed that the Phoenix would provide shareholder loans of up to NIS 50 million to Gamma for the purpose of repaying the existing shareholder loans in Gamma. Completion of the transaction is contingent upon the fulfillment of certain conditions, including the approval of the Antitrust General Director. The expected after-tax profit to Leumi Card amounts to some NIS 19 million.

Profit Centers in the Group

The following table sets out details regarding the contribution of the Group’s main profit centers to the net operating profit:

	2007(1)	2006(1)	Change	**2007**(2)	2006(2)	Change
	NIS millions		%	NIS millions		%
The Bank	**1,934**	760	154.5	**2,127**	858	147.6
Consolidated companies in Israel (4)	**710**	364	95.1	**710**	364	95.1
Consolidated companies abroad (5)	**220**	157	40.1	**27**	59	(54.2)
Companies included on the equity basis (4)	**120**	173	(30.6)	**120**	173	(30.6)
Net operating profit	**2,984**	1,454	105.2	**2,984**	1,454	105.2(3)
Profit of the subsidiaries abroad, in nominal terms (US$ millions) (6)	**91**	72	26.4	**91**	72	26.4

(1) Translation adjustments in respect of overseas investments were offset against translation adjustments of the sources of financing at the Bank after the effect of taxes.
(2) According to the Financial Statements (not including translation adjustments of the sources of financing at the Bank).
(3) After neutralizing the effect of the special salary expenses, the net operating profit rose by 51.1%.
(4) Companies included on the equity basis of subsidiaries in Israel were included in consolidated companies in Israel.
(5) Following certain adjustments to Israeli accounting principles.
(6) As reported by the subsidiaries abroad, including branches abroad and minority interests (translation for convenience purposes).

Following are the main changes in the contributions of the profit centers (following translation adjustments):

The Bank

The increase in the net operating profit at the Bank derives mainly from:
- An increase of NIS 529 million in the net interest income;
- A decrease of NIS 416 million in the provisions for doubtful debts;
- An increase of NIS 367 million in operating income;
- A decrease of NIS 652 million in special salary expenses.

Subsidiaries in Israel

- The increase in the net operating profit of consolidated companies in Israel derives mainly from an increase in the profits of Leumi Mortgage Bank in the amount of NIS 169 million, mainly as a result of a reduction in the provisions for doubtful debts. In addition, the profits of Leumi & Co. improved by the sum of NIS 123 million, mainly as a result of the sale of a portion of the investment in Cellcom, the profits of the Arab Israel Bank improved by NIS 27 million and the profits of Leumi Card improved by NIS 22 million.

Subsidiaries Abroad

The decrease in profits in shekels of subsidiaries abroad derives from negative exchange rate differentials in respect of the investment in 2007, which were higher than the negative exchange rate differentials during the corresponding period in 2006, particularly in respect of the subsidiary in the United States. This rise in the negative exchange rate differentials was partially offset by an improvement in the profitability of the subsidiaries in the United States, Switzerland and in the United Kingdom. The total contribution to profit of the subsidiaries abroad, following the convenience translation to U.S. dollars, amounted to some US$ 79 million, compared with some US$ 64 million in the corresponding period in 2006. The contribution of the subsidiaries abroad in shekels, after certain adjustments to the accounting principles in Israel, and after offsetting the exchange rate differentials in respect of the sources of financing (after the effect of taxes), totalled NIS 220 million, compared with NIS 157 million in the corresponding period in 2006. Without the effect of the exchange rate differentials in respect of the net cost of the sources of financing, the profit of the subsidiaries abroad totaled NIS 27 million, compared with NIS 59 million in the corresponding period in 2006, a decrease of NIS 32 million, which arises mainly from exchange rate differentials in respect of the investments abroad.

The following table sets out a summary of the aforesaid data:

	For the year ended December 31	
	2007	2006
	NIS millions	
Profits of the subsidiaries in shekels (the Group's share)	**335**	237
Exchange rate differentials in respect of the investment	**(308)**	(178)
Exchange rate differentials in respect of the net cost of the sources of financing	**193**	98
Total contribution of the subsidiaries (after offsetting the net sources of financing)	**220**	157

For additional details on the subsidiaries, see pages 151-159.

The following table sets out the results of the subsidiaries abroad, as reported by them:

	2007	2006	Change
	In millions		%
Bank Leumi USA – US$	**35.1**	22.8	53.9
Bank Leumi (UK) – GBP	**12.1**	12.0	0.8
Bank Leumi (Switzerland) - CHF	**10.7**	13.2	(18.9)
Bank Leumi (Luxembourg) – EUR	**2.9**	1.9	52.6
Luxinvest - USD	**2.0**	7.7	(74.0)
Leumi Romania – RON*	**1.4**	(10.5)	-
Leumi Re – USD	**9.7**	5.3	83.0
Others – USD	**0.4**	0.8	78.8

1 RON = USD 0.407

Activities According to the Group's Structure

The volume of activities in Israel increased in 2007 by 5.0 % and by 1.0% abroad.

Credit to the public in activities in Israel totaled some NIS 173.6 billion at the end of 2007, compared with NIS 161.6 billion at the end of 2006, an increase of 7.4%. Credit to the public in activities abroad amounted to NIS 24.9 billion at the end of 2007, compared with NIS 22.2 billion at the end of 2006, an increase of 12.2%.

Deposits of the public in activities in Israel totaled some NIS 203.2 billion at the end of 2007, compared with NIS 195.8 billion at the end of 2006, an increase of 3.8%. Total deposits in activities abroad amounted to some NIS 34.8 billion at the end of 2007, a decrease of 3.3%.

The following table sets out a breakdown of operating profit after taxes (excluding companies included on the equity basis):

	2007	2006	Difference
	NIS millions		
The Bank (1)	**1,934**	760	1,174(3)
Consolidated companies in Israel (2)	**640**	363	277
Consolidated companies abroad (1)(2)	**226**	160	66
Total	**2,800**	1,283	1,517

(1) After neutralizing the effect of net exchange rate differentials in respect of the financing of investments abroad.
(2) Not including data of companies included on the equity basis controlled by them.
(3) After neutralizing the effect of special salary expenses, an increase of NIS 719 million.

In addition, income in Israel was recorded from the profits of companies included on the equity basis in the amount of NIS 184 million, compared with NIS 171 million in 2006. Total net operating profit in Israel totaled NIS 2,764 million in 2007, an increase of NIS 1,467 million, 113% compared with 2006, and after neutralizing special salary expenses, an increase of NIS 998 million.

Information According to Geographical Regions*

The following table sets out principal data according to geographical regions (in NIS millions):

	Total Balance Sheet			Credit to the Public			Deposits of the Public		
	December 31								
Region	**2007**	2006	Change	**2007**	2006	Change	**2007**	2006	Change
			%			%			%
Israel	**257,326**	244,956	5.0	**173,598**	161,577	7.4	**203,243**	195,787	3.8
United States	**22,427**	24,461	(8.3)	**13,371**	12,776	4.7	**17,774**	19,886	(10.6)
Great Britain	**11,027**	10,600	4.0	**7,860**	6,548	19.4	**9,033**	8,501	6.3
Switzerland	**3,110**	2,960	5.1	**2,192**	1,859	17.9	**543**	555	(2.2)
Luxembourg	**5,893**	4,748	24.1	**135**	147	(8.2)	**5,861**	5,877	(0.3)
Romania	**1,790**	1,044	71.5	**942**	443	112.6	**1,148**	735	56.2
Others abroad	**578**	572	1.0	**459**	414	10.9	**443**	482	(8.1)

* Categorized according to the location of the office.

The following table sets out a breakdown of the net profit by geographical area:

	NIS millions		
Region	**2007**	2006	% Change
Israel (1)	**3,308**	3,465	(4.5)
United States (2)	**(37)**	(85)	(56.5)
Great Britain (3)	**45**	138	(67.4)
Switzerland (4)	**9**	(1)	+
Luxembourg (5)	**26**	14	85.7
Romania (6)	**(29)**	(20)	-
Others abroad (7)	**35**	23	52.5
Total	**3,357**	3,534	(5.0)

The profit from activities abroad is shown according to the contribution in the consolidated financial statements.

1. Net profit in Israel increased by some NIS 157 million. Net operating profit at the Bank in Israel increased by some NIS 1,521 million (excluding companies included on the equity basis). The increase at the Bank derives mainly from the following:
   – an increase in net interest income of NIS 529 million;
   – a decrease in the provisions for doubtful debts of NIS 416 million;
   – an increase in operating and other income of NIS 367 million;
   – a decrease in operating expenses of NIS 329 million (of which, salaries accounted for NIS 334 million), of which, special salary expenses decreased by NIS 667 million.

   On the other hand, the decrease in the net profit from extraordinary items partially offset the aforesaid changes.
   In addition, the net profit increased at a number of subsidiaries in Israel, mainly: Leumi Mortgage Bank, Arab Israel Bank, Leumi Card and Leumi & Co.

2. The decline in the loss of the subsidiary in the United States derives from the increase in profits of the subsidiary, which was partially offset by appreciation of the shekel against the dollar, compared with a lesser appreciation in 2006.

3. The decline in the profits of the subsidiary in the United Kingdom derives from the negative exchange rate differentials, due to the appreciation of the shekel against the pound sterling, which was partially offset by the increase in the subsidiary's profits.

4. The profits of the subsidiary in Switzerland derive provisions in respect of an exceptional event recorded in 2006.

5. The increase in the profits derives from an improvement in the subsidiary's profitability.

6. The change in the loss in Romania derives from the appreciation of the shekel against the Ron, which was partially offset by improved profitability (move to profit).

7. The profit relates mainly to Leumi Re and derives from the release of insurance reserves in respect of pending claims.

For additional details, see note 28B to the Financial Statements.
For additional details of the profits of the subsidiaries abroad, as reported by them, see below, on pages 51-52.

Activities of Major Subsidiaries and Affiliates*

The Leumi Group operates in Israel and abroad through subsidiaries which are banks, a mortgage bank, finance companies and financial services companies. The Group also invests in non-banking corporations operating in the fields of insurance, infrastructure and real estate.

(See page 162 with regard to investments in non-banking corporations).

The Bank's total investments in subsidiaries and affiliates amounted to NIS 12,258 million on 31 December 2007, compared with NIS 12,778 million on 31 December 2006, and their contribution to the Group's net profit amounted to NIS 859 million, compared with NIS 600 million in 2006. After offsetting translation adjustments in respect of overseas investments, their contribution to profit was NIS 1,052 million, compared with NIS 696 million in 2006.

The following table sets out the breakdown of the contribution of the Bank and its subsidiaries and affiliates to the net profit of the Group [(1)]:

		Return on Group's Investment		Contribution [(1)] to Group's Profit		
		2007	2006	**2007**	2006	Change
		%	%	NIS millions		%
The Bank [(2)]		**-**	-	**2,305**	2,836	(18.7)
Consolidated subsidiaries in Israel, total		**10.9**	8.0	**709**	366	93.7
of which:	Leumi Mortgage Bank	**11.7**	2.8	**219**	50	338.0
	Arab Israel Bank	**24.6**	17.9	**88**	61	44.3
	Leumi Card	**86.6**	-	**104**	82	26.8
	Leumi & Co. Investment House [(3)]	**39.9**	2.4	**128**	5	-
	Leumi Securities and Investments (previously Psagot Ofek)	**1.5**	14.2	**12**	41	(70.7)
	Leumi Capital Market Services Ltd. (previously Leumi Gemel)	**3.6**	-	**20**	38	(47.4)
	Leumi L.P. Ltd. (previously Leumi-Pia)	**-**	-	**(1)**	26	-
	Leumi Real Holdings	**13.4**	4.2	**65**	17	282.4
	Leumi Industrial Development	**3.7**	1.5	**4**	2	100.0
	Leumi Agricultural Development	**1.8**	5.9	**1**	4	(75.0)
	Leumi Finance	**6.5**	4.2	**10**	7	42.9
	Leumi Leasing and Investments	**5.5**	3.4	**43**	24	79.2
	Others	**3.1**	2.8	**16**	9	77.7
Overseas consolidated subsidiaries, total [(2)]		**5.0**	3.6	**223**	157	42.0
of which:	Leumi USA (BLC)	**3.9**	1.0	**92**	24	283.3
	Leumi (UK)	**10.1**	12.0	**77**	114	(32.5)
	Leumi Switzerland	**2.3**	0.4	**14**	3	366.7
	Leumi Luxembourg	**14.1**	9.9	**17**	11	54.5
	Leumi Romania	**-**	-	**(19)**	(26)	+
	Leumi Re	**36.1**	25.0	**37**	26	42.3
Companies included on the equity basis, total		**10.2**	12.2	**120**	173	(30.6)
Group's total net profit		**17.4**	20.1	**3,357**	3,534	(5.0)

(1) The profit (loss) shown is according to the Group's share in the results. The profit from the sale of holdings in companies is attributed to the Bank.
(2) Translation adjustments in respect of overseas investments were offset against translation adjustments of the financing sources at the Bank after the effect of taxes. For details on profitability without the offset of translation adjustments see below on page 151.
(3) Including the profit and/or loss of the companies included on the equity basis of Leumi & Co.
See Note 28 to the Financial Statements for further details.
See Note 6 to the Financial Statements concerning the investment in and contribution to Group profit of each of the major subsidiaries.
* Definition of subsidiaries and affiliates – see Note 1E(1) to the Financial Statements.

Consolidated Subsidiaries in Israel

The Bank's total investments in consolidated subsidiaries in Israel amounted to NIS 5,201 million on 31 December 2007, compared with NIS 6,130 million on 31 December 2006. Their contribution to Group net profit amounted to some NIS 709 million in 2007, compared with NIS 366 million in 2006, an increase of NIS 343 million, or 93.7%. The increase in profit stems mainly from a decrease in the profits of Leumi Mortgage Bank, Leumi & Co., Arab Israel Bank and Leumi Card. The Group’s return on investment in the above companies was 10.9% in 2007 compared with 8.0% in 2006.

Financial and other data concerning the major consolidated subsidiaries is presented below on the basis of their financial statements:

The Arab Israel Bank Ltd.

The Arab Israel Bank was established in 1960 with the object of providing financial services to and providing a solution for the special requirements of the Arab population.

The Arab Israel Bank operates through 26 branches, situated mainly in the north of Israel and in the northern "Triangle", serving the Arab sector. Arab Israel Bank engages in the entire range of banking activities. The Arab Israel Bank's total assets amounted to NIS 4,216 million at the end of 2007, compared with NIS 3,927 million at the end of 2006. Net profit of the Arab Israel Bank totaled NIS 88.5 million in 2007, compared with NIS 61.6 million in 2006, an increase of 43.7%. The net return on shareholders' equity reached 23.4% in 2007, compared with 17.3% in 2006.

Shareholders' equity of the Arab Israel Bank amounted to NIS 334 million as at 31 December 2007, compared with NIS 335 million as at 31 December 2006. The Arab Israel Bank distributed a dividend of NIS 90 million for 2007.

The ratio of equity to risk assets reached 16.38% as at 31 December 2007, compared with 19.49% as at 31 December 2006.

Medium and Long-Term Financing Companies(1)

The assets of these companies amounted to NIS 11.0 billion at the end of 2007, compared with NIS 7.5 billion at the end of 2006. The business activity of these companies complements the activity of the Bank. The net profit of these companies amounted to some NIS 61.1 million in 2007, compared with NIS 35.8 million in 2006.

Below are details concerning the main companies:

Leumi Leasing & Investments Ltd.

The company finances the acquisition of equipment pursuant to medium and long term leases and also operates as a complementary unit to the Construction and Real Estate Division of the Group.
The balance of credit to the public totaled NIS 976 million as at 31 December 2007, compared with NIS 671 million at the end of 2006.
The company’s total assets totaled NIS 1,071 million as at 31 December 2007 as compared with NIS 938 million at the end of 2006.
The net profit in 2007 totaled NIS 43.4 million, compared with a profit of NIS 23.8 million in 2006.

(1) Including Leumi Industrial Development, Leumi Agricultural Development, Leumi Finance Company and Leumi Leasing & Investments.

Leumi Finance Company Ltd.

The company serves as the Leumi Group's vehicle for the issue of debentures to the Israeli public. The proceeds of these issues are earmarked for deposit at the Bank for its use, at its discretion and its responsibility.

Total assets of the company amounted to NIS 9,689 million at the end of 2007, compared with NIS 6,343 million at the end of 2006. Shareholders' equity amounted to NIS 157 million as at 31 December 2007. The company's net profit amounted to NIS 10.3 million in 2007, compared with net profit of NIS 6.8 million in 2006.

The Bank has undertaken to indemnify Leumi Finance in respect of amounts that it is unable to pay, in respect of the indemnity that it granted to its directors and other officers and also to the lawyers of the said issues, with regard to these issues.

See page 20 above regarding the issue of capital notes by the company.

Leumi Industrial Development Ltd.

Leumi Industrial Development's total assets amounted to NIS 104 million at the end of 2007, similar to the amount at the end of 2006. Shareholders' equity amounted to NIS 104 million as at 31 December 2007. The net profit of Leumi Industrial Development amounted to NIS 3.9 million in 2007, compared with a net profit of NIS 1.6 million in 2006.

Leumi Agricultural Development Ltd.

Leumi Agricultural Development's total assets amounted to NIS 100 million at the end of 2007, compared with NIS 102 million at the end of 2006. Shareholders' equity amounted to NIS 100 million as at 31 December 2007. The net profit of Leumi Agricultural Development amounted to NIS 3.6 million in 2007, similar to the net profit in 2006.

Leumi Mortgage Bank Ltd.

Leumi Mortgage Bank was founded in 1921 and is the oldest mortgage bank in Israel.

Leumi Mortgage Bank mainly concentrates its activities on granting loans to apartment purchasers, loans for construction and renovation of real estate and loans for any financing purpose related to pledging existing residential properties.

Total credit to the public at Leumi Mortgage Bank was NIS 35.8 billion at the end of 2007, compared with NIS 33.0 billion at the end of 2006, an increase of 8.3%. This amount does not include credit from deposits according to the extent of collection totaling NIS 8.0 billion, compared with NIS 8.2 billion at the end of 2006, which, in accordance with the directives of the Supervisor of Banks, may not be included in the balance of credit to the public in the balance sheet.

Leumi Mortgage Bank's share of the credit portfolio in the mortgage bank system as at 31 December 2007, according to the Bank of Israel report on activities, was 25.9% including credit to contractors.

Leumi Mortgage Bank's total assets amounted to NIS 36.0 billion on 31 December 2007, compared with NIS 33.3 billion at the end of 2006, an increase of 8.2%.

The net profit of Leumi Mortgage Bank amounted to NIS 219 million in 2007, compared with NIS 50 million in 2006, an increase of 342.3%. The net return on shareholders' equity came to 11.6% in 2007, compared with 2.9% in 2006.

Shareholders' equity of Leumi Mortgage Bank amounted to NIS 2,024 million at the end of 2007, compared with NIS 1,800 million at the end of 2006, an increase of 12.4% which stems mainly from accumulated net profit.

The capital adequacy ratio (ratio of shareholders' equity to risk assets) was 9.96% at the end of 2007, compared with 9.69% at the end of 2006. The minimum rate required by the Supervisor of Banks is 9.0%.

Leumi Mortgage Bank received a guarantee from the Bank in the sum of NIS 3 million (NIS 4 million in 2006) to secure a group of loans.

Leumi Mortgage Bank operates through representative offices spread throughout the country and its operations in Leumi branches (80 mortgage desks) and through 9 independent branches.

In consideration for the use of the Bank's branches, communications and other services, Leumi Mortgage Bank paid NIS 34 million to the Bank in 2007, as compared with NIS 31 million in 2006.

On 1 January 2006 the Supervisor of Banks of the Bank of Israel published a circular regarding the manner of calculation of the provision for doubtful debts in respect of housing loans. The new circular applies as from the financial statements as at 31 March 2006.

The effect of the circular, which applies from the first quarter of 2006, on the provision for doubtful debts, according to the figures as at 31 December 2005, was the addition of some NIS 64 million. The said gap derives primarily from the reduction of the provisions as of the balance sheet date in respect of assets that were realized and their consideration received after the balance sheet date, from the clearance of loans in arrears after the balance sheet date, assets whose realization is expected in the near future and also receipts expected in respect of insurance indemnities. According to the directive issued by the Supervisor of Banks, the reduction of the provision in the cases noted will only be made in the event that the cash is received by the bank before the date of the financial statements.

Regarding the legal claims against Leumi Mortgage Bank – see Notes 18 I(3) to I(4) to the Financial Statements.

Leumi & Co. Investment House Ltd (“Leumi & Co.”)

Leumi & Co. is the non-banking investments vehicle of the Leumi Group and specializes in providing a full range of investment banking services, business and financial services, capital raising and investments, mergers and acquisitions services, organizing public and private issues, economic advice and appraisals. With regard to underwriting services, see paragraph D below.

Leumi & Co. employs a staff of 134 people, most of whom are economists, accountants and other academics.

Leumi & Co. ended 2007 with a profit of NIS 134 million, compared with a profit of NIS 13 million in 2006.

Shareholders' equity as at 31 December 2007 totaled NIS 492 million, compared with NIS 264 million at the end of 2006.

Below are details concerning the development of the main fields of activity:

A. Investments in Non-Banking Companies

Leumi & Co. is responsible for the management of the non-banking holdings portfolio of the Leumi Group.
Leumi & Co. engages in initiating, locating and carrying out direct investments in businesses and companies. Leumi & Co. has invested in 53 companies, venture capital funds and private equity funds active in the fields of hi-tech, communications, commerce and real estate. The balance of the investments and undertakings to invest in these companies and businesses as at 31 December 2007 amounted to some NIS 1,261 million.

The non-banking investment policy of the Leumi Group is in line with the restrictions of the Banking (Licensing) Law, minority holdings of up to 20% of all forms of control, without control. The Group focuses on investments with potential for long-term returns.

With regard to investments in companies, the following considerations, *inter alia*, are taken into account:

- The quality of the partners, management ability and control systems.
- Examination of risks, exposures and their realization.
- Estimation of economic and accounting returns in the long-term, with a view to achieving a positive contribution to profitability, compared with marginal returns on capital, and while examining up-side possibilities.
- Synergy with group businesses and widening the variety of sources of income.
- Matching the scope of the investment to the management resources required for it.

The non-banking investment portfolio combines investments in companies and funds, where the choice of funds places emphasis on the quality of the management team and organizational infrastructure, historical performance, investment strategy, the contribution of the investment to the risk spread in relation to the existing portfolio, terms of participation (legal structure of the fund, management agreements, partnership agreements and management costs of the fund) and the identity of additional partners.

Leumi & Co. invests in non-banking corporations as an auxiliary corporation under the provisions of the Banking (Licensing) Law. Since it is unable to control the companies in which it has invested in the light of legal restrictions, Leumi & Co. stringently examines the quality of the management, the stability of the partners and the nature of the investment.

The investment portfolio of Leumi & Co. includes, *inter alia,* holdings in:

- Super-Pharm Israel Ltd., Israel's leading drugstore chain
- Cellcom Israel Ltd., which operates a cellular phone network.
- Africa Israel Properties Ltd., which is responsible for the activities of the Africa Israel Group in initiating, establishing and operating structures for industry, office space and commerce in Israel and abroad.
- Netafim (A.C.S) Ltd., which engages in the production and marketing of irrigation systems (through Tene Irrigation Investment Fund L.P.).
- Yashir I.D.I. Insurance Co. Ltd.
- Fox-Wizel Ltd, which engages in designing, manufacturing and marketing clothing and fashion accessories.
- Keshet Broadcasting Ltd., which is one of the two license holders of the Second Television Channel.
- Technorov Holdings (1993) Ltd., which invests in hi-tech companies.
- Tene Investment in the Kibbutzim Industries Fund and Tene Growth Capital (Investment Fund), which specialize in investments in mature companies among kibbutz industries.
- Hanita Coatings R.C.A. L.P., which engages in the development, metallization, coating and covering of films and polymer sheets.
- Caesar Stone Ltd., which manufactures and markets quartz surfaces (through Tene Quartz Surfaces Investment Fund L.P.).
- Lumenis Ltd., which manufactures laser equipment for beauty and medical treatments (through L.M. Partners L.P.).
- Aman Holdings (A.C.S) Ltd. which engages in high pressure casting and the manufacture of aluminum alloy products and brass (through Tene High Pressure Casting Investment Fund L.P.).
- In addition, Leumi & Co. has invested NIS 324 million in venture capital, real estate and private equity funds out of undertakings to invest some NIS 667 million. The balance of the amount will be transferred to the funds on request.

B. Strategic Cooperation with an Overseas Investment Bank

Leumi & Co. has signed a strategic cooperation agreement with the Jefferies Broadview investment bank for the provision of investment banking services in the fields of mergers and acquisitions, issues and capital raising abroad, with a focus on companies active in the fields of technology and the life sciences.

Jefferies Broadview is a leading investment bank in the USA and one of the major market-makers on the NASDAQ and the New York Stock Exchange.
The Broadview Group, a division of Jefferies, has been one of the dominant investment bankers in the M&A market for Israeli technology companies in the last decade.

C. Investment Banking Services

Leumi & Co. assists its customers in executing merger and acquisition transactions. The services are provided to Israeli and foreign companies wishing to effect strategic expansion by way of acquisition, or to investors or controlling shareholders interesting in selling or reducing their investments.

The basket of services within this framework includes: assistance in the definition of the company's requirements and strategic objectives, the determination of the optimal investment/investor for the achievement of those objectives, the identification of target investments/investors on a global basis, assistance in making contact with the target company, involvement in negotiations until their conclusion, deal structuring in a manner that serves the customer's objectives and assistance in accessing sources of finance for the transaction.

In its operations, Leumi & Co. cooperates with investment houses and other entities in Israel and around the world.

D. Underwriting and Management of Issues

Until 1 July 2007, Leumi & Co. engaged in the management of public and private issues through its subsidiary, Leumi & Co. Underwriters Ltd. Leumi & Co. Underwriters provided issuing companies with all the services required for the issue: structuring the issue, setting up a consortium of underwriters and marketing the issue.
The company ended 2007 with a net profit of NIS 4.1 million compared with NIS 9.5 million in the previous year.

From 1 July 2007, following the coming into effect of the Securities (Underwriting) (Amendment) Regulations, 2007, which imposed significant restrictions on the management of issues by underwriting companies in which a banking corporation has a holding of 20% or more, Leumi & Co. Underwriters assumed the status of an inactive underwriter and suspended its underwriting activity. From this date, Leumi & Co. has been active in underwriting through Psagot Leumi & Co. Underwriting Ltd., a company in which Leumi & Co. holds 19.99% of the capital and the voting rights. The remaining rights in the company are held by Psagot Ofek Investment House (Finances) Ltd.

E. Economic Analyses and Appraisals

The subsidiary National Consultants (Natconsult) Ltd. engages in economic analyses, economic appraisals and financial counseling for economic entities in the Israeli economy.
The company prepares economic studies and valuations for capital raising purposes, the examination of investments and the extension of credit.
In addition, the company reviews the large companies traded on the Israeli capital market on an ongoing basis as well as many Israeli companies traded on NASDAQ, for Bank Leumi, and for institutional entities.

G. Leumi Start Venture Capital Fund

Leumi & Co. manages the Leumi Start Ltd. venture capital fund through the management company Leumi Start Management (2000) Ltd. (a wholly-owned subsidiary). The two companies were established in 2000. Leumi Start Ltd. is a fund of the Fund of Funds type, which has raised some NIS 72 million from private customers and the Bank, and has invested in five venture capital funds. The state of the fund is influenced by the state of the companies and the technological ventures in which the venture capital funds have invested, the state of the economy worldwide and of the technology sector in particular.

Overseas Consolidated Companies, Branches and Agencies

The Group's international activity is carried out by a network of subsidiary companies, branches, agencies and representative offices spread across 21 countries in 86 offices and branches. The Bank's main units are located in the world's most important financial centers: New York, London, Zurich and Luxembourg.

The Group's deployment overseas is operated in order to maximize the business potential of Israeli business customers, local middle-market customers that operate in sectors of the economy in which Leumi has the expertise, know-how and resources needed to provide financial services, international entities active in Israel and local Jewish communities where the units and representative offices are located. The Bank's major overseas target population is commercial companies and wealthy private customers. These customers receive a range of services, such as private banking services, investment financing, foreign trade and transactions in foreign currency and their derivatives. The cooperation between the overseas units and the Bank in Israel and amongst the overseas units enables maximum utilization of the relative advantage of each and every unit.

The Bank has decided to extend the Group's international activity, both by expanding existing activity and through acquisitions and mergers. In light of this decision, the acquisition of a bank in Romania was completed in August 2006. The bank operates 35 branches and agencies and engages in a wide range of financial activity, including taking of deposits, granting credit, international trade and foreign currency activity.

In parallel with the launching of the strategic aim of expanding the Bank's international activity and as a constituent part thereof, the Bank is reinforcing the monitoring and control of its overseas units.

For this purpose, a department which collects information regarding exposure to risks at the subsidiaries was established in the International and Private Banking Division. This department will engage in ongoing monitoring, analysis, identification, mapping and evaluation of material points of risk in the overseas subsidiaries. This unit will report to the Board of Directors of the Bank on a quarterly basis on ongoing developments and special findings.

The Bank's total investment in overseas units amounted to NIS 4,409 million at the end of 2007, compared with NIS 4,382 million at the end of 2006.

The following table sets out the contributions of the major overseas consolidated companies to the Group's net profit:

	Yield on the Group's investment				Contribution to the Group's profit					
	For the year ended December 31									
	2007*	2006*	**2007****	2006**	**2007***	2006*	**2007****	2006**	Rate of change	
	%		%		NIS millions				%	%
Leumi USA (B.L.C.)	**3.9**	1.0	**-**	-	**92**	24	**(42)**	(91)	283.3	+
Leumi UK	**10.1**	12.0	**5.8**	14.6	**77**	114	**45**	138	(32.5)	(67.4)
Leumi Switzerland	**2.3**	0.4	**1.6**	-	**14**	3	**10**	(1)	+	+
Leumi Luxembourg	**14.1**	9.9	**15.3**	11.1	**17**	11	**18**	13	54.5	38.5
Leumi Re	**36.1**	25.0	**30.3**	19.8	**37**	26	**31**	21	42.3	47.6
Leumi Romania	**-**	-	**-**	-	**(19)**	(26)	**(29)**	(20)	+	(45.0)
Others	**2.2**	3.2	**-**	-	**5**	5	**(3)**	(1)	-	-
Total of overseas consolidated companies	**5.0**	3.6	**0.7**	1.4	**223**	157	**30**	59	42.0	(49.2)

* Translation adjustments in respect of the overseas investments have been set-off against the translation adjustments in respect of the Bank's sources of finance after the effect of tax. The following are the amounts offset:
Leumi USA-NIS (134.5) million in 2007, compared with NIS (115.5) million in 2006.
Leumi UK-NIS (32.3) million in 2007, compared with NIS 24.4 million in 2006.
Leumi Switzerland-NIS (4.2) million in 2007 compared with NIS (3.2) million in 2006.

** According to the financial statements.

The contribution of the consolidated overseas companies, including exchange rate differentials in respect of the investment, to the Group's reported net profit in shekels in 2007 amounted to a profit in the sum of NIS 27 million, compared with a profit of NIS 59 million in 2006.

The change in the contribution to profit derives mainly from the effect of the appreciation of the shekel against the dollar, the Swiss franc and the pound sterling, which was partially offset by the depreciation of the shekel against the euro. The net effect of the exchange differentials was to decrease the profits by NIS 308 million in 2007 compared with a NIS 178 million decrease of profits in 2006. The net financing expenses that were incurred by the Bank and partially offset these exchange differentials amounted to some NIS (193) million in 2007 compared with NIS (98) million in 2006.

The following table sets out a summary of the above data:

	For the year ended 31 December	
	2007	2006
	In NIS millions	
The units' profits in shekels (the Group's share of operating activities)	**335**	237
Exchange rate differentials in respect of the investment	**(308)**	(178)
Total	**27**	59
Exchange rate differentials in respect of the cost of sources of finance, net	**193**	(98)
Total contribution of the units (after offsetting the sources of finance, net)	**220**	157

The following table sets out details of the net profit (loss) of the overseas units, as reported by them:

	2007	2006	Change
	In millions		%
Bank Leumi USA ($)	**35.1**	22.8	53.9
Bank Leumi UK (£)	**12.1**	12.0	0.8
Bank Leumi Switzerland (CHF)	**10.7**	13.2	(18.9)
Bank Leumi Luxembourg (euro)	**2.9**	1.9	52.6
Luxinvest ($)	**2.0**	7.7	(74.0)
Leumi Romania (ron)	**1.4**	(10.5)	-
Leumi Re ($)	**9.7**	5.3	83.0
Other ($)	**0.4**	0.8	(50.0)

The following table sets out a summary of the assets and liabilities of the Bank's overseas units and branches (in US$ millions* prior to offsetting mutual balances):

	31 December	
	2007	2006
Credit to the public	**6,450**	5,208
Deposits with banks	**2,235**	2,362
Securities	**3,590**	3,661
Other assets	**452**	401
Total	**12,727**	11,632
Deposits of the public	**9,366**	8,669
Deposits from banks	**944**	578
Other liabilities	**1,252**	1,288
Shareholders' equity	**1,165**	1,097
Total	**12,727**	11,632
Total trust deposits and managed securities	**11,274**	9,373

The assets of the consolidated foreign subsidiaries and overseas branches of the Bank amounted to NIS 49 billion (US$ 12.7 billion) at the end of 2007, compared with NIS 49.1 billion (US$ 11.6 billion) at the end of 2006.

* The translation to US dollars is a convenience translation of the data according to the representative rates of exchange on 31 December 2007 and 31 December 2006, respectively.
- The amounts are as published by the subsidiaries.
- The data in shekel terms are presented in the report according to sectors - see Note 28 to the Financial Statements.

The following table sets out principal data regarding the Bank's overseas units (in US$ millions) on 31 December 2007:

	USA	UK	Switzerland	Luxembourg	Romania
Total assets	**5,828**	**2,853**	**850**	**807**	**440**
Credit to the public	**3,453**	**2,019**	**565**	**35**	**245**
Deposits of the public	**4,852**	**2,386**	**202**	**742**	**301**
Shareholders' equity	**600**	**190**	**149**	**43**	**89**
Trust deposits and managed securities	**3,468**	**581**	**5,689**	**707**	**2**
Net profit	**35**	**24**	**10**	**3**	**0.5**
Return on equity (%)	**6.8**	**14.3**	**6.8**	**11.8**	**1.5**

The net profit of all the consolidated overseas companies, including overseas branches, as published by them, totaled US$ 91 million in 2007, compared with US$ 72 million in 2006, an increase of US$ 19 million.

The contribution of the overseas units to the net profit in shekels of the Group in 2007 totaled NIS 27 million, compared with NIS 59 million in 2006, a decrease of 54.2%

The decrease in the units' contribution in shekels derives from negative exchange rate differentials in respect of the overseas investments as compared with lower negative exchange rate differentials in 2006, which was partially offset by the increase in the profitability of the units in the United States, Luxembourg and Romania.

See Notes 6 and 28 to the Financial Statements for further details concerning the contribution of the units to the Group's profit.

Bank Leumi le-Israel Corporation

Bank Leumi le-Israel Corporation (“BLL Corp.”) was incorporated in the United States in 1984 and is a wholly owned subsidiary of the Bank. BLL Corp. is defined under US law as a bank holding company, and its principal activity is the holding of its subsidiary, Bank Leumi USA.

BLL Corp.’s total assets amounted to US$ 5.8 billion as at 31 December 2007, similar to the end of 2006, and the annual profit amounted to US$ 35.1 million, compared with US$ 30.1 million in 2006, an increase of 16.4%.

The return on equity of BLL Corp. reached 6.8%, compared with 6.3% in 2006.

As at 31 December 2007, the equity amounted to US$ 600 million. The ratio of equity to total assets was 10.3% and the ratio of equity to risk assets was 12.3%.

In 2004, BLL Corp., together with a professional entity and additional private investors, participated in establishing an investment company (SBIC), which is incorporated as a limited partnership, under a US government program to encourage small businesses - the Small Business Investment Program (SBA Act) which is operated by a government entity, the Small Business Administration (“SBA”).

BLL Corp. has undertaken to invest US$ 12.5 million, and all the other limited partners together have undertaken to invest a further US$ 43.4 million. The SBA has given an undertaking for matching financing up to a ratio of 2:1.

In the years 2004 to 2007, BLL Corp. invested some US$ 8.7 million, and less accrued expenses the balance of the investment as at 31 December 2007 totaled some US$ 5.6 million.

Bank Leumi USA

Bank Leumi USA (BLUSA), incorporated in 1968, holds a commercial banking license from the State of New York and is a member of the FDIC (Federal Deposit Insurance Corp.). BLUSA has three branches in the State of New York, four branches in California, three branches in Florida, two in Illinois and an additional branch in the Cayman Islands.

BLUSA engages in commercial banking, primarily in financing medium and larger sized local companies, in international banking and also private banking for US and non-US residents. BLUSA offers full banking services to Israeli companies and to Israeli residents interested in the products and services of an American bank.

BLUSA’s consolidated assets amounted to US$ 5.8 billion on 31 December 2007, similar to at the end of December 2006. Total shareholders’ equity amounted to US$ 455 million on 31 December 2007 compared with US$ 416 million at the end of 2006. Credit to the public totaled US$ 3,453 million at the end of 2007, an increase of 15.1%, while deposits of the public, which totaled US$ 4,888 million, increased by 2.1%.

Customers’ managed securities portfolios, which are not included in the balance sheet, totaled US$ 3,468 million at the end of 2007, compared with US$ 2,932 million at the end of 2006.

BLUSA ended 2007 with a net profit of US$ 30.5 million, compared with US$ 25.8 million in 2006.

The return on equity of net profit in 2007 was 7.6% compared with 7.1% in 2006.

The balance of the provision for doubtful debts amounted to US$ 63 million at the end of 2007, constituting 1.8% of total credit to the public. This provision is 2.8 times more than the non-performing loans.

The ratio of equity to total assets was 7.8% (7.2% in 2006) and the ratio of equity to risk assets was 11.03% (11.5% in 2006). These ratios exceed the US supervisory authorities’ capital adequacy requirements.

BLUSA established and has been operating since June 2001, a wholly-owned brokerage company in New York called Leumi Investment Services Inc. ("LISI"), through which most of the securities transactions for BLUSA's customers are carried out.

LISI holds a license from the NASD to engage in securities brokerage operations and serves BLUSA's private banking customers, including both US and non-US residents. LISI acts as an agent/broker/dealer and engages in purchasing and selling securities for and on behalf of its customers and executes options transactions ancillary to securities transactions, for its customers. The company acts as an agent in the sale of insurance and in the marketing of mutual funds managed by large investment houses.

As part of BLUSA's business activity, leasing activity was expanded through a subsidiary. In addition, private banking activity for international customers was expanded through the establishment of a new unit for the management of international private banking customers in Aventura, Florida. Some of the activities carried out in New York has been transferred to this unit. In parallel, BLUSA expanded private banking activity for wealthy local customers.

BLUSA is taking steps to expand the volume of its activity both by expanding its network of branches and also by locating opportunities for acquisitions and mergers.

At the beginning of 2008, BLUSA decided to replace most of its existing computer systems (and ancillary infrastructures). Negotiations are being held with suppliers and it is anticipated that they will be completed during the first half of 2008. The project will continue for 2 to 3 years and is estimated to cost some US$ 33 million.

As the result of an audit conducted by the supervisory authorities in the USA, BLUSA has taken steps to improve and strengthen its controls and procedures in respect of the prevention of money laundering.

For details of an SEC investigation see the section "Legal Proceedings" on page 203 below.

The Bank's Branches and Agency

The Bank operates an agency in New York, a branch in Panama and a branch in Georgetown.

Total assets of the agency in New York and the branches in Panama and Georgetown amounted to some US$ 1,196 million at the end of 2007 (before offsetting mutual balances), compared with some US$ 934 million at the end of 2006. Credit to the public totaled US$ 110 million at the end of 2007, compared with US$ 103 million at the end of 2006. Deposits of the public totaled US$ 887 million at the end of 2007, compared with US$ 880 million at the end of 2006. The profit for 2007 amounted to US$ 4.9 million, compared with US$ 2.6 million in 2006.

The Panama branch provides banking services, including credit and international trade activities. The majority of its customers are business customers from the Panama free trade zone that import merchandise from the Far East and export it mainly to Central and South American countries. The principal services for these customers are within the fields of international trade and short-term financing.

The Georgetown branch is registered in the Cayman Islands and operates in accordance with the local laws and directives. The branch's principal activity is to accept deposits of Israeli customers, both private customers and companies.

Bank Leumi (UK)

Bank Leumi (UK) plc was founded in 1959 and continues the activity of the Group in England that began in 1902. It is currently the largest Israeli owned bank in the UK. The subsidiary operates in London, and through a branch in Manchester and a banking subsidiary in the Island of Jersey, and also through a trust company in Jersey, Leumi Overseas Trust Corporation Limited, which is wholly-owned by Bank Leumi (Jersey) Ltd.

Bank Leumi (UK) engages in commercial and private banking. The commercial banking activity includes real estate financing, international trade, Israel-related business and Israeli companies active in the UK.

Bank Leumi (UK) finances a wide range of activities in the real estate field in the UK and Western Europe, including real estate investment and development and financing of commercial and residential real estate. The financing is provided to both local and non-resident customers.

Since 2005, Bank Leumi (UK) has expanded its activity through the acquisition of private banking activity in Jersey and in London. Bank Leumi (UK) has also recruited a team that specializes in financing international commodity trade, and thus added to its many years of experience in the field of financing international trade and expanded its customer base.

In 2006, in order to expand the range of products offered to its customers, Bank Leumi (UK) established a subsidiary, Leumi ABL Ltd., to operate in the field of asset based lending, including invoice discounting and factoring. The company began operating in offices in the south of England in June 2006.

In July 2007, Bank Leumi (UK) opened a representative office in Israel, in order to expand its private banking business.

In October 2007, Mr. Menachem Friedman was appointed as Managing Director and CEO of Bank Leumi (UK). Mr. Friedman has thirty years of experience within the Leumi Group, during which he served in a variety of senior management positions. Mr. Baruch Lederman, the previous CEO, has returned to the Bank in Israel and has been appointed Head the Banking Division.

Total consolidated assets of Bank Leumi (UK) amounted to £ 1,423 million at the end of 2007, compared with £ 1,277 million at the end of 2006.

Deposits of the public increased from £ 1,044 million at the end of 2006 to £ 1,190 million at the end of 2007. Bank Leumi (Jersey)'s portion of the balance of deposits at the end of 2007 was £ 239 million.

Credit to the public expanded from some £ 788 million at the end of 2006 to £ 1,007 million at the end of 2007. Bank Leumi (Jersey)'s portion of the balance of credit at the end of 2007 was £ 130 million.

Capital, reserves and surpluses totaled some £ 95 million on 31 December 2007, compared with some £ 91 million at the end of 2006.

Bank Leumi (UK)'s board of directors resolved to change its mix of shareholders' equity, and at the end of 2006, Bank Leumi (UK) increased its Tier II capital by £ 30.6 million by means of the issue of a subordinated loan to the Bank in this amount, while decreasing its Tier I capital by the distribution of a dividend of £ 3.10 per share, for a total of £ 30.6 million.

In November of 2007, Bank Leumi (UK) increased its Tier II capital by £ 7.5 million and in February 2008, it increased its Tier II capital by £ 5.0 million.

The purpose of the change in the capital mix was to match the capital structure of Bank Leumi (UK) to the standard in the banking industry in the UK. This capital mix will be maintained with the expansion of the bank.

The consolidated net profit of Bank Leumi (UK) amounted to £ 12.1 million in 2007, compared with £ 12.6 million in 2006, a decrease of 4.0%.

The return on equity of net profit in 2007 amounted to 14.3%, compared with 11.5% in 2006. The capital to total assets ratio was 6.7% (7.1% in 2006) and the capital to risk assets ratio was 14.13% (in 2006 – 15.85%).

Bank Leumi Switzerland

Bank Leumi (Switzerland) (above and below "Bank Leumi Switzerland"), was founded in 1953.

Bank Leumi Switzerland has two branches, in Zurich and Geneva. Bank Leumi Switzerland also has a wholly-owned subsidiary that manages mutual funds, the closing of which began at the end of 2007, and two representative offices, in Israel and Hungary. Bank Leumi Switzerland specializes in providing private banking services to international customers, including receiving trust deposits, selling structured products, managing discretionary accounts and managing securities investment portfolios.

Total assets of Bank Leumi Switzerland amounted to CHF 956 million at the end of 2007, compared with CHF 903 million at the end of 2006. The profit in 2007 amounted to CHF 11 million, compared with CHF 12 million in 2006, a decrease of 8.3%.

Total capital and reserves, including inner reserves, amounted to CHF 167 million at the end of 2007 (of which CHF 2 million was inner reserves), compared with 2006 when this amount stood at CHF 220 million (of which CHF 3 million was inner reserves).

Bank Leumi Switzerland's board of directors resolved in February 2007 to change its mix of shareholders' equity by increasing its Tier II capital by CHF 50.0 million by means of the issue of a subordinated loan to the Bank in a similar amount, and in parallel, the Tier I capital was decreased by the distribution of an ordinary dividend of CHF 12.8 million, and a one-time dividend of CHF 50.0 million. The purpose of the change was to match the capital structure of Bank Leumi Switzerland to the standard in the banking industry in Switzerland.

At the beginning of January 2001, Bank Leumi Switzerland discovered, at its Zurich branch, accounts of customers in respect of which suspicions arose that unauthorized transactions had been carried out by a senior local employee, who served as a member of the management of Bank Leumi Switzerland and managed the private banking department. He was immediately released from his duties and dismissed by Bank Leumi Switzerland, which filed a criminal complaint against him. In December 2006, the general prosecutor announced the filing of an indictment against the employee, and the trial will begin during the course of 2008.

At the end of 2007, the volume of trust deposits and securities portfolios managed and/or held for customers amounted to CHF 6.6 billion, compared with CHF 6.4 billion at the end of 2006.

Bank Leumi Switzerland offers five investment strategies in various currencies that are matched to the customer's risk profile. In 2007, the balance of discretionary accounts decreased slightly, and amounted to CHF 693 million.
In addition, Bank Leumi Switzerland continued distributing structured products and alternative investments to its customers.

In December 2007, the Bank acquired 1,460 additional shares, constituting 2.2% the fully paid share capital of Bank Leumi Switzerland. Following the said acquisition, the Bank's holdings in Leumi Switzerland afford it the right to receive 84.1% of the profits and 93.9% of the voting rights.

Leumi International Investments N.V. ("LII")

The company serves as the vehicle through which the Bank Leumi Group issues notes to the public overseas. The proceeds are intended for the use of the Group. In December 1997, the company published an offering circular for a Medium Term Note Program, pursuant to which LII can issue notes up to a total of US$ 1.0 billion, guaranteed by the Bank. The notes were listed on the Official List of the London Stock Exchange. No funds were raised through the above-mentioned program during the years 2006- 2007.

In total, LII has raised US$ 1.087 billion within the context of this program, of which some US$ 578 billion had been repaid by the end of 2007.

The program is still open and allows additional issues and/or further issues in place of notes redeemed, on terms to be determined. As the date of this Report, US$ 491 million could be raised.

On 18 December 2006, the registration of the above securities in issue at the time was transferred from the Official List to the Professional Securities Market of the London Stock Exchange, following the coming into effect of new regulations in the European Union. This was done with the consent of the trustee of the program.

Bank Leumi (Luxembourg)

Bank Leumi Luxembourg S.A. was established in 1994 and opened to the public in May 1995. Bank Leumi Luxembourg provides its customers with a selection of private banking services, including deposits, trust deposits and investments in securities.

Total assets at the end of 2007 amounted to some € 547 million, compared with some € 518 million at the end of 2006.

At the end of 2007, deposits of the public totaled some € 505 million as against some € 473 million at the end of 2006. Trust deposits and securities held by customers of the bank totaled € 657 million at the end of 2007, compared with € 687 million in 2006. In 2007, Bank Leumi Luxembourg expanded its capital market activities. In February 2006 Bank Leumi Luxembourg opened a representative office in Israel.

In 2007 the net profit totaled € 2,300 thousand as compared with a profit of € 1,842 thousand in 2006.

The capital means of Bank Leumi Luxembourg totaled some € 29 million (including € 2.5 million of uncalled authorized capital), similar to at the end of 2006.

Leumi (Latin America)

Leumi (Latin America) S.A. was established in 1980 and operates through a head office in Montevideo and a branch in Punta del Este. Leumi (Latin America) provides private banking services to overseas customers.

Total assets of Leumi (Latin America) were US$ 39.2 million at the end of 2007, compared with US$ 36 million at the end of 2006. Capital, reserves and surpluses totaled some US$ 7.8 million on 31 December 2007, compared with some US$ 6.1 million at the end of 2006.

The year 2007 ended with a profit of some US$ 109.4 thousand compared with a profit of some US$ 230 thousand in 2006. The balance of off-balance sheet activity totaled some US$ 318.7 million in 2007, compared with US$ 209 million in 2006.

Brazil Representative Office

In December 2005, an investigation was commenced in Brazil at the Bank's representative office and that of another large Israeli bank in Sao Paolo, which was carried out by the local police. As part of the investigation, a number of customers were questioned and documents taken. The Bank submitted a request to transfer the investigation to the federal police, and the judge approved the request and ordered the transfer of the investigation to the federal authorities. The Bank has requested that the investigation be closed, in the light of the legal opinions of the local counsel representing the Bank. In the second half of last year, there were no developments whatsoever in this regard and at this stage, it is not possible to estimate the results of the investigation or whether it will be continued or closed.

Bank Leumi Romania

In August 2006, the Bank acquired over 99% of the issued and fully paid share capital of Eurom Bank S.A. from S.C. Kolal B.V, for a consideration of some US$ 46 million. An advance and amounts paid to cover loans and expenses in the amount of US$ 12 million were offset against this sum.

The name of the company was changed to Bank Leumi Romania in August 2006.

In September 2006, the Bank increased Bank Leumi Romania’s shareholders’ equity by some US$19 million.

During 2007, the Bank increased Bank Leumi Romania’s shareholders’ equity by some US$ 50 million and in January 2008, it was increased by an additional US$ 14 million.

The financial statements of Bank Leumi Romania have been consolidated in the Leumi Group’s Financial Statements since the third quarter of 2006.

Leumi Romania is a banking institution in Romania, and operates some 29 branches and 6 agencies, and engages in varied financial activity that includes the taking of deposits, the extension of credit, international trade and foreign currency activities.

2007 ended with a profit of some 1.4 million Ron (some US $0.6 million), compared with a loss of some 18.8 million Ron (some US$ 6.7 million) at the end of 2006.

The total assets of Bank Leumi Romania amounted to 1,081 million Ron (US$ 440 million) at the end of 2007, compared with 572 million Ron (some US$ 223 million) at the end of 2006. Deposits of the public amounted to 738 million Ron (some US$ 301 million) at the end of 2007, compared with some 451 million Ron (some US$ 176 million) at the end of 2006, and credit to the public amounted to 602 million Ron (some US$ 245 million), compared with some 270 million Ron (some US$ 105million) at the end of 2006.

The capital, reserves and surpluses amounted to some 219 million Ron (some US$ 89 million) at the end of 2007, compared with 95 million Ron (some US$ 37 million) at the end of 2006.

1 Ron = US$0.401 (US$ 0.390 at the end of 2006).

Leumi Re

In June 2002, the Bank established Leumi Re Ltd. in the Island of Guernsey. The company is wholly owned by the Bank and serves as a reinsurer for insurance companies that insure the Leumi Group. The company’s issued capital is US$ 30 million, of which US$ 6 million is fully paid. Furthermore, the Bank undertook in a guarantee to make additional amounts available to Leumi Re, up to an amount of US$ 9 million.

The Bank has also given an unlimited guarantee to the insurer, New Hampshire Insurance Company, to secure payment of the insurer’s claims against Leumi Re Ltd.

The company was established with the approval of the Bank of Israel, which determined that:
- the Bank shall hold 100% of the means of control of the company;
- the company shall engage in banking insurance, insuring liabilities and insuring property;
- the company shall only engage in insurance for the Bank Leumi Group.

The company’s total assets at the end of 2007 amounted to US$ 39.4 million, compared with US$ 37.9 million at the end of 2006, and the insurance reserves amounted to some US$ 9.2 million, compared with some US$ 11.8 million at the end of 2006. The net profit for 2007 amounted to US$ 9.7 million, compared with US$ 5.3 million in 2006.

Since 2003, the financial statements of the company have been prepared on the basis of the revised accounting rules of the Association of British Insurers. In accordance with these rules, the company's financial statements are prepared on an annual basis according to which the insurance reserves are calculated on the basis of an assessment of the estimated cost of settling the claims that have been reported, as at the date of the statements.

Capital Market and Financial Services Activities of the Bank and the Group

Mutual Funds

Following the reform of the capital market, the Bank sold its activities in the field of mutual fund management in 2006. Beginning in 2007, the Bank has received only a distribution commission, in accordance with the law.

Provident Funds

Following the legislation regarding the reform of the capital market, the Bank, together with Leumi Capital Market Services Ltd. (previously, Leumi Gemel Ltd.), sold the goodwill, activities, assets and liabilities related to the provident funds managed by Leumi Capital Market Services Ltd.

On 31 January 2007, the sale of additional provident funds, the largest of which being Sion, a Central Severance Pay Fund, Tzur and Sagi, to Prisma Provident Funds Ltd. was completed, at a price of some NIS 418 million, reflecting a price reduction due to adjustments agreed to between the parties. The net profit of the Bank, following adjustments and tax provisions, was some NIS 257 million.

Together with the signing of the agreements with the purchasers of the provident funds, distribution agreements and agreements for the provisions of operating services were signed with Leumi Capital Market Services Ltd.

Supplementary Training Funds

Following the reform of the capital market, on 15 July 2007, the sale of the activities of Kahal Employees Supplementary Training Fund Ltd. (“Kahal”) – and of Kahal Paths Supplementary Training Fund (managed by Kahal Study Funds Management (1996) Ltd.) ("Kahal Management") was completed, pursuant to an agreement signed on 26 May 2006 between the Bank, Israel Discount Bank Ltd., Kahal and Kahal Management, and between Migdal Capital Markets (1965) Ltd. on behalf of a company under its control and Migdal Insurance and Financial Holdings Ltd. on behalf of a company under its control (the "Purchaser"), for the sale of the goodwill, management rights, additional rights and means of control of the banks in Kahal, and for the sale of the goodwill, activities, assets and liabilities relating to the supplementary training funds managed by Kahal Management, for consideration of NIS 264 million. The Bank's share of the consideration amount is NIS 150 million. The Bank’s net profit, after adjustments and tax provisions, is some NIS 93 million.

Additionally, the Bank entered into an agreement with Kahal and with the Purchaser for the provision of operating services by the Bank to the funds sold, as well as a distribution agreement, under which the Bank will distribute the funds. The Bank intends to provide its customers with counseling regarding investments in supplementary training funds, through investment counselors.

Pension Counseling

The Bank is at an advanced stage of preparation for its entry into the pension counseling field. These preparations involve the development of computerized tools and the training and recruiting of staff. The Bank has submitted an application for a pension counseling license to the Supervisor of the Capital Markets, Insurance and Savings Department after an outline was agreed upon, which allows the large banks (Leumi and Hapoalim) to begin to engage in pension counseling, as described above on page 94.

For additional details see Note 31 to the Financial Statements and pages 32-33 of the Report.

Leumi Global Managers Funds

During the course of 2004 Leumi Global Managers ("LGM") was established in Luxembourg, which manages funds overseas through the manager-of-managers system. The funds are marketed throughout the Leumi Group overseas, subject to the laws applicable to the operations.

The establishment of the LGM funds is the result of cooperation between the Leumi Group and SEI Investments Company ("SEI"), a leading international company in this field, which as at the end of December 2007 managed assets exceeding US$ 200 billion.

SEI specializes in managing funds through the manager-of-managers system. SEI's funds are managed by portfolio managers who are specialists in the specific market in which the fund invests. SEI specializes in active management of the funds, while operating risk control and monitoring measures that allows it to use a combination of investment managers and to replace investment managers with others, when in SEI's opinion the others have a greater potential to achieve a yield over time.

The LGM funds include eight funds with varying characteristics relating to yield, risk, currency and investment amounts, which suit the needs of the customers of the Leumi Group.

As of 31 December 2007, the LGM funds had accumulated some US$ 520 million.

The Bank Leumi le-Israel Trust Co. Ltd.

This company, founded in 1939, provides a range of trust services which address the business and personal needs of its customers. In the capital market field, the company serves as trustee of issues of debenture and exchange traded certificates, as trustee for the allotment of options and shares to employees and interested parties, and also as a trustee of pledged shares. Other fields of activity in which the company engages: trusteeship of financial assets for Israeli and foreign residents, management of real estate assets (including buying and selling), escrow accounts – supervision of agreement implementation, safeguarding original source computer programs in trust, managing private and public funds, executing wills and administering estates and representation at general meetings of companies.

The company's income from trust business for 2007 amounted to NIS 11.4 million, compared with some NIS 10.5 million in 2006. The company's net profit in 2007 amounted to NIS 4.3 million, similar to the amount in 2006.

Competition

The company's main competitors are the large accounting and law firms, some of the banks' trustee companies and additional bodies which provide trust services.

Customers

The company provides services to a range of customers; to private customers, Israeli and overseas residents, it provides services in the fields of financial asset management, real-estate management and the execution of wills and the management of estates. It provides services in the fields of trusteeship to business customers, companies and institutional bodies for the issue of debentures, options to employees, pledges on shares and representation at general meetings of companies.

In the last two years there has been a significant increase in the scope of the company's activities in the field of trusteeship for issues of debentures and exchange traded certificates. During 2007, the company became trustee of additional public and private issues having a volume of some NIS 4.5 billion, similar to the volume in 2006.

During the course of 2005, the Israel Securities Authority issued directives which mainly restrict trust companies that are associated with the banking groups from acting as trustees for debenture issues, which may restrict the company's ability to act as trustee for certain issues. The basis for these directives is the Authority's fear of conflicts of interest between the trustee and its parent company (the Bank) and other companies in the Group. Thus for example, the company cannot serve as trustee for an issue of a company that has material obligations to the Bank, or where the proceeds of the issue are placed on deposit with the Bank.

Trust Business

In addition to the Bank Leumi le-Israel Trust Co. Ltd. mentioned above, a number of additional companies in the Group also engage in trust services, particularly Bank Leumi Switzerland, a subsidiary of Bank Leumi (UK) in the Island of Jersey and Bank Leumi USA.

These activities yielded the following income:

- Trusteeship for monies, securities, and real estate:	some NIS 13.2 million (NIS 14.2 million in 2006)
- Estate and property management:	some NIS 0.7 million (NIS 0.9 million in 2006)
- Agent for deposits and loans, share transfers, and management of investment accounts:	some NIS 18.0 million (NIS 18.3 million in 2006)
- Trustee for debenture and mutual fund holders:	some NIS 3.7 million (NIS 2.8 million in 2006)

Non-Banking Activities of Companies Included on the Equity Basis

Total investments of the Group in companies included on the equity basis amounted to NIS 1,873 million as at 31 December 2007, compared with NIS 1,251 million as at 31 December 2006. The contribution to net operating profit of companies included on the equity basis amounted to NIS 184 million in 2007, compared with NIS 171 million in 2006.

See pages 133-134 with regard to the sale of two non-banking companies.

Exposure to Risks and Methods of Risk Management

General

The Bank's activity in a spectrum of financial activities involves taking risks, primarily credit risks and market risks, including liquidity risks. These risks are accompanied by operating risks and legal risks.

The work methods and procedures in the field of risk management in Israel and abroad are examined and revised on an ongoing basis, taking into account the Bank’s policy and changes occurring in the business environment and in the Bank of Israel's directives and requirements.

Risk management is carried out in accordance with the Bank of Israel’s Proper Banking Management Directive No. 339, which addresses risk management and control. The Members of Management responsible for risks are:

Mr Z. Nahari	– Manager of Market Risks
Ms. R. Russak-Aminoach	– Manager of Credit Risks
Mr I. Malach	– Manager of Operating Risks
Mr N. Bitterman	– Manager of Legal Risks

Risk management is carried out by the Risk Management Control Department, which reports directly to the Chief Executive Officer. The control and supervision of risk management is carried out by Management committees for the management of the various risks, as follows:
- the senior committee for Group risk management, headed by the Chief Executive Officer;
- specialized committees, headed by the risk managers.

In addition, business risk control officers have been appointed in all of the divisions and subsidiaries.

1. Market Risk Exposure and Management

The business results, the fair value of assets and liabilities, shareholders' equity, cash-flows and the value of the Bank are exposed to market risks arising from volatility in interest rates, exchange rates, the CPI, the prices of securities in Israel and abroad and other economic indices.

The ongoing management of market risks is intended to support the achievement of business goals by estimating the forecasted profit from managing the risks on the one hand, and the damages that can result from exposure to these risks on the other hand. Risk management is based on forecasts and ongoing evaluations of developments in the capital and money markets. The Bank manages the exposures to market risks in a dynamic manner.

The market risk management policy prescribes limits on the financial exposure. The limits are intended to reduce the damage that could be caused as a result of unexpected changes in the markets. The system of limits delineates the impact of exposure of the economic value, the accounting profit and the liquidity situation to unexpected changes in the various risk factors – interest rates, the CPI, exchange rates, etc.

During 2007, a gradual expansion of the activity in the dealing rooms and in the *nostro* portfolios was approved, including entry into new spheres of activity/instruments, expansion of activities in existing fields and revision/expansion of risk frameworks and levels of exposure. The extension of the limits was expressed in internal limits, without affecting the uppermost limits previously approved by the Board of Directors.

Pursuant to the 2008 work plan, and due to the forecast of increased activity in the corporate bond channel (subject to market developments), the limits on investments in the available for sale and trading portfolios were extended.

According to the strategic plan of the Capital Markets Division to increase profitability (in the dealing rooms, in the *nostro* portfolios, and in the Financial Management Department), a controlled, higher level of market risks is planned to be taken, while taking into account developments in the global economic situation in 2008. Accordingly, and pursuant to the work plan approved by the Board of Directors at the beginning of 2008, the framework for investment in foreign securities was expanded, while extending the limits of exposure to changes in interest and in the VAR.

The management of market risks also includes the subsidiaries in Israel, with the exception of Leumi Mortgage Bank and Leumi & Co. Investment House Ltd., which have independent market risk management and policies, due to the dissimilar nature of their activities as compared with the Bank. The limits prescribed at the Group level also apply to these companies.

All the subsidiaries have adopted an independent policy for market risk management. The frameworks for market risk exposures are determined according to a uniform format, which was approved by the Bank. These frameworks have been examined by the Bank's Manager of Market Risks and found to be suitable. The 2008 work plan includes a re-examination of the market risks of the overseas subsidiaries, this, in light of the developments in the markets.

Information regarding the position of the exposures according to the prescribed frameworks is received from the subsidiaries once a month or upon request, and is taken into account in the overview of the exposures in the Group.

Following are the capital requirements in respect of market risks, in accordance with the Banking Supervision Department regulations:

	31 December 2007	31 December 2006
	NIS millions	
Capital requirements in respect of		
Interest risks	**321**	246
Share price risk	**55**	6
Exchange rate risk	**113**	127
Inflation risk	**-**	13
Options	**99**	75
Total capital requirement in respect of market risks	**588**	467

1.1 Basis Exposure

The exposure to basis risk is expressed as the loss which may occur as a result of changes in the CPI and exchange rates, in the difference between the value of the assets and the value of the liabilities, including the effect of futures transactions, in each of the linkage sectors. Basis exposure can also include exposure to equity indices. This exposure is expressed as the loss that can occur as a result of a change in these indices.

The policy of Management is to manage the risks deriving from basis exposure in a controlled manner within the framework of the limits set by the Board of Directors, and to establish on an ongoing and up-to-date basis the extent of exposure in each linkage sector, in accordance with economic forecasts of developments in the capital and money markets, and of inflation and the anticipated relative prices in the various sectors.

The consolidated subsidiaries in Israel generally invest their available capital in debentures and in shekel deposits with banks, in accordance with the policy approved by their boards of directors.

The Bank's overseas subsidiaries generally maintain a balance between the assets and liabilities in the various currencies, and their available capital is invested in the local currency. The said subsidiaries adopt policies based on resolutions of their local boards of directors overseas, for managing basis exposures within limits on amounts and periods, which policies are coordinated with the Capital Markets Division.

1.1.1 Basis Exposure and Compliance with Limits

The basis exposure, which is calculated in accordance with generally accepted accounting principles, is presented in Note 16 to the Financial Statements.
Certain changes are made for the purpose of ongoing management, which take into account the Bank's economic approach to basis risks. The principal changes are set out below:

– "non-performing credit in foreign currency" – classified in the Financial Statements, pursuant to accounting principles and restrictions prescribed by the Supervisor of Banks, as a foreign currency asset, despite the fact that it does not bear exchange rate differentials exceeding the determining rate in the event of devaluation. However, for exposure management purposes, due to the lack of symmetry, these assets do not bear positive exchange rate differentials exceeding the determining rate, and are therefore classified as shekel credit.

– "deferred taxes" in respect of pension obligations – from an accounting perspective, are presented as unlinked shekels, as opposed to presentation as a CPI-linked asset from the economic perspective, pursuant to the obligation in respect of which the tax was recorded.

– "the general provision for doubtful debts" – from the accounting perspective, this provision is deducted proportionately from the linkage sectors, while from an economic perspective, this provision constitutes an unlinked shekel quasi-capital obligation.

– the adjustment to market value of debentures in the available for sale shekel portfolio – from the accounting perspective, this adjustment is deducted/added to the balance of the portfolio according to linkage sector, while from the economic viewpoint, this provision constitutes a quasi-capital item.

The exposure to basis risks is defined as a percentage of the Bank's exposed capital. The capital is defined as an unlinked shekel source.

The exposed capital includes the shareholders' equity and certain reserves, less investments in consolidated subsidiaries and affiliates and in fixed assets. The investments in overseas subsidiaries that are financed from deposits in foreign currency are not deducted from shareholders' equity.

The following table presents the actual basis exposure compared with the limits prescribed by the Board of Directors, as on December 31, 2007. The data is presented in NIS millions and in terms of a percentage (%) of the exposed capital.

	The Group		
	Approved limits Maximum surplus (deficit)	**Actual exposure* %**	**NIS millions**
Unlinked Israeli currency	**50%-(100)%**	**(31.0)**	**(4,417)**
CPI-linked Israeli currency	**100%-(50)%**	**30.3**	**4,321**
Foreign currency and foreign currency-linked	**25%-(10)%**	**0.7**	**96**

* In addition, the Bank and subsidiaries have limits on the maximum position allowed for investments in each and every currency.

The investment mix of the exposed capital in the various linkage sectors is determined on an on-going basis within the limits presented above, and on the basis of forecasts regarding the relevant market variables. During 2007, an average of some 50% of the exposed capital was invested in the unlinked shekel sector, with the balance invested mainly in the CPI-linked shekel sector. Since a relatively low volume of capital was channeled to the foreign currency and foreign-currency-linked sector, the change in exchange rates did not have a material effect on the pre-tax profit. Changes in the exchange rate do affect the effective tax rate, since exchange rate differentials in respect of the investments abroad are not taken into account in the income basis for calculating the provision for taxes.
Subject to the rates of the changes in the exchange rates of the various currencies relative to the shekel, and considering the volume of the investments abroad, this may have a material effect on the provision for taxes and, therefore, on the net profit.

An appreciation of 1% in the exchange rate of the shekel against the currencies in which the investments were made abroad (mainly the US$, £, CHF and the euro) has an affect of some NIS 12 million on the net profit.

For additional details, see the section on the provision for taxes on pages 59-60.

In 2007, the capital invested in the CPI-linked sector ranged between a maximum of 60% and a minimum of 23%.

During 2007, the Group complied with all the basis exposure limits approved by the Board of Directors.

The following table shows the sensitivity to changes in the exchange rates of the principal foreign currencies as at 31 December 2007. The measurement relates to the influence of such changes on the Bank's capital, and includes the activity in balance-sheet and off-balance-sheet instruments (the theoretical change in the Bank's capital does not include the effects of tax in respect of financing the overseas investments), as explained above:

	US$	euro	£	CHF	Yen
			NIS millions		
Increase of 5% in exchange rate	(17)	5	4	1	3
Increase of 10% in exchange rate	(44)	9	12	3	12
Decrease of 5% in exchange rate	(9)	(13)	(4)	-	3
Decrease of 10% in exchange rate	(28)	(25)	(7)	-	9

These data do not take into account the effect of a change in the exchange rates on the income and expense cash flows in foreign currency. According to the assessment of the Bank's Management, a 1% decline in the exchange rate of the shekel against the foreign currencies reduces the net after tax annual profit by some NIS 10 million, as a result of the effect on the net income cash flow in foreign currency.

Post-Balance-Sheet Events

After the balance-sheet date and up until shortly before the publication of the Financial Statements the high volatility in the capital and money markets persisted, and found expression, *inter alia*, in changes on the capital markets in Israel and worldwide, and in the continuing trend of volatility in the shekel *vis-à-vis* most foreign currencies.

These events will have adverse effects on the Financial Statements for the first quarter of 2008, mainly with respect to the matters specified below:

1. Negative exchange rate differentials in respect of the investments abroad (which do not constitute part of the tax base and are not recognized as an expense for tax purposes), will cause higher tax provisions.

2. The income less expenses in or linked to foreign currencies (which are translated according to a current exchange rate), will cause a reduction in income, compared with their translation according to the exchange rate on 31 December 2007.

3. The declines in prices on the various stock exchanges, and particularly the declines in prices of debentures in Israel and abroad, will cause a reduction in the fair value of the above-mentioned investments, which, for the most part, is recorded in capital reserve.

4. The changes in the exchange rates affect the gap between the assets and liabilities in and linked to foreign currency.

   It is emphasized that should there be further developments at a later date, they may have financial effects on the Financial Statements for the year 2008, whose extent is dependent on future developments in these markets.

The information presented above is "forward-looking information." For the meaning of this term, see page 43 above, in the section entitled "Description of the Banking Corporation's Business and Forward-Looking Information" in the Directors' Report.

1.2. Interest Exposure

The exposure to changes in interest derives from the gap between the interest payment dates and the interest adjustment dates of the assets and liabilities in each of the sectors. For the purpose of managing interest risk, the gaps between the assets and liabilities in future periods are examined (gap reports), and comparisons are made of the average duration of the assets, liabilities and capital in each sector. In addition, the exposure to changes in interest is measured in each sector, in relation to the potential erosion of the economic value[1] and annual accounting profit resulting from a shift of the yield curve in each of the sectors.

The principal exposure is in the CPI-linked sector, since the majority of the assets and liabilities in this sector have fixed medium and long-term interest rates.
In the unlinked shekel sector, the interest exposure is usually lower, since the majority of the assets and liabilities are short-term and/or have floating interest rates.
In the foreign currency (including foreign-currency-linked) sector, exposure is also usually lower than in the CPI-linked sector, since:

- most of the activity bears floating interest rates. Assets and liabilities are matched according to the interest adjustment dates;

- the existence of a variety of financial instruments in the international markets facilitates the reduction of the exposure in this sector.

Floating Interest

As mentioned above, a significant part of the financial assets and liabilities carries floating interest, as described below:

- In the CPI-linked sector, activity at floating interest is relatively minor. The interest on loans usually changes once a year and relates to the average rate of interest on interest free loans out of the bank's means, were provided or renewed by the mortgage banks, as published twice monthly by the Bank of Israel. At the end of 2007, this interest rate was 4.2%.

- In the unlinked shekel sector, there is extensive activity in prime-based floating interest. The prime interest rate is the base interest charged on current account overdraft balances. A significant portion of the deposits in this sector also carry prime-related interest. Prime interest is set periodically by the Bank and, in recent years, has changed soon after changes in the Bank of Israel's declared monetary interest rate. Prime interest is 1.5% higher than the monetary interest rate. The prime interest rate at the end of 2007 was 5.75%.

- In the foreign currency sector, a large portion of the activity is based on the LIBOR (London Interbank Offered Rate). The LIBOR is the interest rate in the interbank market in London on interbank deposits for the relevant period, and is published daily at 11:00 a.m. (London time) by the Reuters news service. The volatility of the LIBOR intensified considerably as of the second half of 2007. The volatility of the LIBOR increased greatly as from the middle of 2007. At the end of 2007, the US$ LIBOR rate for three and six months was 4.7%.

[1] The economic value of the capital is defined as the difference between the present value of the assets and liabilities. When calculating present value, cash flows of the risk-less yield curve are deducted i.e., government debentures.

1.2.1 Interest Exposure and Compliance with Limits

The following table presents the exposure to interest changes at the Group level, calculated according to accounting principles. For detailed data on interest exposure, see Exhibit D to the Management Review.

	31 December 2007			31 December 2006		
	Unlinked	**CPI-linked**	**Foreign currency and foreign currency-linked**	Unlinked	CPI-linked	Foreign currency and foreign currency-linked
Average duration (in years):						
of assets [(1)]	**0.42**	**3.51**	**0.54**	0.42	3.67	0.61
of liabilities [(1)]	**0.29**	**3.84**	**0.35**	0.26	3.65	0.48
The gap in duration	**0.13**	**(0.33)**	**0.19**	0.16	0.02	0.13
Difference in the internal rate of return (%)	**3.04**	**1.27**	**1.01**	2.03	0.62	1.06

(1) Excluding forward transactions and options.

The average duration of liabilities in the CPI-linked sector is calculated after taking into account estimates of early repayments of savings plans and withdrawals at exit points, on the basis of a model which estimates the anticipated early repayments on the basis of the behavior of the savers. The average duration of liabilities, according to the original cash-flow of the savings schemes is higher, and reaches 3.86 years, while the gap in the internal rate of return (IRR) amounts to 1.19%.

The data presented above takes into account early repayments of CPI-linked mortgages, pursuant to a statistical model which estimates expected repayments on the basis of the borrowers' behavior and the development of market variables. The average duration of assets at the end of 2007, according to the original cash flow, without taking into account early repayments, is higher, and reaches 3.77 years, and the IRR gap amounts to some 1.19%.

Current account balances are presented in Exhibit D to the Management Review pursuant to directives of the Bank of Israel as demand deposits for up to one month. However, for the purposes of interest exposure, a certain percentage of the current account balances in shekels and in foreign currency is spread over a repayment period of up to ten years, this being in accordance with a behavioral model whose basic assumptions are updated on an ongoing basis. Taking into account the above assumptions, the average duration of liabilities is greater and reaches 0.49 years in unlinked shekels and 0.42 years in foreign currency deposits, with the IRR gap reaching 4.35% and 1.56% respectively.

The actual interest exposure is managed on the basis of economic exposures and is based on various behavioral assumptions regarding payment dates of the assets and liabilities, as stated.

With the aim of limiting interest risks, the Board of Directors of the Bank and the boards of directors of the local and overseas subsidiaries have approved limits on the maximum potential erosion of the economic value and the accounting profit as a result of parallel changes in the interest curves.

The following table shows the limits on interest exposure and the actual exposure as on 31 December 2007, in NIS millions:

	Potential erosion of economic value		Potential erosion of annual profit*	
Effect of a change of 1% in the interest curve:	**Limit**	**Actual exposure**	**Limit**	**Actual exposure**
Group level	**1,000**	**330**	**500**	**256**

* The maximum erosion of the annual profit in each of the next three years.

During 2007, the potential erosion of the economic value and annual profit ranged between NIS 330 million and NIS 600 million, and between NIS 141 million and NIS 256 million respectively.

The potential erosion of the economic value of the capital resulting from a 1% change in interest rates decreased by some 37% from the beginning of the year, and amounted to some NIS 330 million at the end of December 2007. The majority of the decrease in exposure occurred during the fourth quarter and derived from the vigorous activity in derivatives (long-term CPI-linked commitment), from the raising of subordinated deposits and also from the activity in the trading portfolios.

The potential erosion of the accounting profit resulting from a 1% change in interest rates increased by some 45%, and amounted to NIS 256 million at the end of December 2007. During the year, a change in direction of the exposure was recorded, from exposure to a rise in interest to exposure to a fall in interest, mainly as a result of a reduction in the exposure in the trading portfolios and the execution of long CPI/forex transactions that are revalued on the basis of market value.
During 2007, the Group complied with all the interest exposure limits set by the Board of Directors.

In addition, monitoring and reporting is carried out regarding the potential interest exposure arising from the Bank's liabilities for future pension and severance pay payments to active employees who have yet to retire. Employees are entitled to choose between two tracks – either to receive severance pay and provident fund savings or to receive a pension. Taking this exposure into account, the potential interest exposure of the economic value at the Group level at the end of December 2007 increases from NIS 330 million to NIS 527 million, and the potential erosion of the accounting profit decreases from NIS 256 million to NIS 179 million.

1.3 Value at Risk (VAR)

The Bank manages the exposure to market risks by various means, as mentioned above, as well as by means of a statistical model – the VAR model, as required by the Bank of Israel. The risk measured by the VAR relates to the potential loss from holding all the balance-sheet and off-balance-sheet positions exposed to market risks, and not solely in respect of the positions in the trading portfolios.

The VAR model measures the expected potential loss (the expected decrease in the present value of the assets less the liabilities) from the current portfolio make-up, at a given confidence level, over a given future period, as a result of possible changes in market prices. The VAR is calculated monthly at Group level, and more frequently at the Bank level and for the trading portfolios.

The VAR is calculated according to the parametric model, which is based on the historical behavior of the various market risk factors during the period (year) prior to the calculation and on the assumption that the distribution of changes in the parameters is normal.
The VAR model has a number of weaknesses. The model assumes that the statistical structure of the changes in prices in the capital market gives an indication of the future behavior of these prices. In the parametric VAR model there is also an assumption of multivariate normal distribution of the changes in risk factors. This measurement, by definition, ignores losses that are liable to occur over and above the given significance level (the distribution tail). Examination of stress scenarios provides the lacking perspective.

In order to test the validity of the VAR model, the Bank performs daily backtesting, by comparing the actual change in the economic value of the Bank with the estimated change as derived from the VAR model. The tests performed thus far confirm the validity of the model.

The Bank also periodically calculates the VAR using an historical simulation, and examines any gap between the two measurement methods. Historical simulation enables risk to be measured without reliance on a particular probability structure.

The VAR of the option book in the trading portfolio is examined using both the parametric and the Monte Carlo simulation method (this method is used to test the non-linear risk components).

The following table presents the limits and risk in terms of parametric VAR, at a confidence level of 99% and for a two-week position holding period, in NIS millions:

	Limit	**31 December 2007**	**Average 2007**	31 December 2006	Average 2006
Total at Group level	500	**290**	**256**	206	231
Total at Group level on mark-to-market portfolios	300	**141**	**85**	29	38

The exposure, in VAR terms, of the economic value of the Group increased during 2007 by NIS 84 million, and totalled NIS 290 million at the end of December 2007.

The increase in the VAR derives, for the most part, from a change in the Group's investment mix – an increase in investment in shares, hedge funds and futures contracts in the foreign-currency sector, and a rise in volatility, which were partially offset by the decrease in interest exposure, a decrease in basis exposure, and a rise in the diversification effect (which leads to the offset of exposures as a result of the impact of the correlations between the various risk factors).

During 2007, the VAR of the economic value ranged between a maximum of NIS 311 million and a minimum of NIS 206 million.

The exposure in terms of VAR on the Group's mark-to-market portfolios increase during 2007 by NIS 112 million, and totalled NIS 141 million at the end of December 2007. The major part of the increase in VAR arose from an increase in activity in CPI-linked derivatives and investment in futures contracts on share indices and foreign currency hedge funds.

In 2007, the VAR of the mark-to-market portfolios ranged between a maximum of NIS 146 million and a minimum of NIS 29 million.

Pursuant to the Board of Directors' approval, the Bank has been operating within a wider framework of limits since the beginning of 2008.

The following table presents the extended limits:

Limits, in NIS millions	During 2007	As of 2008
Potential erosion of annual profit as a result of a 1% change in interest	500	700
The exposure in terms of the VAR of the economic value	500	700
The exposure in terms of the VAR of mark-to-market portfolios	300	500

1.3.1 The Board of Directors' Limits for Stress Scenarios

The global and domestic markets are subject to shocks from time to time, which manifest themselves in especially high volatility of the parameters, which deviate from normal historical behavior. The VAR does not provide information about losses that may occur in extreme market conditions, and exceeding the predetermined confidence level. Thus, in addition to the VAR measurement, risk is also measured in stress scenarios.

In addition to the limits detailed above regarding basis and interest exposures and VAR, the Board of Directors has also set limits for the maximum potential loss in the event of a realization of a stress scenario.
The scenario includes extreme changes that occur simultaneously in the principal parameters of market risks (mainly changes in inflation, exchange rates, interest rates and the stock markets in Israel and abroad).
A team led by Dr. Ruth Arad, the Chairperson of the Scenarios Committee and the Head of Risk Management Control, is responsible for the periodic definition and updating of the stress scenarios.

The limit determines that the decrease in economic value of shareholders' equity resulting from a stress scenario will not exceed NIS 2 billion, after taxes. During 2007, the Bank complied with this limit. The scenario and limit do not include the effect of credit risks.

1.4. Liquidity Risk

Liquidity is defined as the corporation's ability to finance increases in assets and comply with its liability payment. The ability to withstand a liquidity risk involves uncertainty regarding the possibility of raising sources and/or realizing assets in an unexpected manner within a short period, without causing a significant loss.

The Bank implements an overall liquidity risk management policy in Israeli and foreign currency (including foreign-currency linked), pursuant to the directives of the Bank of Israel. The purpose of the policy is to support the achievement of business goals while evaluating and limiting losses that may arise from exposure to liquidity risks.

The Bank maintains ongoing monitoring of the liquidity position and liquidity risk indices. Liquidity risk is measured and managed through an internal model whose purpose is to evaluate and monitor the liquid means at the Bank's disposal, under various scenarios, as follows:

- a normal scenario that assumes the ordinary course of business, which ensures that the Bank is able to finance an increase in assets and that it has sufficient sources to pay all its obligations, without having to incur expenses or losses in the process.
- a statistical scenario relating to an exceptional situation under normal operating conditions, which estimates, at the desired assurance level, the maximum possible decline in the liquidity level during a given period on the basis of some 300 historical observations in Israeli currency and some 250 in foreign currency.
- two stress scenarios, assuring the continuation of the Bank's activities at reasonable cost during a bridging period of about a month when stress conditions prevail, as follows:
  - a systemic stress scenario, deriving from a negative external event, such as a failure in the capital market or in the entire banking system, which will affect Leumi.
  - a stress scenario at Leumi, deriving from a negative internal event occurring solely at Leumi, such as a strike by Leumi employees, the lowering of the Bank's credit rating, embezzlement or fraud of a significant scale, and so on.

The liquidity position is examined in each of the scenarios by means of:
- the liquidity gap between total liquid assets and total liquid liabilities according to payment periods. The liquidity gap is examined for each of the periods: one day, up to one week, up to one month, up to three months, up to six months and up to one year.
- the ratio between total liquid assets and total liquid liabilities according to each of the said payment periods.

The liquidity management policy at Group level is based on the following principles:

- each subsidiary in Israel and abroad is responsible for the formulation and maintenance of an independent liquidity management policy, while maintaining strict compliance with obligatory directives of the relevant regulatory authorities.
- the subsidiaries may rely, amongst other sources, on the use of credit lines from Bank Leumi, subject to prior arrangement, and subject to regulatory limits.

The following are the regulatory limitations on the transfer of liquid means between Group companies in Israel and abroad:

- the Bank of Israel does not limit the making of deposits by the Bank with Group subsidiaries in Israel and abroad. However, there are limits on the investment of capital by the Bank in companies abroad.
- the directives of the authorities in the United States limit any kind of exposure of banks in the United States to an associated company, to a maximum rate of 10% of the capital of the bank in the United States, and with regard to the group to which the bank in the United States belongs, to a maximum rate of 20% of its capital.
- the directives in Great Britain limit the making of deposits with any Group company and with all Group companies combined, to a maximum rate of 25% of the capital of the bank in the UK.
- the directives in Switzerland require that deposits of sums exceeding 25% of the capital of the bank in Switzerland be deducted from its capital.

A contingency plan has been prepared as part of the preparations for an extreme scenario, which includes the strategy for managing a liquidity crisis, including the appointment of a management team responsible for dealing with the crisis and defining the procedures and steps required for contending therewith.

In addition to the model described above, Leumi operates an additional measurement system for early warning of exceptional and unexpected developments in liquidity risk, as follows:

– as part of the ongoing management of liquidity in Israeli currency and foreign currency, forecasts are made of the daily liquidity situation, using the Bank's existing information systems. At the end of each business day, the gap between the forecasted liquidity and the actual liquidity is measured. The spread of the gap is used for updating the model and for improving the quality of the forecasting of the liquidity situation.
– in the foreign currency sector, the rate of long-term assets being financed by short-term liabilities, the "long/short" ratio, is also monitored.

1.4.1 Liquidity and Compliance with Limits

As required by the Bank of Israel's Directive No. 342, the Board of Directors has approved the policy for managing liquidity risks and prescribed limits, as follows: the liquidity ratio must be higher than 1 and the liquidity gap must be higher than zero in each of the scenarios during the planned periods of one day, one week and one month (as detailed above in paragraph 1.4).

The following table presents the liquidity gap and liquidity ratio in Israeli currency and foreign currency, in each of the four types of defined scenario, for a repayment period of one month, as at 31 December 2007:

Scenario/period	**Israeli currency for one month**		**Foreign currency for one month**	
	Gap in NIS billions	**Ratio in %**	**Gap in NIS billions**	**Ratio in %**
Regular	20.7	13.4	22.8	13.1
Statistical	15.5	3.5	19.9	5.1
Stress at Leumi	6.5	1.3	7.6	1.4
Systemic stress	9.3	1.7	8.4	1.5

During the first months of 2007, the Bank of Israel continued to balance the liquidity situation of the banking system via monetary loans. The system's dependence on these sources increased during those months, *inter alia*, due to the government's absorption of the liquidity through the privatization of the oil refineries (in the sum of some NIS 6.4 billion).

As of March 2007, the Bank of Israel has been reducing the net volume of "Makam" offerings, by some NIS 3 billion per month, in a reversal of the trend of recent years. The liquidity situation of the banking system was further improved at the end of June 2007, following the redemption of government debentures totaling some NIS 20 billion.

At the beginning of September 2007, the implementation of the last stage of the Real Time Gross Settlement (RTGS) system was completed.

RTGS provides for the real-time settlement of large payments. The system performs final and irrevocable settling for all the clearing houses (net) and all the customers' instructions (gross) according to the payment channel selected by them. Final clearance in real time during the business day as stated also requires extreme accuracy from the banks, as well as ongoing real-time control of their ability to supply the liquidity needs and be prepared to carry out the payment (transfers to other banks) in large sums during the course of the business day.

With the objective of increasing the banks' ability to meet the above-mentioned needs for intra-day liquidity, the Bank of Israel recognizes foreign currency deposits with the Bank of Israel for a period of thirty days as collateral for providing monetary loans to the banks. For this purpose, Leumi has been depositing foreign currency deposits with the Bank of Israel since September, in sums of between US$ 200 million and US$ 500 million.

In light of the introduction of RTGS, the expected introduction of the CLS and the developments in the capital markets, the model's assumptions are being re-examined.

1.5. Derivative financial instruments

The Board of Directors of the Bank sets the policy for market-making and trading in derivatives, the exposure limits and the range of instruments that may be used.
The Bank’s transactions in derivatives are carried out with banking corporations, members of the Tel Aviv Stock Exchange and foreign brokers, who are obliged to meet requirements for capital adequacy or for a level of collateral, as well as with customers of the Bank who are obliged to provide collateral in accordance with Bank procedures.

The trading rooms are intended for commercial activities with customers for managing and hedging risks, in the context of the management of market risks. The activities are conducted within the framework of specific limits that the Board of Directors has approved for activities in derivatives. The foreign currency trading room trades a wide range of financial instruments, including vanilla options and complex options, such as: options on the average exercise price, knock in and knock out options and binary options.

The multiplicity of products, the volume of activity and its decentralization among various units of the Bank necessitate specialization and coordination among the various bodies. Therefore, Prof. Daniel Tsiddon, a member of Management, has been appointed as Chief Derivatives Officer, professionally responsible for this activity and for supervision of this field.

The following table presents a summary of open transactions as on 31 December 2007, compared with the previous year (par value in NIS millions):

	31 December 2007	31 December 2006
Hedging transactions	**2,734**	6,898
ALM and other transactions:		
Interest contracts	**118,775**	56,191
Currency contracts	**192,160**	134,528
Contracts in shares, share indices and goods	**25,999**	34,010
Total	**339,668**	231,627

For details regarding accounting policies for recording of balances, income and expenses from these types of instruments, see Note 1J – Significant Accounting Policies in the Financial Statements.

In 2007, the net income from ALM and other transactions in derivatives totalled some NIS 6 million only, compared with income of some NIS 1,065 million in 2006, including exchange rate differentials.

For further details, see Exhibit C to the Management Review and Note 20 of the Financial Statements.

Accounting Aspects - The Bank of Israel determined directives for reporting to the public on the treatment of derivatives based on the application of the international accounting standards FASB 133 and 138.
The directives prescribe accounting and reporting rules for derivatives, including rules in respect of derivatives embedded in other contracts. The directives require recognition of all derivatives as an asset or liability in the balance sheet and their measurement according to fair value. At the same time, they dictate the conditions under which it is possible to designate a derivative for hedging a balance-sheet asset or liability.

According to instructions of the Bank of Israel, a transaction is recognized as a hedging transaction only if there is a specific hedged asset that meets the strict compliance tests. Thus, most of transactions are not defined as hedging transactions, but rather as “other” transactions, despite the fact that some of them are intended to neutralize financial risks embedded in the overall balance-sheet activities of the Group.

As opposed to the above accounting treatment, *i.e.*, reporting of “other” transactions in terms of fair value, the balance-sheet activity actually covered by derivatives is not reported according to fair value. The income and expenses from these balance-sheet items are recorded in the statement of profit and loss on an accrual basis. Therefore, there is no accounting matching between the manner of recording the income and expenses in respect of derivative transactions and the balance-sheet items actually covered.

Structured Products – During 2007, the activity in structured products, deposits and debentures, continued, allowing customers the chance of a high yield compared with standard, non-structured products, against taking the risk of losing bank interest. This is usually with no risk to the deposit principal. The yield on the products is conditional upon certain parameters, such as a pre-defined range of exchange rate or interest rate variables, participation in the rise in a share index or basket of shares. The Bank's exposure to market risks from these activities is very small, since a policy of management, control and specific and full hedging is adopted for the exposures deriving from structured products, through the use of derivatives or assets matched back-to-back with the Bank's liabilities.

Activity in the *Maof* Market – The Bank operates in the *Maof* (financial futures) market with respect to the share indices on behalf of its customers only. With respect to options on the shekel/dollar and shekel/euro exchange rates, the Bank operates in the *Maof* market both for its customers and on its own account, while maintaining collateral in accordance with Tel Aviv Stock Exchange requirements.

Credit Risks and Counter-party Risks in Financial Instruments – A number of selected customers are permitted by the Bank to trade on credit in the *Maof* market in a portfolio consisting of shares and options on the Tel Aviv 25 index and the bank shares index, options on the shekel/dollar and shekel/euro rates, and foreign equity derivatives in portfolios comprised of assets and liabilities in shekels and dollars. There is close continuous review of the risk in these portfolios in relation to the collateral and to the approved credit lines, calculated on the basis of the requirements of the Tel Aviv Stock Exchange and the credit policy prescribed by the Bank's Board of Directors in this regard.

Leumi is a leading bank in the field of shekel-based derivatives and it makes markets in most of the products.

The dealing rooms provide immediate services both directly to customers active in derivatives, as well as to branches of the Bank that work with customers who are not connected to the dealing room.

A foreign-currency and derivatives dealing room covers activity with customers and the Bank’s *nostro* activity on its own account. Positions are managed in accordance with the specific limits approved by the Board of Directors regarding the management of the various derivative portfolios.

Both the basis and interest exposure created as a result of this activity of the dealing rooms included within the framework of limits approved by the Board of Directors for basis and interest exposure.

1.5.1 Limits on Activities in Derivatives

The limits on basis and interest exposure, as well as actual exposures, also take into account the exposures stemming from the activity in derivatives.
Additional special limits have not been set with respect to basis and interest exposure from the activity in forwards, swaps, futures, IRS and similar types of derivatives. Their economic value has the same sensitivity as regular financial instruments.

On the other hand, additional special limits have been set in respect of activity in options, since their economic value is particularly sensitive to basis and interest changes and, in particular, to the volatility (standard deviation) of the underlying assets. The principal limits prescribed for activity in options are as follows:

- limits on the maximum permitted exposure in activity in shekel/foreign currency and foreign currency/foreign currency options.

The limits relate to the maximum permitted erosion in the value of the option portfolio managed in the dealing room resulting from changes in the following parameters: in the price of the underlying asset (delta and gamma limits), in the volatility of the underlying asset, (vega limit) in interest (rho limit) and resulting from the passage of a business day (effect of shortening of the option period, the theta limit).

Furthermore, limits were prescribed for extreme scenarios of changes in the exchange rates and in volatility.

In respect of option activity, it was determined that accumulated losses of US$ 2.5 million and above must be reported to the Board of Directors.

During 2007, all activity in derivatives was within the limits set by the Board of Directors.

1.6 Policy Implementation and Control of Market Risk Management

Market risk management policy is discussed, formulated and controlled through the market risk management committee (ALCO), chaired by the Manager of Market Risks, with the participation of senior Bank officials involved in asset and liability management.
The policy that is formulated in the aforesaid committee is discussed and controlled through the senior committee for risk management, chaired by the Chief Executive Officer, with the participation of all the risk managers (credit, market, operating and legal) and the Head of the Risk Management Control Department. The policy approved by the executive committee is presented to the Board of Directors for discussion and approval. The Board of Directors also determines the limits on the amounts of the various types of exposures. Any change in policy is also submitted to the Board of Directors for approval.
The exposures to market risks, the frameworks set for them and the authorities for managing them are summarized in a document called the “Exposure Document” as required by the Bank of Israel’s Proper Banking Management Directive No. 339.
This document includes the report on market risk at the Bank and Group levels, methodologies for measuring risks and reporting on the limits and the compliance therewith, and, at least once a quarter, the document is distributed to the Board of Directors, for discussion and reports on the limits and exposure policy.

The basis exposure and interest exposure situation is detailed above on pages 164-169 of this Report and in Note 16 to the Financial Statements.

The exposure situation, including exposure to market risks, is examined and discussed on a weekly basis in the “management committee for current issues,” chaired by the Chief Executive Officer and, in her absence, by the Manager of Market Risks. The Manager of Market Risks has full authority to take action to increase, reduce or open a new exposure within the limits prescribed in resolutions of the Board of Directors and the management committee for current issues. Any new activity in financial instruments that differs significantly from the existing instruments is submitted for the approval of the Board of Directors. The Manager of Market Risks also has the authority to take immediate action in response to exceptional developments in the various markets, provided that that the action does not result in a breach of the limits set by the Board of Directors.

A monthly report is submitted to the management committee for current issues, chaired by the Chief Executive Officer, on the exposure situation and on compliance with the limits set by the Board of Directors for exposure to market and liquidity risks, while the Chief Executive Officer reports to the Board of Directors every month to six weeks, within the context of the Chief Executive Officer's Report to the Board of Directors.

The Head of the Risk Management Control Department, who reports directly to the Chief Executive Officer, examines compliance with the limits set by the Board of Directors and the Management of the Bank, and reports thereon in the Exposure Document. The level of the exposure to market risks on a VAR basis, as well as the possible damage to the Bank's capital in stress scenarios, are reported to the Chief Executive Officer and the Manager of Market Risks, and to the Board of Directors within the context of the Chief Executive Officer's Report.

Each quarter, the Board of Directors holds a detailed discussion of the market risk exposure policy, and also receives a status report on compliance with the limits at Group level. The report also includes data on the exposure situation in VAR terms at the Bank and the Group, and also on the damage that the Bank might sustain in stress scenarios.

At the time of approval of the quarterly and annual Financial Statements, the Manager of Market Risks reports to the Board of Directors on compliance with the prescribed limits.

In 2007, there were no material deviations from the limits prescribed for the management of the various market and liquidity exposures.

2. Operating Risks

The activities of the Bank, as a financial intermediary, include operating risks. In accordance with risk management policy, the Bank must identify these risks, assess the damage that may be caused if the risks materialize, supervise the risks and act to minimize the chances of their materializing and the resulting damage.

An operating risk is defined as "the risk of loss resulting from inadequate or failed internal processes, people and systems, or resulting from external events. This risk includes legal risk, but excludes strategic and reputational risks."

The operating risks are managed in the following ways:

A. A Manager of Operating Risks was appointed, who is responsible for formulating the policy for managing operating risks, for instructing the various units in the prevention or minimizing of operating risks, and for preparing procedures for monitoring, reporting and control. In the framework of adapting the organizational structure so as to support risk management policy, a designated risk management section was established at Matam to centralize the handling of all types of risks – business (credit and market) and operating risks.

   An operating risk controller was appointed, who reports to the Head of the Risk Management Control Department, to function independently and be responsible for developing methodologies for identifying, measuring, supervising and controlling operating risks; preparing policies and procedures pertaining to the management and control of operating risks; planning and implementation of operating risk evaluation methodology; planning and implementation of a risk reporting system for operating risk.

   A designated officer was appointed in the Risk Management Control Department, who is professionally responsible for the work of the business risk control officers and the ongoing liason with them.

B. A policy document at Group level was prepared, which delineates the systems, the organizational frameworks and the administrative functions that operate in order to minimize operating risks in the Group. The overseas subsidiaries have prepared similar documents subject to adjustments required by the business environment in which they operate. In addition, a work procedure was prepared and distributed to the business risk control officers, who constitute the operational entity responsible for dealing with and minimizing operating risks in the various divisions. The procedure defines the powers of the business risk control officers, work interfaces, and the principal work processes related to operational risks.

C. Mapping of operating risks is one of the main tools for their control and supervision. A structured process of mapping operating risks has been carried out in the units of the Bank and in the subsidiaries, including a definition of the manner of managing the risk and recommended modes of action (if required) for minimizing the risks.

During this process, special emphasis was placed on mapping risks of fraud and embezzlement, pursuant to a directive of the Bank of Israel.

Within the context of the operating risk management policy, the mapping of the Group's risk must be updated every three years. As from the second half of 2007, an operating risk review is being carried out in the Leumi Group. Within the scope of this review, the material business processes are documented and, based on them, risks and the control thereof are mapped, and the severity of the risks is evaluated. Procedures were formulated in preparation for the review, which define how the review is to be performed, including a document that specifies the risk evaluation methodology and provides instructions for performing the evaluation.

D. An information system was developed for documenting and monitoring the management of operating risks that have been identified in the organization and for documenting operating risk events. The automated system also supports the monitoring process required for implementing the controls. The management database that was set up enables analysis and study of what occurs in the organization from the view point of the various causes of failure, the banking activities, the severity of the risk, the factors responsible for the risk, etc. Systems were developed on the basis of business law, which generate alerts to irregular/suspicious activity in the various business fields, in order to minimize the exposures in these areas.

E. A model for evaluating operating risks was built, according to the relevant directives of the Basel Committee and the methodological tools in existence in this field. The results of the operating risk evaluation of the production systems, which is carried out by the completion of questionnaires at the level of each system, are added to the updated risk map included in the risk review on the basis of the business processes in which the operating systems are involved.

In addition, a risk evaluation system was implemented in relation to projects/prototypes relating to the development of information systems, the findings were analyzed and recommendations published for comprehensive action for reducing the level of exposure. The evaluation of operating risks was also integrated into the ongoing work process in the production systems on the basis of a designated model developed for this purpose. Analysis of the results of risk evaluations facilitates identification of high-risk systems, which also must be addressed to ensure compliance with Proper Banking Management Directive No. 357.

F. A conclusion-drawing forum is convened quarterly, attended by representatives of all of the divisions. Failures that have occurred within the Bank and/or in other financial organizations are discussed at these meetings, in order to determine modes of action to minimize the chances of recurrence of the events and the damage caused in respect thereof. Follow-up of the forum's decisions is monitored until they are fully implemented.

G. In the light of conclusion-drawing process with respect to failures, and the risk reviews that are being carried out, automated controls have been integrated into the operating systems, work procedures have been revised and management information has been made available to assist managers in the control process.

H. Additional activities were carried out to promote assimilation of operating risk management and to disseminate information on this subject, through publishing items on the Bank's knowledge management website regarding what is being done both at the Bank and elsewhere in this field.

I. The Bank carries out preparations for recovery and continuity of business activity in the event of disaster. The activity is comprised of three layers:
   - technological infrastructure;
   - action plans and procedures;
   - periodic emergency drills.

   The activity is coordinated by a business continuity management team.

3. Compliance

The Compliance Department began operating in the Group, pursuant to the requirements of the authorities, in 2001. The Chief Compliance Officer heads the Compliance Department, which is also responsible for implementation of the Prohibition of Money Laundering Act, 2000 and the Prohibition of the Financing of Terror Act, 2005.

The complexity of developments in banking activity oblige the Bank to comply strictly with all the obligations applicable to a banking corporation in its relations with its customers, by virtue of primary legislation, regulations, permits and Bank of Israel directives.

Proper Banking Management Directive No. 308 obligates banks to enforce consumer directives, *i.e.*, provisions of law and directives issued by the authorities that govern a bank's relations with its customers. In accordance with Directive No. 308, an infrastructure review was carried out, under which the consumer directives and the risks of the occurrence of events which deviate from the directives were mapped, and controls were defined to prevent their occurrence.
In 2005, extensive action was taken at the Bank to train employees and assimilation of consumer directives. The Bank also declared that the subject of compliance was of supreme importance, and that the status and activities of the Compliance Department must be upgraded.
A committee was appointed at the Bank, whose role was to formulate a plan for the operation of the Compliance Department and compliance officers in the Group, to ensure conformance with international standards and the Basel Committee requirements, including, *inter alia*, the mapping and prioritization of additional laws, regulations and permits relevant to the Bank's operation, over and above the requirements of Directive No. 308, along with the formulation of work processes, means of control, procedures and training.

The committee has completed its task, and, on the basis of its recommendations, the principles of the model recommended for implementation in the Bank were presented to the Bank's Management and to the Audit Committee of the Board of Directors. This model includes a broadening of the concept of the compliance risk, the implementation of a decentralized compliance model and the tools and computerized systems needed for the effective management of the compliance function. Further, in light of the great importance that the Bank attaches to this subject, additional human resources have been allocated. *Inter alia*, 16 full-time compliance officers were appointed to the Bank's major branches for the focused handling and control of compliance and prohibition of money laundering issues.
The Compliance Department maintains contact with the Bank's overseas subsidiaries for the purpose of examining their preparations for implementing the subject of compliance in general, and the prohibition of money laundering and the financing of terrorism in particular.

4. Prohibition of Money Laundering and the Financing of Terrorism

During 2007, the Bank continued the activities required for the implementation of the provisions of the legislation pertaining to the prohibition of money laundering, including: actions for improving data and for blocking accounts, dissemination of publications to the various units, developing and improving the computer systems and increasing the number of employees dealing with the subject. The staff of the Compliance Department have participated in a variety of training activities to heighten awareness of the importance of this subject.

Following an audit of the Bank by the Bank of Israel regarding the implementation of the Prohibition on Money Laundering Law, the Supervisor of Banks submitted a request to the Committee for the Imposition of Monetary Sanctions to impose a monetary sanction on the Bank in respect of a *prima facie* breach of the provisions of section 7 of the Prohibition on Money Laundering Law. On 31 July 2007, the Supervisor of Banks notified the Bank that the Committee had decided to impose a monetary sanction on the Bank in the amount of NIS 425,000. In the notification, it was stated that the Committee had considered the following facts, in determining the size of the sanction:

1. Most of the violations were first time violations, were not continuing or serious violations, and were small in scope relative to the size of the Bank and the complexity of its operations.
2. During the audit, the Bank cooperated in disclosing violations and their consequences, and took effective measures to correct the deficiencies and to prevent their recurrence.

It was also noted that the Committee believed that the subjects of prohibition of money laundering and the prohibition on the financing of terror were being managed at the Bank professionally and prudently, and that the Management of the Bank had invested considerable resources (financial and other) to implement the directives in this area.

Prohibition on Money Laundering (The Banking Corporations' Requirement regarding Identification, Reporting and Record-Keeping for the Prevention of Money Laundering and the Financing of Terrorism) Order, 2006

On 12 December 2006, the amendment to the Prohibition on Money Laundering (The Banking Corporations' Requirements regarding Identification, Reporting and Record-Keeping) Order, 2001, was published, and will from now on be known as the “Prohibition on Money Laundering (The Banking Corporations' Requirement regarding Identification, Reporting and Record-Keeping for the Prevention of Money Laundering and Financing Terrorism) Order” (the “Order”).
Various subjects were included in the amended Order, including certain concessions for banking corporations. However, its principal purpose is the extension of the Order’s directives to credit cards, and the practical implementation of the directives of the Prohibition on Financing Terrorism Law, 2005.

For the first time, the Order has been applied to credit cards and, as such, it imposes various obligations both on the banks that themselves issue the cards, and on the issue of cards though companies that are banking auxiliary corporations engaged in issuing credit cards.

Furthermore, for the purposes of implementing the directives of the Prohibition on Financing Terrorism Law, 2005 (the "Law"), the Order has been amended on a number of matters, with stricter provisions mainly with regard to transactions with financial institutions in a state or territory mentioned in the Fourth Schedule to the Order. An obligation was included in the Order requiring banking corporations to examine the persons executing certain transactions and the parties to certain transactions against the names contained in the list of organizations and persons declared as “a designated terrorist organization” or as a “terrorist”, at the time of executing certain transactions. In addition, more stringent reporting obligations have been imposed in relation to the transactions executed by the entities detailed above. For purposes of implementing the provisions of the Law, the Prohibition on Financing Terrorism (Permit for Actions involving Property) Regulations, 2006 were published on the same day, which include a permit of the Minister of Finance to banking corporations, pursuant to section 9(d) of the Law.

On 27 August 2007, a Bank of Israel circular was published imposing additional obligations on banks in relation to activities with banks operating in the Palestinian Authority. The Bank has made preparations to implement the said directives as required.

5. Legal Risks

The Bank of Israel defines legal risk as the risk of loss resulting from the inability to legally enforce the performance of an agreement.

Legal risks dealt with by the Bank under the program that has been prepared, as detailed below, include risks deriving from legislation, regulations, case law and regulators’ directives, risks deriving from operations not backed by satisfactory agreements or without legal advice, and risks deriving from legal proceedings. The purpose of the program is to minimize and manage these risks.

A program for managing legal risks is implemented in the Bank. The program includes a policy document and interfaces between the Legal Division and the Bank's various units. With regard to subsidiaries in Israel and overseas, a separate policy document has been prepared, and each company has prepared a legal risk management document appropriate to its activities, in accordance with the instructions in the said policy document.

The program places emphasis on:

- the identification of sources of material legal risks and dealing with them, while appointing the person responsible for carrying out instructions;
- the preparation of appropriate agreements, instructions and procedures;
- legal opinions on the implications of statutory provisions (including case law) and regulators' directives, the examination of their implications on the Bank's work, and the drawing of conclusions with regard to various matters.

6. Fair Value

In accordance with the directives of the Bank of Israel, the fair value of all financial instruments, *i.e.* all the monetary assets and liabilities of the Bank and of its subsidiaries, is presented in Note 18D to the Financial Statements. The fair value of a financial instrument is defined as the price paid by a buyer to a seller in an arm's length transaction.
When there is an active market, the market price constitutes the fair value. Market prices do not exist for a significant portion of the financial instruments of the Bank and its subsidiaries. In the absence of a market price, the fair value is an estimate, based on the present value of the cash flows, as specified in Note 18D.
The fair-value estimates are based on the conditions existing on the date of the Financial Statements and do not necessarily represent future fair values.
In March 2007, the Bank's Board of Directors prescribed a limit of US$ 1 billion for the total transactions whose fair value is determined by the Bank on the basis of quotations received from the counterparty to the transaction. As a rule, these are financial institutions of high repute in the capital markets, who meet criteria prescribed by the Management of the Bank.

The calculation of fair value is based, to a great extent, on subjective evaluation. Therefore, great care should be exercised when using this information, since it does not indicate the economic value of the Bank and its subsidiaries and also cannot be used for comparisons between the various banks.

It should be noted that the data relating to fair value does not take into account the effect of taxes in the event of a positive or negative gap between the fair value and the book value of assets and/or liabilities presented on an accrual basis. The data appearing in Note 18D to the Financial Statements show that the fair value of the monetary assets at the end of 2007 was NIS 1,427 million higher than the balance-sheet value (in 2006, higher by NIS 616 million), while the fair value of financial liabilities was NIS 1,704 million higher than the balance-sheet value (in 2006, higher by NIS 1,333 million). The gap mainly derives from the fact that the assets in the balance sheet already include adjustments to fair value of securities in the available for sale and trading portfolios in the sum of some NIS 827 million, compared with NIS 1,090 million at the end of 2006.

The change in the fair value of the monetary assets and liabilities beyond that recorded in the 2007 Financial Statements derives mainly from the decline in interest rates in the economy, and particularly in the unlinked shekel sector, similar to the decline in 2006.

7. Credit Risk Exposure and Management

Following are the weighted balances of the credit risk in the balance sheet:

	December 31, 2007						
	Balance-sheet	**Weighting rates**				**Deduction**	**Risk**
	balances	**0%**	**20%**	**50%**	**100%**	**from equity**	**balances**
	In NIS millions						
Assets							
Cash and deposits in banks	42,329	8,253	34,073	-	3	-	6,818
Securities	47,169	15,456	18,135	-	13,578	-	17,205
Securities borrowed or purchased under buy-back agreements	655	655	-	-	-	-	-
Credit to the public	198,890	14,842	1,689	14,676	167,683	-	175,359
Credit to the government	642	563	-	-	79	-	79
Investments in companies included on the equity basis	1,873	-	-	-	1,808	65	1,808
Buildings and equipment	3,276	-	-	-	3,276	-	3,276
Other assets	7,650	404	2,809	-	4,149	288	4,711
Total assets	302,484	40,173	56,706	14,676	190,576	353	209,256

	December 31, 2006						
	Balance-sheet	Weighting rates				Deduction	Risk
	balances	0%	20%	50%	100%	from equity	balances
	In NIS millions						
Assets							
Cash and deposits in banks	47,609	5,642	41,574	-	393	-	8,708
Securities	46,375	18,135	18,810	-	9,430	-	13,192
Credit to the public	184,132	14,200	1,674	13,562	154,696	-	161,812
Credit to the government	1,020	868	-	-	152	-	152
Investments in companies included on the equity basis (a)	1,251	-	-	-	1,188	63	1,188
Buildings and equipment	3,056	-	-	-	3,056	-	3,056
Other assets	6,230	173	1,877	-	4,026	154	4,401
Total assets	289,673	39,018	63,935	13,562	172,941	217	192,509

(a) Balances of investments in shares and subordinated capital notes of financial companies are deducted from the equity, and therefore, also from the balance of securities and from investments in companies included on the equity basis.

Strategies

The Bank's credit policy is based on the spreading of risks and their supervised management. This is effected through the spread of the Bank's credit portfolio among the various sectors of the economy and among a large number of borrowers. The credit policy serves as a guideline for the managements of designated subsidiaries in Israel and abroad, but the managements of these subsidiaries delineate the policy in the market segments being managed by them, except in relation to certain fields, for which there is Group-wide policy.

Since it fulfills a central role in financing the Israeli economy, the Bank implements a strategy of involvement in the principal activity sectors of the economy and provides credit to the various types of manufacturing and commercial sectors, to the diverse public sector, to individuals and to households.

Within the context of the credit policy of the Bank in Israel, principles and rules have been prescribed according to which the Bank's credit portfolio is to be granted, managed and supervised, with the object to improving the quality of the portfolio and reduce the risk inherent in its management. These principles and rules relate both to the individual customer and to the economy and business sectors.

The Bank's Board of Directors approves the Bank's credit and collateral policy, and sectorial and other limits.

Regarding the exposure to groups of borrowers, until the end of 2006, the Bank had operated in accordance with the provisions of the Bank of Israel's Proper Banking Management Directive No. 313, which prescribed that the total exposure to a "group of borrowers" should not exceed 30% of the Bank's capital, while the total exposure to the "six largest groups of borrowers" should not exceed 135% of the Bank's capital. As from the beginning of 2007, the Bank received the Bank of Israel's approval and changed to an alternative exposure policy. Pursuant to this policy, the exposure to a group of borrowers should not exceed 25% of the Bank's capital, so that the total exposure to the six largest groups of borrowers can reach up to 150% of the Bank's capital.

As at 31 December 2007, the obligations of the largest group of borrowers reached 19.9% of the Bank's capital. The obligations of the largest single borrower reached 10.0% of the Bank's capital. The obligations of the six largest groups of borrowers reached 99.5% of the Bank's capital.

The trend of expanding economic activity, which encompassed the majority of sectors in the economy, was expressed by a rapid increase in employment and by a fall in the unemployment rate, and was influenced by an increase in local demand, particularly in private consumption and in investments. Nonetheless, growth was also significantly influenced by the increase in the exports of goods and services and by a significant broadening of imports.

Despite the moderation of global economic growth, mainly in the United States, and in contrast to the negative developments in the financial markets since the beginning of the second half of 2007, the situation of households in Israel continued to improve during the past year, and consequently, the proceeds in the trade and services sectors continued to rise. The rise in activity in the majority of sectors of the economy, including the first signs of an increase in activity in the construction sector, was expressed by a continuing improvement in the level of profitability in many sectors.
Industrial exports expanded in 2007, including and especially the export of chemicals and oil refinery products. In addition, there was a significant rise in imports of consumer goods, which reflects the significant increase in private consumption.
The tourism sector, which suffered during 2006 due to the Second Lebanese War, recovered during 2007.

The year 2007 was characterized by the continuing rise in the proportion of nonbank credit provided to the business sector, at the expense of bank credit.
The crisis in the housing and mortgages field in the United States – the "sub-prime" crisis – triggered the onset of a slowdown of economic activity in many countries, including a decline in demand, which is also liable to affect the Israeli economy, and cause a slowdown in growth.
The sharp drop in share prices in the stock markets throughout the world, against the back-drop of the crisis and the great volatility in the markets, have already affected the domestic stock market.
Following the crisis in the capital market, the Bank has taken steps to identify borrowers that have also been raising sources of financing in recent years in the capital market, when the amounts raised were characterized by a narrow capital base and a low funding cost, in order to ascertain the capability of these borrowers to continue recycling current maturities. Under particular scrutiny are borrowers that earmarked the monies raised as equity for leveraging investments abroad.

Following the drop in stock prices on exchanges around the world, the Bank has been closely monitoring and controlling the effect of the erosion on the exposure to potential borrowers. *Inter alia*, the Bank has been monitoring debts based on shares which constitute a significant portion of their asset value and/or the collateral upon which the bank is relying, as well as borrowers that intended to base future repayments on sources raised on the stock exchange.

A "domino effect" following the events on stock exchanges around the world could also lead to chain reactions and to considerable volatility both in the currency exchange rates and in the prices of commodities. Therefore, the Bank is also focusing on identifying exposures to changes in exchange rates and commodity prices, and on monitoring customers who face exposure risks, while offering borrowers the opportunity to use banking means to protect themselves and reduce exposures.

In light of the current degree of uncertainty, the effects of risk factors, such as the current geopolitical risk in the economy, the risk of entering a slowdown, or an adverse effect on exports due to the economic situation in the United States, the Bank is implementing a cautious credit policy in relation to the various branches of the economy and credit sectors. The Bank is continuing to incorporate more stringent controls in its credit policy in relation to credit whose risk level has risen, the supervision of credit authorities, the broadening of the preliminary examinations prior to the execution of transactions, the setting of stringent criteria in relation to the various types of transactions and setting the threshold conditions for approving transactions, such as the requirements for equity and collateral for the various types of financing. The Bank examines and revises the risk rating of borrowers very frequently, mainly in connection with the possible effect of a downturn in demand for consumer goods and real-estate, in relation to certain sectors of the economy in Israel and internationally, and in connection with geographical regions that were particularly affected. In instances when the Bank deems it warranted action is taken to reduce the exposure and/or to call for additional collateral and/or to increase the margins.

The Bank continues to take steps to identify and rectify deficiencies in credit and collateral documents. In addition, the Bank has developed methodologies for identifying, classifying and marking problematic credit and for calculating adequate provisions, and is integrating them into the business lines.

On 31 December 2007, the Banking Supervision Department issued to banking corporations an amendment to the regulations for reporting to the public on the subject of "Measurement and Disclosure of Impaired Debts, Credit Risks and Provisions for Credit Losses."

For details, see Note 1 X(b) to the Financial Statements.

Credit Policy in Overseas Subsidiaries – In each of the Bank's overseas subsidiaries, the credit policy of the subsidiary is approved by the local board of directors and is presented to the Credit Risk Management Committee of the Bank in Israel. As in Israel, the credit policy of the overseas subsidiaries is also based on the spread of risk among the various sectors of the economy, while determining exposure limits for the various sectors of the economy and various activity segments. In addition, a collateral policy is prescribed within the scope of the credit policy, which includes rules and principles regarding the various types of collateral, the rate of reliance thereon and the like. All this is done in accordance with and subject to all the banking regulations and directives in each country. Various levels of credit-granting authorities have been determined in each subsidiary. In addition, in subsidiaries granting commercial credit, there is a process for rating borrowers according to risk levels and, in subsidiaries with a substantial credit volume, a credit review unit operates and performs an ongoing examination of the risk level of the Bank's customers.

Processes:

The Bank performs periodic analyses of the various branches and sectors of the economy according to the risks and prospects inherent in each branch, and defines the appropriate credit policy for each branch of the economy. In the field of credit management, the risk monitoring and control processes have been improved by deepening the process of centralizing business customers in the appropriate divisions and within the framework of specialized branches.

The Credit Risk Management Unit of the Corporate Division's Credit Department examines the credit lines of the major borrowers of the Bank, approves transactions or passes them on for deliberation by the appropriate credit committee. This unit is unique to Leumi; it was established during 2006 after an in-depth examination, the purpose of which was to tighten the credit controls and to improve the quality of the Bank's credit portfolio and the service to customers.

Financing of the construction and real-estate sector, which is concentrated in a separate unit, is carried out using specific analytical and monitoring tools, which assist the Bank in the decision-making process and in monitoring the financing being provided to various projects. The Real Estate Credit Risk Management Unit examines the credit lines of the major borrowers, approves transactions or passes them on for deliberation by the appropriate credit committee, in the manner described above.

The financing in this sector is carried out while ensuring diversification of the credit portfolio and by differentiating between the various construction segments: residential, income-producing properties intended for commercial and office use, and construction for industry and trade, and by differentiating between the geographic areas where the projects are located, according to relevant demand.

A material portion of the financing of construction is carried out in the closed “construction lending” format, which is characterized by periodic reviews and close monitoring, with reliance on and with the assistance of external construction supervisors.

As part of the Bank’s strategy to finance its customers wherever they operate, and with the aim of spreading risks, the Bank also participates in the financing of real estate abroad. The financing is provided for selected customers in a controlled manner, in preferred countries, taking the political and economic risk of the country into consideration, and while meticulously scrutinizing the projects, with the Bank’s overseas subsidiaries or other local banks participating in the projects.

Financing transactions for the acquisition of various types of means of control is credit provided to a borrower, when the primary source of repayment of the credit derives from the corporation being acquired via Bank financing. The Bank’s equity requirements, the collateral and other conditions for financing the acquisition of means of control are prescribed under the Bank’s credit policy.
The Bank of Israel has prescribed limits on financing the acquisition of a means of control in corporations in the Proper Banking Management Directives, and the Bank is in compliance therewith.

The Bank established a dedicated unit to handle complex transactions for financing investments in infrastructure projects (power stations, desalination facilities, toll roads, BOT projects and the like). This unit examines the transactions and structures the financing package, including possible cooperation with capital market entities in the financing of the transaction.

The Bank continues to take steps to identify and rectify deficiencies in credit and collateral documents. In addition, the Bank has developed methodologies for identifying, classifying and marking problematic credit and is integrating them in the business lines.

Concurrently, considerable resources are being invested in improving control tools and computerized information systems that are available to the credit decision-makers.

In the private credit sector, in addition to the continuous monitoring of activities in accounts and the adjustment of current-account and credit-card facilities in accordance with these activities, credit is renewed and re-adjusted to the level of activity in the account aided by decision support systems.

The granting of credit in the private credit sector up to a defined maximum sum is examined with a credit scoring system on the basis of the level of risk inherent in the account. Corporate and commercial credit and major private customers are rated through a credit rating system operated at the Bank. The system is constantly being improved in order to tailor it to the current credit characteristics and to contend with a range of borrowers from the various sectors of the economy according to their level of complexity, financial performance, the amount of collateral and size. This credit rating assists Management in the decision-making process, in credit costing and in monitoring the quality of the credit over time. Credit risks depends on the PD (the probability of default) by the borrower during a given period, the extent of the EAD (the exposure at default) and the LGD (the loss given default – the expected loss from the borrower in default). The borrower evaluation system, together with the system for measuring customer profitability, provide the basis for the connection between the level of risk and the return.

Proper Banking Management Directive No. 339

The Bank is organized to and implements the provisions of the Supervisor of Banks’ Proper Banking Management Directive No. 339 – in relation to the management of the Bank’s credit risks. The regulation prescribes fundamental principles for the management and control of risks, including the responsibilities of the management entities, the proper involvement of the Board of Directors in risk management, the definition of control systems, the provision of risk evaluation and measurement tools, and the arrangement of systems for the control and supervision of these risks.

Conclusion-drawing process

A process of drawing conclusions on credit matters is carried out at the Bank, with the participation of executives from the Bank's various units. Conclusion-drawing committees were established in the various divisions for this purpose. These committees convene periodically in order to discuss incidents of credit default, to analyze the implications and the significance of the findings in relation to such incidents, and to formulate recommendations for improving the work processes and enhancing business efficiency. These recommendations are reflected in revisions of the credit and collateral policies, in amendments of the work procedures at the Bank and in updates of the training programs.

Description of the Approaches and Statistical Methods Used to Determine Specific Provisions for Doubtful Debts

Process of Identifying Sensitive Accounts and Classifying Problematic Debts –

Principles have been prescribed within the scope of the Bank's credit policy, according to which credit is to be granted, managed and supervised, and the objectives of which are to improve the quality of the portfolio and reduce the risk inherent in the management thereof. The Bank examines the credit portfolio on an ongoing basis and in accordance with its procedures, with the objective of identifying borrowers, as soon as possible, whose level of risk and exposure has risen and so require special management attention and close monitoring due to risk characteristics or economic/market conditions that are liable to affect the borrowers' position, with the aim of improving their position. The assessment of the severity of the problem is carried out while exercising discretion by the business personnel dealing with the borrowers and by the Credit Department in the Corporate Division. They perform an honest objective of the difficulties identified, for the purpose of assigning the risk rating and, if necessary, making specific provisions.

As part of the means employed by the Bank for credit risk management, a methodology for identifying and classifying problem loans has been developed, and the Bank is preparing to implement it in all lines of the banking business. This methodology includes a structured, quarterly work process, under which the customer's file is thoroughly reviewed, using a number of criteria that provide an early warning of it becoming a problem loan. Another aspect of the methodology being employed systematically examines the adequacy of the provision for doubtful debts, in respect of the obligations about which the Bank has doubts, while setting basic criteria for the method of calculating the provisions for doubtful debts. The calculation is performed according to the debt's characteristics, an assessment regarding the customer's business position and its ability to continue operating, the business environment in which it operates, the extent to which it has met its obligations in the past and a realistic evaluation of the collateral and the ability to exercise it, at the discretion of the Bank's Management. The Credit Risk Management Unit (CRMU) in the Corporate Division and the Construction and Real-Estate Division participate in the process of examining the adequacy of the provisions.

The process described of estimating the potential losses in the credit portfolio involves, to a great extent, uncertainty and subjective assessments in relation to all matters pertaining to classifying the debt as problematic, and pertaining to the factors used in calculating the provisions for doubtful debts. These assessments and estimates are likely to have a material effect on the size of the provision for doubtful debts.
Debts are classified, and the size of the principal and/or interest provisions is determined, pursuant to the Supervisor of Bank's Proper Banking Management Directive No. 314.
The categories according to which the provision is calculated are determined pursuant to prescribed procedures and according to different levels of authority.

The Bank's Doubtful Debts Committee, which is chaired by the Chief Executive Officer, holds a discussion each quarter of the provisions required for the quarter. During these discussions, recommendations are presented for the quarterly provision needed at the customer level. Further, during the discussion of the Financial Statements, a discussion of the provisions for doubtful debts is held by the Board of Directors, in order to approve the amount of the provisions. Data on the debts and collateral of the principal customers for

which a provision is required is submitted as background material for the discussion by the Board, along with the amounts of the provisions proposed by the Management.
The control process is concluded by the decisions regarding the classification of the debt and/or making of a provision.

Additional Provision:

Pursuant to the Supervisor of Banks' Proper Banking Management Directive No. 315, an additional provision is made, which is calculated according to the various classifications of debts, according to a prescribed formula. It should be noted that a change in the additional provision does not affect the tax liability, since the additional provision is not recognized as an expense for tax purposes.

Policy and Processes regarding Validation and Management of Collateral

As a policy, the Bank strives to avoid providing credit without collateral. The volume of collateral required from a borrower derives, *inter alia*, from the level of credit risk. The collateral being received is not the principal consideration for approving credit, but rather additional support, intended to minimize the loss to the Bank in the event of the business/financial failure of the borrower.

Within the context of the collateral policy for all branches of the economy, principles and rules were determined concerning the types of collateral and the amounts required. Collateral requirements and rates are derived from the level of risk that the Bank is willing to assume when granting the credit, but special emphasis is placed on the borrowers' risk ratings and their repayment capacity as criteria for providing credit, as opposed to the weight attributed to the customary collateral.
Collateral is matched to the kind of credit that it secures, taking into account the length of the period, the types of linkage, the nature of the credit and its purpose, as well as the time frame within which the collateral can be realized. The Bank customarily verifies the value of collateral by obtaining up-to-date appraisals/valuations. The CRMU in the real-estate unit of the Corporate Division operates an "appraisal section" whose function, *inter alia,* is to examine the valuations of the assets pledged to the Bank, which are performed by qualified appraisers, and to determine the maximum value of the assets as collateral.
In certain instances, when the facts justify doing so, the Bank accepts partial collateral, while relying on the customer's proven financial strength and capacity in respect of the unsecured portion, and while stipulating various covenants.
The hierarchy of authorities for providing credit at Leumi is determined, *inter alia*, according to the level of the collateral's implications on the borrower's risk rating. The lower the collateral is in relation to the credit, the less influence it has on improving the risk rating.
The Bank has a computerized system enabling information to be produced about the types of collateral. Instructions have been issued concerning the various types of collateral, their management, determining their value (using external appraisers, financial data, etc.), dealing with the receipt of collateral, and monitoring changes in collateral and in its value. Officers empowered to authorize the credit operate according to prescribed policy in relation to the rates of collateral, which are automatically calculated by the computerized system pursuant to the prescribed policy.

The Bank's collateral procedures contain the business and legal principles on whose basis the various types of collateral are to be received. These instructions also include the operational aspects regarding the procedure for receiving collateral (for example: requisite forms, registration with registrars, if needed), the reliance rates for collateral in respect of each type of collateral, control processes that must be performed, etc.

Following is a description of the usual types of collateral accepted by the Bank:

- pledge/offset of monies being administered at the Bank or by external parties (shekel/foreign currency deposits, savings, securities, provident funds);
- pledge of sources for repayment which are paid into the bank account (deferred receivables, credit card vouchers, direct debits, open accounts);
- bank guarantees from banks in Israel and abroad / State guarantees / retaining of interbranch securities;
- third-party guarantees;
- foreign trade risk insurance policies;
- real estate;

– floating charges;
– movable assets (vehicles, equipment);
– pledge and assignment of rights by way of charge (pledges of contract/invoices).

Following are data showing reductions in credit risk in the Group as on 31 December 2007, in NIS millions:

	Secured by government debentures	Secured by bank securities	Secured by deposits	Covered by bank guarantees	Covered by credit risk insurance
Credit to the public	**2,247**	**13**	**12,573**	**1,710**	**22**
Other assets	**14**	**-**	**41**	**-**	**-**
Book value equivalents of transactions in which the balance represents a credit risk.	**176**	**-**	**2,215**	**578**	**1**
Book value of derivatives	**201**	**-**	**411**	**-**	**-**

Structure and Organization of Risk Management Functions

The Manager of Credit Risks – The Head of the Corporate Division also serves as the Group's Manager of Credit Risks.

The Senior Committee for Risk Management – chaired by the Chief Executive Officer of the Bank, whose members are the Bank's risk managers – managers of market risks, legal risks, operating risks and credit risks – as well as the Bank's Chief Risk Control Manager. The functions of the committee include, *inter alia*, formulating policy for each of the risk categories, which are submitted for the approval of the Board of Directors; adapting the risk mix to the Bank's strategy; ensuring that the various risk categories are controlled and managed on an ongoing basis within the framework of the limits set in the policy.

The Credit Risk Management Committee – chaired by the Manager of Credit Risks, and comprised of senior personnel from all relevant units of the Bank. The Committee convenes at least once quarterly, and according to circumstances and the need for discussions, and deliberates issues pertaining to the credit risk management policy of the Bank, its subsidiaries and its overseas offices, as well as issues associated with credit risks, including those defined by the Senior Committee for Risk Management.

The Credit Department – reports to the Manager of Credit Risks, includes, *inter alia*, the following units:

The Credit Risk Management Unit – operates within the framework of the Credit Department in the Bank's Corporate Division, performs periodic monitoring and control of the customers of the Corporate Division/the Construction and Real-Estate Division, in order to validate the borrower's risk rating, this beyond the routine daily control that the account managers perform in relation to customers under their care. The majority of the unit's work focuses on the independent examination of the account managers' recommendations for determining credit facilities for financing of customers under their handling, and identifying customers whose situation has deteriorated, while indicating the main risks characterizing the credit portfolio and providing recommendations for the continued handling of the customers. As part of the rationale behind the establishment of the CRMU, and with the aim of improving and simplifying the decision-making process and shortening the timeframes for providing credit, a change was made in the hierarchy of credit authorities at the various levels so that many credit applications are within the approval authority of the CRMU. This enables more time to be allocated for discussing borrowers characterized by a high level of exposure and complex transactions. The CRMU also carries out a number of systemic assignments: periodic control, the building of methodologies, etc.

Credit Portfolio Management Section – operates within the framework of the Credit Department in the Bank's Corporate Division; its functions include, *inter alia*, the following issues: evaluating the performance of the Bank's credit portfolio (in terms of yield versus risk), creating transparency in the structure of the credit portfolio according to risk levels and factors, formulating guidelines for the credit portfolio structure that is desirable to the Bank, formulating recommendations for limits on the credit portfolio. The Credit Portfolio Management Section examines the impact of marginal transactions on the structure and risk of the credit portfolio, and provides recommendations for executing transactions/operations to improve the structure and risk of the portfolio. The assumption is that active sophisticated management of the credit portfolio will lead to reprioritizing the capital allocation and to freeing up of capital against which credit was provided with a low level of contribution, in favor of business initiatives with more profitable market sectors/borrowers, and lead to improved margins.

Credit Risks and Policy Section – operates within the framework of the Credit Department and is responsible, *inter alia*, for updating the Bank's credit policy and supervising the processes of drawing conclusions in the Bank, for implementing regulatory directives pertaining to credit at the Bank, as well as for reporting to the Bank of Israel about large single borrowers, groups of borrowers and transactions for the acquisition of means of control in a company. The section is also responsible for reporting to the Bank's Management and to the Bank's Board of Directors, in relation to all matters pertaining to credit exposures, including the risk posed by single borrowers and groups of borrowers, transactions for the acquisition of means of control, sectorial risks and risks pertaining to sensitive accounts and problem loans at the Bank.

Credit Management and Control Section – operates within the framework of the Credit Department and is responsible, *inter alia*, for the method of managing the various credit committees in the Bank, the format for submitting material for discussion at credit committee meetings, letters of credit authority, publications in the fields of credit and collateral, the checking of credit and collateral documents, as well as the adequacy of insurance policies relating to pledged assets.

Additional Units Engaging in Credit Risks:

Special Credits Department – reports directly to the Manager of Credit Risks, and coordinates the handling of problem customers of the Bank, who are transferred for its attention according to criteria determined by the Bank's Management. The primary objective is to rehabilitate the customer and improve his financial strength and his debt servicing capability. Lacking such capability, the Department takes action to recover the debt while minimizing the damage to the Bank.

Credit Risk Management Control and Loan Review Unit

This unit operates within the framework of the Risk Management Control Department, and is subordinate to the Chief Executive Officer.

Its functions include, *inter alia*, controlling the implementation of the Bank's credit policy, identifying credit risks, from which systemic issues are derived having implications on the Bank's overall credit risk, as well as advancing the Bank's preparations towards implementing the Basel II Accord.
The Loan Review Unit performs independent ongoing evaluations of the level of risk of the Bank's principal business customers and determines the credit rating of these borrowers. This unit operates independently and separately from the Bank's credit teams.
The unit transfers a review of the overall credit control activity to the Chief Executive Officer and to the Board of Directors, which includes, *inter alia*, data on the scope of the review, the findings and how they were dealt with, as well as the implications on the quality of the Bank's credit portfolio. In addition, it also gives its opinion on the quality of the borrowers' ratings as included in their files.

Model Development and Credit Risk Measurement Section

This section is responsible for the development of methodologies and construction of quantitative models and tools for measuring and controlling credit risks in the Leumi Group. These methodologies, which are approved by the Credit Risk Management Committee, support improving the link between the risk profile of the Bank, the risk management systems and its capital, in conformance with the regulatory requirements under the provisions of the Basel II Accord.

The Character and Scope of the Reporting Systems on Risk and/or Systems for its Measurement

The Bank is taking action to improve the computerized information systems made available to the decision-makers in the Bank on credit matters. It ensures the maintenance of ongoing, up-to-date reporting to the Banking Supervision Department and to members of the Bank's Management. The reporting to the Banking Supervision Department includes reports about various credit matters, including credit risks according to branches of the economy, financial instruments, the structure of the shareholders' equity and the minimum capital ratio, major single borrowers and groups of borrowers, problem loans, the additional provision, the credit exposures of the subsidiaries abroad, connected parties, etc.
The reports to the Management of the Bank and/or to the Board of Directors concern the development of credit and exceptional or major transactions, the results of quarterly reviews of the risk rating of borrowers in particular and of the overall credit portfolio in general, quarterly reports of credit concentration according to sectors, single borrowers and groups of borrowers, countries, Israeli and foreign banks *vis-à-vis* the limits set by the Banking Supervision Department, and internal limits, the spread of problem loans among the Bank’s various units, and information about customers with special sensitivity, etc.

Hedging Policy and/or Risk Reduction and Strategies and Processes for Monitoring the Continuing Efficacy of Risk-Reducing Hedging Activities

The developments in the international foreign currency markets and the volatility in the exchange rates of the various currencies and their implications on borrowers active in foreign currency necessitate an increase in the monitoring, supervision and control activities. To this end, the Bank has updated the instructions addressing the adjustment required between the base of currency of the credit and the currency of the cash flow providing the source of the repayment of the credit. Following the continuing erosion of the U.S. dollar exchange rate, and its effect on the credit exposure of borrowers in certain sectors of the economy, mainly borrowers whose main source of income derives from exports, awareness of the issue of currency exposure was raised and special attention was paid to borrowers facing potentially high levels of exposure. When necessary, the borrower’s rating is updated, while requiring the strengthening of the equity and collateral.

If it is found that a borrower faces exposure/sensitivity to changes in exchange rates, the degree of the borrower’s sensitivity must be examined from broad perspective by the relevant functionary at the Bank. The examination takes into account all the criteria that, if met, would require that the borrower be added to the list of sensitive customers, and the borrower's sensitivity to changes in the relevant exchange rates and commodity prices must be weighted and quantified.
For the purpose of hedging various credit risks, the Bank recommends that its customers use means of protection against macro-economic variables, such as: the CPI, the exchange rate and commodity prices. The Bank suggests to the borrower that it avail itself of financial instruments that enable it to protect itself against sharp rate changes, while reducing the level of risk in the credit. By using these instruments, the financial exposure, and, to a certain extent, also the real exposure, may be hedged and the risk reduced to a minimum.
When a solution is not found to cover fully the exposure to changes in exchange rates, the Bank examines the need for taking measures to reduce the exposure, such as: changing the credit terms, increasing the collateral requirements, and reducing the borrower obligations, as well as cancelling lines that have not yet been utilized.
Various escape clauses are included in the credit documents, which enable the Bank to discontinue providing credit in foreign currency and to replace it with credit in Israeli currency.

Due to the high volatility in the prices of commodities internationally, special attention is also paid to sectors that are liable to be adversely affected by this trend.
With the aim of improving the range of products and the level of service to customers, financial instruments are made available to customers that enable customers to protect themselves from rate, linkage and interest exposures, and thus, improve their financial stability, while reducing their levels of risk.

The Bank is taking action to adapt the risk management systems to conform to the directives deriving from the recommendations of the Basel Committee and is prepared to add the estimated economic capital allocation according to the types of risks and the levels thereof. For the purpose of costing the credit and banking services, tools are being built in the Bank for calculating the minimum risk premium required for risk adequacy in new loans being provided, also taking into account the capital allocation deriving from the risk level, with emphasis on those instances where the capital allotment required for that borrower and/or activity is subject to an effective regulatory limit.

8. Credit Risk in Derivatives Activity

Following are the weighted balances of the off-balance-sheet credit risk:

	December 31, 2007						
	Par value balances	**Book value**	**Weighting rates 0%**	**20%**	**50%**	**100%**	**Risk balances**
	In NIS millions						
Off-balance-sheet instruments							
Transactions whose balance represents:							
Credit risk	**93,141**	**26,658**	**2,418**	**1,202**	**-**	**23,038**	**23,278**
Derivatives	**226,230**	**23,113**	**678**	**15,076**	**-**	**7,359**	**10,374**
Others	**1,123**	**112**	**-**	**-**	**-**	**112**	**112**
Total off-balance-sheet instruments	**320,494**	**49,883**	**3,096**	**16,278**	**-**	**30,509**	**33,764**

	December 31, 2006						
	Par value balances	Book value	Weighting rates 0%	20%	50%	100%	Risk balances
	In NIS millions						
Off-balance-sheet instruments							
Transactions whose balance represents:							
Credit risk	84,825	22,988	3,191	802	-	18,995	19,155
Derivatives	129,321	13,740	548	7,877	-	5,315	6,890
Others	999	100	-	-	-	100	100
Total off-balance-sheet instruments	215,145	36,828	3,739	8,679	-	24,410	26,145

The par value amount of a transaction in derivatives does not reflect its credit risk. Credit risk is measured by the maximum loss, according to scenarios, that the Bank may incur if the counter-party to the transaction does not comply with the terms of the transaction, after deducting enforceable set-off agreements.

The credit risk at a specified date is defined as the total loss or profit that has arisen from the transaction as at that date, plus the potential risk of additional future loss, this potential being estimated according to the level of expected volatility of the underlying asset and the duration of the remaining period until final settlement of the transaction.

Customers’ activity in transactions in the various types of derivatives is monitored by the Derivatives Risk Management Department in the Bank’s Capital Markets Division. This department is responsible for the models for calculating the collateral requirement, the parameters used in the models, the computer systems that measure compliance with the frameworks of the activity, work procedures at the branches, and the legal forms that customers sign. In addition, an overview of the control is carried out in relation to all customers, while, with respect to a number of customers working according to complex strategies or in new types of activities not yet computerized, direct monitoring is performed of the collateral requirement *vis-à-vis* the actual collateral and activity frameworks.

Application of the Financial Assets Agreements Law (netting) enables all futures transactions between the bank and the customer to be considered as a single transaction. This law enables payments to be offset in respect of futures transactions by affixing a single sum, should the customer become insolvent. Accordingly, the legal forms have been amended and the customers' signatures on the amended documents were obtained.

With reference to forward transactions and/or purchased options, the collateral requirement is calculated according to a schematic model; *i.e.,* a coefficient is added to the mark-to-market revaluation, which constitutes a safety cushion that covers a possible impairment in the value of the transaction as a result of changes in market prices. This continues until the customer adds collateral as required by the Bank. When the customer's portfolio contains an open position on the writing of an option, an open position for the purchase of an option and a forward in the same pair of currencies and/or transactions, with a price limit, the collateral requirement is calculated according to the scenarios model. The calculation of the value of the transactions in the portfolio is carried out for a pair of currencies under 49 different scenarios (changes in the spot rate and in the standard deviation), and the requirement is determined according to the worst-case scenario in each pair of currencies. The parameters used for both models are determined from time to time and are also based on historical data. The parameters used for determining collateral for activity in *Maof* options are those set by the *Maof* clearing house.
It is important to note that the computer systems are updated in real time in relation to executed transactions and market prices. Prior to carrying out a new transaction for a customer, the trader in the dealing room performs a simulation in order to ensure that the new transaction will not cause the customer to exceed his approved activity frameworks.
If a customer has additional liabilities at the Bank, the credit risk deriving from derivatives is included in the customer's total indebtedness at the Bank.

Following are the exposures pertaining to a counter-party's credit risk, in NIS millions:

a. Derivatives hedging a positive gross fair value	98
b. ALM derivatives with a positive gross fair value	4,532
c. Other derivatives with a positive gross fair value	317
Total fair value	4,947
Total collateral held	55

9. Evaluation of Exposure to Risk Factors in the Leumi Group

In accordance with Bank of Israel regulations, the table below specifies the risk factors to which the Group is exposed in respect of its banking activity, and Management's estimates of the level of the various risks.

Risk factors are assessed according to their degrees of severity – low, medium and high. A high risk is defined as a risk that is likely to cause damage to the Group's operations should it materialize; a medium risk is defined as a risk that, should it materialize, is liable to delay the growth of the Group and the attainment of its business objectives, while a low risk is defined as a risk that, should it materialize, is liable to be expressed by an adverse effect on the annual profit and a reduction in, or non-payment of, a dividend. It is important to note that the severity of risk refers only to the materialization of unforeseen damages. Estimations of a fixed and foreseen level of adverse events are part of the Bank's business planning and are reflected on an on-going basis in the financial results. The report on risk factors refers to deviations from the anticipated values that might erode the anticipated profit and, in extreme cases, even part of the Group's equity.

In order to provide a reasonable level of confidence, a risk factor that with a probability of 90% will not be realized in a particular year has been chosen as a realistic risk threshold (that is to say, the probability that damage will occur at the level of severity indicated in a particular year is less than 10%).

A low risk is defined as a risk whose materialization will not cause the ratio of capital to risk assets to drop by more than 1%. A moderate risk is defined as a risk whose materialization will not cause the ratio of capital to risk assets to drop by more than 2%, and to a level of 10%.

The assessed loss is calculated after the effect of taxes.

The various risks and evaluation methods are specified below:

1. Credit risks

The risk of loss resulting from the possibility that a borrower may not meet its obligations.

The Leumi Group adopts a cautious credit policy in relation to the various branches of the economy and credit sectors. The Group incorporates into its policy stringent controls over credit whose risk level has risen, the supervision of authority to grant credit, the extention of the examinations made prior to the execution of transactions, the setting of stringent criteria in relation to the various types of transaction and the raising of the threshold conditions for approving transactions, such as increasing the requirements for equity and collateral for the various types of financing.

The Group's capital adequacy ratio is higher than the minimum capital adequacy required by the Bank of Israel – of 9%. This capital surplus reduces the adverse impact of credit events and reduces the possibility of significant damage to the business activities or to the stability of the Group. Credit is the core business of the Leumi Group, and a general deterioration in the field of credit, whether in a particular branch or in the economy as a whole, would no doubt cause heavy losses to the Group. The total credit risk of the Group is estimated as being at a medium level and is defined as the sum of the three components specified hereunder:

1.1 The risk in respect of borrowers and collateral – the distribution of the shared loss of the major borrowers in the Bank was examined, with a significant rise in the probability of failure due to the fear of a global recession. The maximum loss at the prescribed confidence level is of moderate scale.

1.2 The risk in respect of sectorial concentration – the distribution of the loss was examined, assuming that the Bank's activity is divided into five major sectors, an assumption that, of course, is very conservative. The added risk in respect of sectorial concentration derives from the difference between the risk spread obtained and a similar distribution assuming dispersal among a large number of sectors. The additional risk at the prescribed confidence level is low scale.

1.3 Groups of borrowers – distribution of the loss was examined assuming that each of the borrowing groups constituted a single borrower. The significance of this assumption is a perfect correlation between all the companies in a particular borrowing group. The additional risk in respect of groups of borrowers was derived from the difference between the risk distribution obtained and the risk distribution assuming a large number of small borrowers and is low.

For additional details regarding credit risk exposures, see pages 181-191.

2. Market risks

Market risk is defined as the risk of loss from balance-sheet or off-balance-sheet positions, deriving from exposure to changes in exchange rates, interest rates, inflation rates and share prices.

In order to evaluate this risk, use may be made of the VAR (the biweekly value at risk) which is calculated for market risks. This value may be normalized so that it matches the description of annual damage at the desired confidence level, both for overall market risk and for its components. After these adjustments are made, the overall annual damage from market risks is equivalent to a low risk. The various risk components (interest, currencies, inflation and shares) are lower, and are also categorized as low risk.

For additional details regarding exposure to and management of market risks see pages 163-171.

3. Liquidity risk

A liquidity risk is the risk of loss deriving from uncertainty with regard to the availability of sources and the conditions for raising them unexpectedly within a short timeframe.
This risk has been determined as a low risk, since the Bank complies with the liquidity ratios that it set for itself, including probability ratios, and the subsidiaries also comply with the ratios that they set for themselves.

For additional details, see pages 171-173.

4. Operating risk

Operating risk is "the risk of loss resulting from inadequate or a failed internal processes, people and systems, or resulting from external events. This risk includes legal risk, but excludes strategic and reputational risk."

At Bank Leumi and at its subsidiaries, a structured process of mapping operating risks and estimating their severity is carried out in an ongoing basis. This includes defining how the risk should be managed and the recommended modes of operation for minimizing the risks.
As a result of these processes, an information system was developed for documenting and monitoring the management of operating risks. The Bank carries out processes for evaluating and hedging risks of its computerized systems – both the development and production systems. An estimate of the evaluated total exposure to operating risk was performed. The calculation was based on the existing map of operating risks at the Bank as of the end of 2007. During the risk mapping process, the content experts in the various divisions are asked to evaluate the severity of every operating risk under their responsibility using three indices: frequency of adverse events, the characteristic damage per event and exceptional damage per event. The calculation is performed using the LDA (loss distribution approach), which supports the AMA principles of the Basel Accord, and also takes into account extreme events of potential losses. The calculation of capital is done in terms of unforeseen annual damage. In light of the results of the calculation, the operating risk is categorized as low.

For additional details, see pages 176-178.

5. Legal risk

Legal risk is the risk of a loss resulting from the inability to legally enforce the performance of an agreement.

A program for managing legal risks is implemented in the Group, whose objective is to manage and minimize risks deriving from primary and secondary legislation, case law and regulatory directives, risks deriving from operations not backed up by agreements regulating the Bank's full rights, or that cannot be fully enforced, and risks deriving from legal proceedings. The Group's legal risk is categorized as low.

For additional details, see pages 179-180.

6. Reputational risk

A reputational risk is a risk that the publication or public disclosure of a transaction, a party to a transaction or customer-related business practice, as well as business results and events pertaining to the Group, may have an adverse impact on the public's trust in the Group.

The Group’s reputational risk is managed by maintaining high levels of control, orderly work procedures, regular discussions by the Management and Board of Directors and their ability to monitor the current operations. The Leumi Group has a code of ethics governing conduct *vis-à-vis* employees, suppliers and the environment. The quality of the Group's products and services is amongst the highest in Israel, and the financial results prove that the expectations of the shareholders and the public (including analysts) have been met. The treatment of employees and customers is manifest by the minimal number of complaints. The Group's reputational risk is categorized as low.

7. Regional risks

The Group's businesses are affected by the cyclical nature of business activity in Israel, which, in turn, is affected by economic and political events in Israel and around the world. Regulatory changes, changes in policy and legislation can also affect the Group's businesses. The political, security and economic situation in Israel may, of course, have a great impact on the profitability and even the stability of the Group. Since these factors are not exclusive to the Leumi Group and affect the banking system in Israel as a whole, the severity of these risks has not been categorized, although they may be viewed as hyper-risks that affect the financial risks described in the preceding paragraphs.

	Risk Factor	Severity of the risk
1	Overall effect of credit risks	moderate
1.1	Risk in respect of the quality of borrowers and collateral	moderate
1.2	Risk from sectorial concentration	low
1.3	Risk in respect of concentration of borrowers/groups of borrowers	low
2.	General effect of market risks	low
2.1	Interest rate risk	low
2.2	Inflation rate risk	low
2.3	Exchange rate risk	low
2.4	Share price risk	low
3.	Liquidity risk	low
4.	Operating risk	low
5.	Legal risk	low
6.	Reputational	low

Note:
The assessment of risks is "Forward-looking information" (for the definition of this term, see page 43). The degrees of severity of the risk factors in the Leumi Group were assessed by the Management of the Bank. The assessment is a subjective assessment, based on various assumptions regarding the likelihood of the risks materializing and their intensity. Great care should therefore be exercised when using this information, and it should not be used for comparison between the various banks. It should be noted that, due to concerns about a global recession, the economic likelihood of higher probabilities of the various risks materializing was taken into account when making the assessments.

Linkage Status, Repayment Periods and Liquidity Status

A. Linkage Status and Repayment Periods

In accordance with the policy for the management of assets and liabilities according to linkage basis, available capital – which is defined as the total of capital sources and certain reserves, less investments in consolidated companies and fixed assets – is invested in unlinked shekel assets, CPI-linked assets and foreign currency and foreign currency-linked assets. The financing of all of the Bank’s overseas investments from foreign currency sources, back-to-back, prevents basis exposure in their respect.

The trend towards changes in the composition of the portfolio of assets held by the public (which includes deposits and the securities portfolio, including funds) continues to reflect the public’s preference for securities tradable on the stock exchange, as compared with bank deposits. The amount of deposits of the public rose in 2007 by 2.7%, as compared with an increase of 14.4% in the securities portfolio of the Group’s customers, in comparison with increases of 4.5% and 13.5%, respectively, in 2006.

The following are the main changes that took place during 2007 regarding liquidity status, according to repayment periods and according to linkage sectors:

The Bank has maintained liquid assets in excess of the amount of its liquid liabilities throughout the year.

The unlinked shekel sector

The principal activity, some 75%, in the unlinked sector is concentrated in short periods of up to a year.

Credit rose during 2007 by NIS 11.6 billion, which was primarily funded by an increase in the balance of deposits of the public.

During the first quarter of the year, there was a decline in the volume of deposits of the public, primarily in consequence of the diversion of monies to the capital market. The major part of the withdrawals was from short term deposits of up to three months.

Towards the end of the second quarter there was a change in the trend, and by the end of the year an accrual of deposits was recorded, mostly short-term. On an overall annual basis, there was an increase of NIS 8 billion, a 9.0% rise, in shekel deposits.

An examination of the spread according to repayment periods shows that at the end of 2007 there was a surplus of liabilities over assets for periods of up to a year which had increased by some NIS 5.2 billion as compared with the surplus in 2006. The increase arose from an increase in short-term deposits.

For periods of over a year, there was an increase in the surplus of assets in the amount of NIS 10.3 million, compared with 2006. The increase in the surplus resulted primarily from the granting of credit for periods of over a year.

The CPI-linked sector

The majority of the transactions in this sector are for periods longer than a year.

There was no significant change in the investment of capital in this sector as compared with 2006. The increase in credit was financed primarily through futures transactions with a CPI-linked liability constituting a long-term source.

The downward trend in the volume of CPI-linked deposits of the public, which began in 2003 also continued in 2007. The balance of deposits of the public at the end of 2007 amounted to NIS 26.9 billion, a reduction of NIS 4.3 billion (some 13.8%), following the offsetting of some of the decline from an increase in deposits and subordinated notes.
Derivative transactions for the purpose of purchasing CPI hedging by the public increased by some NIS 5.1 billion (+104%), net. Most of the medium and short-term CPI linked hedging was required by companies that had issued CPI-linked debentures on the capital market.

Credit to the public at the end of 2007 amounted to some NIS 53.3 billion, an increase of NIS 3.1 billion (6.2%).

An examination of the spread according to repayment periods shows that at the end of 2007 there was a surplus of liabilities over assets for periods of up to one year, similar to 2006. For repayment periods between one year and five years, the surplus of assets increased. The increase in the assets surplus resulted from the growth in the credit portfolio and the debentures portfolio. The increase in the liabilities surplus for repayment periods above five years resulted from the raising of deposits through the issue of subordinated debentures and from the increase in futures transactions with a CPI-linked liability.

Foreign currency sector

The majority of the activity in this sector is focused in periods of up to one year. From past experience, a large part of the deposits in the foreign currency sector, that are deposited for periods of less than one year, including call deposits, are re-deposited with the Bank in a continuous and ongoing process, which is not highly sensitive to the state of the economy or the position in the financial markets.

Since the beginning of 2007, an increase in the amount of NIS 2.6 billion (2.4%) was recorded in the volume of deposits of the public in foreign currency. Most of the increase was in deposits of Israeli residents. At the same time, the foreign currency securities portfolio increased in the amount of NIS 1.2 billion.

The increase in the volume of the deposits contributed to an increase in the surplus of liabilities over assets for a period of up to a year, and at the same time the increase in the securities portfolio and in futures transactions in which the Bank provided long term credit contributed to an increase in the surplus of assets for periods of over a year.

The following table sets out a summary of the assets and liabilities classified by linkage basis, divided according to periods to maturity, including derivatives (excluding non-monetary items) and also including interest repayment flows:

(See Note 17 to the Financial Statements for further information.)

Surplus of assets over liabilities*	**As of 31 December 2007**			
	Unlinked Israeli currency	**CPI-linked**	**Foreign currency including foreign currency linked**	**Total**
Period remaining to maturity:	**NIS millions**			
Up to one month	**(5,161)**	**531**	**(27,280)**	**(31,910)**
From 1 month to 1 year	**(5,337)**	**(4,037)**	**(4,390)**	**(13,764)**
From 1- 5 years	**14,118**	**5,462**	**28,204**	**47,784**
From 5 - 10 years	**9,899**	**1,429**	**5,730**	**17,058**
More than 10 years	**3,250**	**7,887**	**4,356**	**15,493**
Without maturity date	**1,665**	**23**	**272**	**1,960**
Total	**18,434**	**11,295**	**6,892**	**36,621**

Surplus of assets over liabilities*	As of 31 December 2006			
	Unlinked Israeli currency	CPI-Linked	Foreign currency including foreign currency linked	Total
Period remaining to maturity:	NIS millions			
Up to one month	(1,775)	(761)	(21,785)	(24,321)
From 1 month to 1 year	(3,518)	(2,517)	(2,327)	(8,362)
From 1- 5 years	7,051	4,795	26,968	38,814
From 5 - 10 years	7,227	2,365	2,225	11,817
More than 10 years	1,728	7,135	2,733	11,596
Without maturity date	2,591	(231)	276	2,636
Total	13,304	10,786	8,090	32,180

* After offsetting surplus (deficit) balance in respect of derivatives.

A description of the key points of the policy, the means of monitoring and implementing the policy, and the limits used in the management of market risks, including basis and liquidity risks, are presented in the chapter "Exposure to Risks and Methods of Risk Management" on pages 162-173 above.

B. Liquidity Status and Funding

The system -

In 2007, the Bank of Israel decreased the net volume of *Makam* issues by some NIS 20 billion to a level of some NIS 76 billion. This was after the Bank of Israel's announcement at the end of February 2007 that after more than a decade of gradual expansion of the *Makam* issues, with the purpose of establishing it as a monetary tool while absorbing the economy's liquidity surpluses, the Bank of Israel would begin to use the *Makam* as an active monetary tool.

There was no monetary tender by the Bank of Israel at the end of December 2007, while there was a credit tender in the amount of NIS 7.5 billion at the end of December 2006. The average volume of the net monetary credit tenders in 2007 amounted to some NIS 8.3 billion, an increase of some NIS 7.7 billion as compared with the 2006 average.

In 2007, the net average financing through monetary credit tenders at the Bank amounted to some NIS 3.5 billion, an increase of some NIS 3 billion as compared with the 2006 average.

During 2007, the RTGS (real time gross settlement) system was activated in Israel, for carrying-out shekel transfers during the business day between banks in Israel and the other participants in this system.

On 30 July 2007, the first stage of the system was activated, providing final and irrevocable clearing of the (net) results of all the clearing systems - *Masav*, check clearing and the Stock Exchange. Full operation of the system, including for customers' payments, commenced on 3 September 2007.

In addition, Leumi will become a member of the CLS Clearing House, and will provide *nostro* services in shekels and liquidity services in shekels to the CLS Bank. The date of commencement of operations (according to the latest timetable) in foreign currency will be the first quarter of 2008, and in shekels, the second quarter of 2008.

From January 2007, the Bank of Israel ceased using the "repo" on *Makam* tool for the absorption of liquidity surpluses in the system. From October 2007, the Bank of Israel began executing "repo" type tenders debentures with a volume of NIS 2 billion to inject liquidity for a period of one week, against government *Makam* alongside existing loan tenders. These tenders will also be open to pension funds, provident funds and insurance companies, in addition to banking corporations. These tenders were stopped at the end of December 2007 pending a decision by the Bank of Israel regarding the mechanism for revaluing collateral and regarding the accounting treatment relating to the recording of repo transactions.

Funding (in the Bank)

In 2007, against the background of low interest rates and optimism in the capital market, the trend of the diversion of monies held by the public from deposits to investments in the capital market continued.

The balance of the deposits of the public at the Bank increased by NIS 8.3 billion in 2007, 4.1%. Most of the increase was in the unlinked segment, which rose by 6.3%. After deducting the effect of the change in the exchange rate of the shekel in relation to the foreign currencies, principally the appreciation against the dollar, the increase in the balance of deposits of the public amounted to some NIS 13.5 billion, 6.7%.

The balance of subordinated capital notes decreased by some NIS 0.3 billion.

The volume of the portfolio of Leumi customers' mutual funds increased by some NIS 5.3 billion. The volume of the securities portfolio of customers of the Bank increased by NIS 43.6 billion during the reported period, as a result of the injection of new funds and the increase in market values.

In 2007, the volume of credit to the public rose by NIS 8.3 billion, 6.6%. The main part of the increase was in the unlinked shekel segment, which grew by 12.6%.

Unlinked shekel activity sector

In the unlinked shekel sector, the volume of deposits of the public increased by some NIS 5.7 billion (6.3%), and at the end of the year reached some NIS 95.7 billion. The majority of the increase occurred in the second half of the year.

Credit to the public in unlinked shekels increased by some NIS 8.8 billion, an increase of some 12.6%. The majority of the increase was in the second half of the year.

CPI-linked activity sector

The balance of CPI-linked deposits of the public decreased by some NIS 0.6 billion, a decline of some 2.0%.

The balance of credit in the CPI-linked sector increased by some NIS 1.4 billion, some 6.1%, most of which was in the year's second and third quarters.

Foreign currency and foreign currency-linked activity sector

1. The total of foreign currency assets and foreign currency-linked assets amounted to some NIS 84.3 billion at the end of 2007, a decrease of 6.3%, compared with the end of 2006. The shekel's appreciation against most currencies reduced the volume of assets by some 6.4%. After neutralizing this effect, the volume of foreign currency transactions increased by some 0.1%.

2. The volume of foreign currency and foreign currency-linked loans at the end of 2007 was some NIS 30.6 billion, a decline of 5.5% as compared with the end of 2006. After neutralizing the appreciation of the shekel, there was an increase of some 0.8%.

3. The balance of foreign currency and foreign currency-linked deposits of the public increased by some NIS 3.3 billion, an increase of 4%, despite the sharp appreciation in the exchange rate of the shekel. After excluding the effect of the exchange rate, the balance increased by some NIS 8.5 billion. In dollar terms, there was an increase of US$ 2.1 billion in the deposit balance.

   In view of the considerable rise in its foreign currency liquidity level, the Bank increased its foreign securities portfolio during the reported period from some US$ 3.2 billion to some US$ 4.9 billion, compared with a decrease in the volume of deposits with correspondent banks by some US$ 1.0 billion to US$ 7.8 billion.

Preparations for Basel II

In June 2006, the Basel Committee on Banking Supervision published the final version of the capital adequacy measurement accord (Basel II) which is intended to be implemented following central banks' instructions.

The accord is based on three pillars:

- The first pillar – specifies the different methods for calculating minimum capital requirements, from the standard method through the advanced methods, based on models for internal rating of credit risks, market risks and operating risks.

- The second pillar – deals with risks that are not included in the first pillar and describes a process which banks are to carry out to establish the adequacy of the internal capital allocated to the various risks in accordance with risk assessment process carried out by the banks (known as the Internal Capital Adequacy Assessment Process – ICAAP), and a process for supervisory review to be carried out by the bank regulatory authorities regarding the above-mentioned internal process (known as the Supervisory Review Process – SREP), and refers to the use of stress testing regarding capital adequacy with respect to the various risks.

- The third pillar – deals with proper disclosure and market discipline. It provides for more expansive and detailed disclosure and information than was provided in the past regarding the risks to which a bank is exposed. The information is to be provided on a high qualitative and quantitative level so as to allow the market to evaluate a bank's risk profile.

The innovation in the provisions of Basel II is that for the first time, banking corporations are required to allocate capital for operating risks, in addition to credit risks and market risks, which presently comply with the provisions of Basel I.

The Committee proposes three options for calculating the minimum capital for credit risk and operating risks. The options are characterized by ever-increasing sensitivity to risk.

The Supervisor of Banks announced at the end of January 2007 the implementation of Basel II in the banking system in Israel at the end of 2009, according to the standard method. In the following months, the Supervisor published a number of documents, directives and requirements, mostly based on the documents produced by the Basel Committee in June 2006, along with drafts of documents and directives for consultation with the banking system.

In a letter at the end of May 2007 which included reference to the required preparations, the Supervisor of Banks noted his intention to work to upgrade the risk management system, the controls and the corporate governance in place in the banking corporations, and to adapt the banking supervisory system to a risk oriented supervisory format.

In addition, the Supervisor of Banks announced in a draft from August 2007 that at the time of the first implementation at the end of 2009, the banking corporations would be required to comply, at the least, with the capital calculation requirements based on the standard method for market risks, credit risks and operational risks, as described in the Basel Committee's publications.

At the end of May 2007, the Supervisor of Banks announced the establishment of six working teams to formulate the requirements from the banking corporations in the various areas. Additionally, the Financial Statements Unit of the Banking Supervision Department would continue to deal with the implementation of the third pillar of the Basel II directives. These working teams hold ongoing discussions with the corresponding working teams at the Bank in order to clarify these issues.

As part of a discussion held at the Bank of Israel in September 2007, representatives of the Banking Supervision Department announced that, as of 31 December 2008, the banks would be required to report to the Department regarding the capital requirements according to the standard method set out in the first pillar of Basel II, and that such reporting would be required on a quarterly basis throughout 2009, although the actual allocation of capital during this period was still to be in accordance with the existing directives. The actual allocation of capital in accordance with the requirements of Basel II’s standard method will only be required as of 31 December 2009.

In the context of preparations for the standard method and with a view to examining the consequences of the implementation of the method for the new capital requirements, the banking system was required to carry out a QIS – Quantitative Impact Study – according to the standard method on the data from 31 December 2006, and to present the findings to the Bank of Israel. The Bank complied with this requirement.

The Banking Supervision Department has also published a “Draft Temporary Directive – Regarding the Implementation of Certain Disclosure Requirements from Basel II in the 2007 Financial Statements.”

In February 2008, the Bank of Israel published an additional draft regarding the standard method and the advanced methods. In March 2008 the Bank of Israel published a draft document “Work Program for Risk Oriented Supervision” as part of the second pillar preparations.

The Bank’s and the Subsidiaries’ Preparations

As part of the Group's preparations for the implementation of Basel II, and further to activities carried out during 2004-2005, a project administration was set up at the end of 2005, the role of which is to manage, coordinate, adapt and supervise all the parties involved in the project in the Group, and to bring about the eventual implementation of all the directives of Basel II. In addition, a senior steering committee was appointed for the Basel II project, headed by the Senior Deputy Chief Executive Officer, and including several Members of Management and other senior executives.

In the above context, gap analyses were prepared on the basis of which a working program and road map have been prepared regarding the main master tasks that the Group faces in implementing the directives of Basel II.

For the purpose of compliance with the directives of Basel II, the Bank is preparing to make adjustments and improvements to its computerized infrastructures, including the collection of the required data in order to estimate the risk variables, the development and purchase of advanced systems, the construction of databases and the linking of all these to existing systems. This preparation has been ongoing for some time and will continue in the coming years.

In addition to the changes required in the systems, processes and policies, the Bank has, as previously announced, carried out a structural change in the area of credit risk management, (by establishing a credit risk management unit) to meet both business needs and the requirements arising from the Basel II era.

For further details, see pages 183-184 of the Report.

At the same time, the unit for control of risk management is engaged in the development of models needed in order to implement the advanced approach for calculating PD (Probability of Default) and LGD (Loss Given Default – severity of loss at times of default), for methodological support and examination of the appropriateness of the models in the subsidiaries and overseas offices.

The Bank is examining the possibility of making additional changes in order to comply with the provisions of Basel II.

The Bank’s and the subsidiaries' preparations, including the cost of the computer systems, will require the investment of significant resources in the coming years.

The Bank is also preparing to develop models for calculating economic capital which relate to all risks, and for their integration as a central tool in the decision-making processes of the Bank’s business systems.

For the first time, the Directors Report and the Financial Statements for 2007 present and/or expand certain data which is required pursuant to the third pillar of Basel II, in accordance with the directives of the Banking Supervision Department, as set out below.

Topic	Directors Report	Financial Statements
1. Capital structure	-	Note 13
2. Capital adequacy	-	Note 13
3. Qualitative credit risk disclosure	Pages 181-190	-
4. Quantitative credit risk disclosure	Page 181	Note 13
5. Reducing credit risk	Page 187	-
6. Exposure to credit risk of counterparties	Page 191	-
7. Market risk	Pages 162-173	-
8. Position in shares	Page 86	-

Legal Proceedings

1. Civil Proceedings

1.1 The Bank is a party to legal proceedings that have been brought against it by customers, former customers and various third parties that consider themselves prejudiced or harmed by the Bank’s activity during the ordinary course of its business.

In the opinion of the Management of the Bank, based on legal opinions, appropriate provisions have been included in the Financial Statements to cover possible damages in respect of all the claims.

The causes of action against the Bank are different and varied, including assertions as to the non-execution of instructions or non-execution on time, applications for approval of attachments imposed by third parties on debtors' assets that according to them, are held by the Bank, assertions of charging interest other than in accordance with the interest rates that were agreed upon between the Bank and the customer, interest rates that deviate from those permitted by law, errors in the time of debiting and crediting accounts in respect of checks drawn on them, assertions of coercion to purchase savings schemes and also assertions relating to provident funds, securities, labor relations, drawing checks without cover and failure to honor checks.

In addition, applications to approve class actions have been filed against the Bank.

None of these claims is in an amount that exceeds 1% of the Bank's shareholders' equity on 31 December 2007, some NIS 195 million, except claims described in Note 18 to the Financial Statements.

1.2 Within the context of measures taken to recover debts during the ordinary course of its business, the Bank, *inter alia,* institutes various legal proceedings against debtors and guarantors and proceedings to realize collateral. The Financial Statements contain provisions for doubtful debts that were made by the Bank on the basis of an assessment of all the risks involved in credit to the various sectors of the economy and having regard to the extent of the information concerning the relevant debtor/guarantor regarding his financial strength and the collateral given to the Bank to secure repayment of the debt.

1.3 On 10 June 2004, the Jerusalem District Court, sitting as the Standard Contracts Tribunal, gave judgment on an application that was filed against the Bank by the Attorney-General in 1997, asserting that a current account form that the Bank uses includes clauses that are prejudicial pursuant to the provisions of the Standards Contracts Law, 1982, and they should accordingly be annulled.

In its decision, the tribunal held that certain clauses and parts of clauses in the form (some 29 subjects in all) are prejudicial to the customers and accordingly annulled them or - and in a considerable number of the cases - partially accepted the Bank's position and directed that the clause be changed and not completely annulled. With regard to a not inconsiderable number of the clauses in relation to which there was an assertion that they were prejudicial, the tribunal accepted the Bank's position and did not order their annulment.

An application to the Supreme Court filed by the Bank to stay execution of the directives of the judgment was approved in a decision of 1 December 2005.

Both the Bank and the Attorney-General filed appeals with the Supreme Court against certain parts of the rulings in the judgment. In addition, the Attorney-General filed an application with the tribunal to amend the judgment, such that it shall also apply to contracts signed before the judgment was handed down. The tribunal rejected this application and the Attorney-General appealed this to the Supreme Court.

During the course of the deliberations, the Bank and the Attorney General reached agreements regarding certain issues and these agreements were given the force of a partial judgment, with the parties waiting for the Supreme Court's decision regarding the remaining issues. The changes required by these agreements have been made in the current account form, as well as the changes required by the court's judgment, with respect to the issues regarding which the Bank has not filed an appeal.

1.4 **An Application for the Approval of a Derivative Action on behalf of the Bank against the Controlling Shareholder in Africa Israel and Senior Bank Employees.**

On 11 March 2007, an action and a petition to approve the action as a derivative action in the amount of NIS 158 million were filed in the Tel Aviv-Jaffa District Court. The plaintiff is demanding that he be permitted to file a pecuniary action on behalf of the Bank against the controlling shareholder in Africa Israel Investments Ltd. ("Africa Israel"), and senior employees of the Bank, and two additional senior employees of the Bank who were directors of Africa Israel.

The action focuses on the transaction for the sale by the Bank to the controlling shareholder of Africa Israel of 15.83% of the share capital of Africa Israel. The plaintiff claims that during the negotiations, material information was concealed from the Bank regarding the true value of the real estate division of Africa Israel in Russia, and as a result the shares were sold at too low a value. It is also claimed that, after publication of the said material information, the remaining defendants allowed the transaction to be completed and did not take action to increase the consideration received by the Bank, even though, it is claimed, they were able and obliged to take operative steps to prevent the completion of the transaction in its original format. The damages which the plaintiff wishes to claim in the name of the Bank is the difference between the price at which the shares in Africa Israel were sold by the Bank to the controlling shareholder and what the plaintiff argues is the true value or the appropriate value of these shares.

It should be noted that during 2006, the plaintiff, through his legal representatives, approached the Chairman of the Board of Directors of the Bank and demanded that the Bank file a derivative action in this regard. The Board of Directors discussed this demand, and rejected it. The rejection was notified to the plaintiff's legal representatives.

In November 2007, the plaintiff filed an application to amend the derivative action and the petition for the approval of the action as a derivative action. The plaintiff seeks to add an additional claim, according to which the controlling shareholder of Africa Israel had seemingly hidden from the Bank, during the negotiations with it, the fact that he had “additional significant information” according to which there was “a real possibility of making a public issue of Africa Israel’s real estate assets in Russia.” The plaintiff further argues that since the controlling shareholder concealed this additional information regarding the issue, he has breached his obligations to the Bank and had thus caused the Bank to suffer damages, for which the Bank is owed compensation. This allegation does not refer to the other respondents in the application (officers of the Bank and of Leumi & Co.). In its ruling, handed down on 12 February 2008, the court approved the petition to amend the claim. On 17 March 2008, an amended petition for the approval of a derivative action was filed, as well as an amended derivative action. In the amended court documents, the applicant has for the first time quantified the amount of the additional damage he claims was caused to the Bank, in the amount of NIS 55 million, such that the applicant has placed the amount of the derivative claim at a total amount of NIS 213 million. A preliminary hearing in the case has been set for 14 April 2008.

2. **Other Proceedings**

2.1 In March 2007, an indictment was filed against the Bank, Leumi L.P. Ltd. (formerly Leumi-Pia Trust Management Co. Ltd.), Leumi Management Ltd. (formerly Psagot Managers of Mutual Funds - Leumi Ltd.) and Leumi Securities and Investments Ltd. (formerly Psagot Ofek Investment House Ltd.), subsidiaries of the Bank, and against a number of employees of the Bank and of the said companies at the time of the offence attributed to them, in respect of a breach of section 82 of the Joint Investment Trusts Law, 1984 in its form at the time of the alleged offence, together with section 29(b) of the Penal Law, 1977.

In January 2008, the Tel Aviv-Jaffa Magistrate’s Court approved a plea bargain that had been reached between the Bank and the said companies and the prosecutor. As part of the plea bargain, the prosecutor retracted all the allegations related to the Bank’s employees and the employees of the subsidiaries, and filed an amended indictment against the Bank and the subsidiaries only. The amended indictment was significantly narrower in that it charged the Bank with the offence of lack of supervision only. The prosecutor declared that the circumstances surrounding the offence were not especially serious. The Bank and the subsidiaries admitted to the facts that were the subject of the amended indictment, and the following fines were imposed on them: the Bank – NIS 5 million, Leumi L.P. Ltd. – NIS 10 million, and Leumi Management Ltd. and Leumi Securities and Investments Ltd. – NIS 10 million, which was divided between the two of them.

2.2 In November 2004, investigators of the Antitrust Authority arrived at various offices of the Bank, as well as those of other banks, and gathered written and computerized material for the purposes of investigating a suspected restrictive trade agreement between the banks. In July 2005, investigators of the Antitrust Authority conducted a search at various offices of the Bank, and gathered written and computerized material for the purposes of investigating a suspected restrictive trade agreement between the banks.

On 19 March 2008, the Bank received a letter from the Antitrust Authority stating that the General Director is currently examining the possibility of exercising her authority according to section 43(a)(1) of the Antitrust Law, 1988, and to determine that restrictive trade agreements existed between Bank Hapoalim B.M., Israel Discount Bank Ltd., United Mizrahi Bank Ltd., The First International Bank of Israel Ltd. and the Bank, regarding the transfer of information relating to commissions.

The General Director has permitted the banks to express their positions in writing by 5 May 2008. The Bank is currently examining the notice of the General Director, and the steps to be taken in this regard.

Additionally, in 2005 and the first quarter of 2008, a number of employees of the Bank were summoned for examination at the Antitrust Authority, and the Bank was required to produce documents.

2.3 In 2004, LISI, a wholly-owned subsidiary of BLUSA, discovered *prima facie* improper trades in securities carried out by one of its traders. The matter was reported to the regulatory authorities of BLUSA and LISI and the said trader's employment was terminated. In 2006 the SEC commenced a formal investigation at LISI with regard to the said matter.

See Note 18 to the Financial Statements for further details regarding contingent liabilities.

Restrictions and Supervision of Activities of the Banking Corporation

1. Pursuant to legal provisions, the Bank is subject to the supervision of various authorities with regard to its various activities, and especially with regard to its overall activities, to the supervision of the Bank of Israel, specifically the Governor of the Bank of Israel and the Supervisor of Banks.

   By virtue of the powers granted to the Governor of the Bank of Israel and the Supervisor of Banks, various permits and approvals are issued by them from time to time, for activities and/or holdings in corporations.

2. The Governor of the Bank of Israel has permitted the Bank, by virtue of his authority under section 31 of the Banking (Licensing) Law, 1981, to hold the means of control of overseas corporations (the "Overseas Corporations"), and by virtue of this permit, the Supervisor of Banks has approved holdings by the Overseas Corporations in other corporations (the "Sub-subsidiaries"). In addition, there are specific approvals relating to Sub-subsidiaries. The permit for the holdings in the Overseas Corporations was issued on 23 February 2006 in lieu of previous permits, and such permit was given subject to the Bank acting to implement the requirements of the Supervisor regarding supervision and control of the Overseas Corporations and the Sub-subsidiaries.

   The corporations included in the Governor's permit are: Bank Leumi USA, Bank Leumi (Switzerland), Bank Leumi (UK), Leumi (Latin America), Bank Leumi (Luxembourg), Bank Leumi (Jersey) and Bank Leumi Romania.

   The permit is subject to a number of conditions regarding: levels of holdings; supervision, control and monitoring of the management of the Overseas Corporations and Sub-subsidiaries; the requirement for approval from the Supervisor or reporting to or notifying him regarding various events, such as: investments in corporations, material new activities, the opening of a branch or representative office; and the giving of information and documents to the Supervisor.

3. With regard to restrictions imposed on the depositing of monies between Group companies, see page 172.

Material Contracts

1. An agreement between the Bank and Union Bank of Israel Ltd. ("Union Bank") for the provision of comprehensive computer and operating services, including development and special new projects and relevant training services, by the Bank to Union Bank and related bodies, that was signed in September 2001. The agreement applies retroactively from September 1998 for a period of eleven years, with an option to extend.

   In December of 2007, a supplement to the agreement between the Bank and Union Bank was signed regarding an extension of the contractual relationship, with changes made to the business conditions.

   The period of the new agreement is 10 years, beginning on 1 January 2007, and during such period the Bank will be paid an annual consideration that will gradually increase from some NIS 40 million in the first two years, to some NIS 45 million beginning from the sixth year. (The amounts are linked to the CPI of December 2006 and are dependent on the volume of activities of Union Bank.) The supplement to the agreement has been approved by the Supervisor of Banks and by the General Director of the Antitrust Authority.

2. An agreement from December 1995 between the Bank and the Assessing Officer for Large Enterprises regarding the manner of recognition for tax purposes of provisions for doubtful debts, based, *inter alia*, on the principal recommendations of the committee for the examination of tax aspects regarding doubtful debts.

   The following are the principal rules determined in discussions with the Assessing Officer for the recognition of provisions for doubtful debts for tax purposes and the method of dealing with cancelled provisions. The basis of the rules is the recommendations of the committee appointed by the Income Tax Commissioner for the examination of tax aspects regarding doubtful debts of banks (the "Givoli Committee"), that were published in 1992, and have yet to be incorporated into legislative amendments:

   2.1 Specific provisions for doubtful debts are to be recognized as a tax expense in the year in which they are recorded, subject to paragraph 2.3 below.

   2.2 Provisions for doubtful debts in relation to which specific monitoring is carried out – a mechanism has been determined to compensate the tax authorities, in real values together with interest, in cases where it becomes clear that the past provision was larger than the actual loss.

   2.3 In respect of specific provisions for doubtful debts on debts in Israel in relation to which specific monitoring is not carried out, as of 1990, 20% of the nominal increase in the balance of the provision for doubtful debts in respect of such debts will be added every year for the purpose of calculating profits for income tax purposes, and if the provision decreases, 20% of the decrease will be considered with regard to the Bank as cancellation of unrecognized expenses.
   The Bank has reserved the right the carry out specific monitoring regarding all provisions for doubtful debts. As at 31 December 2007, specific monitoring was carried out for provisions for doubtful debts whose amounts are over NIS 50,000.

   2.4 If at a certain point in the future the balance of provisions for doubtful debts in respect of which specific monitoring is not carried out falls below the nominal balance as of 1 January 1990, in the amount of NIS 307,671 thousand, the Bank will not demand this decrease as an expense for tax purposes, since this amount was recognized in the past as a tax expense.

3. A compromise agreement for the regulation of tax payments in Israel in respect of profits of subsidiaries of the Bank overseas, between the Bank and the Assessing Officer for Large Enterprises from August 1987, which was extended in October 1991 until 1993, and again in March 1994, when its term was extended until such time as one of the sides gives a year's advance notice of its intention to propose changes to the agreement.
   For further details regarding this agreement, see pages 205-207.

4. An agreement from November 2003 between the Bank, Sheroder Assets Ltd. and Yishayahu Landau Holdings (1993) Ltd. in connection with options for the sale of shares of Union Bank held by the Bank. For further details, see Note 18 N to the Financial Statements.

5. An agreement from April 2005 between the Bank and the Tax Authority regarding a set off in respect of profits of an overseas subsidiary. For further details, see Note 26 L to the Financial Statements.

6. A special collective agreement from November 2005 between the Bank and employees' representatives in consequence of the privatization process of the Bank. For further details, see page 207.

7. An agreement from May 2006 between the Bank, Israel Discount Bank Ltd., Kahal Employees Supplementary Training Fund Ltd. ("Kahal"), Kahal Management of Study Funds (1996) Ltd. ("Kahal Management"), and between Migdal Capital Markets (1965) Ltd. on behalf of a company under its control and Migdal Insurance and Financial Holdings Ltd. on behalf of a company under its control (the "Purchaser"), for the sale of the goodwill, management rights, additional rights and means of control of the banks in Kahal, and for the sale of the goodwill, activities, assets and liabilities relating to the supplementary training funds managed by Kahal Management.

8. An agreement from September 2006, based on a binding agreement of principles from December 2005, between the Bank and Leumi Gemel Ltd. (currently Leumi Capital Market Services Ltd.), and between Harel Insurance Company Ltd. and Harel Provident Funds Ltd. for the sale of the goodwill, activities, assets and liabilities relating to five provident funds. For further details, see page 160.

9. A supplement from October 2006 to the binding agreement of principles from December 2006 between the Bank and Leumi Capital Market Services Ltd., and between Prisma Investment House Ltd. (formerly A. Solomon Investments Ltd.), for the sale of the goodwill, activities, assets and liabilities relating to additional provident funds. The agreement was completed in January 2007. For further details, see page 160.

10. Letters of Indemnity as detailed in Note 18 M to the Financial Statements.

Description of the Taxation Position

1. (a) On 13 August 1987 a compromise agreement was signed between the Bank and the Assessing Officer for Large Enterprises, which regulates tax payments in Israel in respect of profits of overseas subsidiaries of the Bank, pursuant to which from 1978 and thereafter the Bank's share of the profits of overseas subsidiaries on a consolidated basis will be included in the Bank's assessment. The agreement provides that it does not determine that the companies owe tax in Israel or that Israeli law applies to them and that the agreement does not constitute a precedent. The agreement was extended on 10 October 1991 with effect until the end of 1993, and again on 13 March 1994 and will be in force until one of the parties gives a year's advance notice of its intention to propose changes to the agreement.

   (b) Pursuant to an arrangement with the tax authorities dated 14 April 2006, as from 2004 the Bank may set off from its tax liability in Israel, in respect of the profits of an overseas subsidiary, an aggregate amount of up to US$ 67 million, but no more than the lower of US$ 3 million or the tax liability in Israel, each year.

2. Amendment No. 11 to the Income Tax (Adjustments by Reason of Inflation) Law, 1985 provided that, *inter alia*, all the assessed parties to whom the amendment applies must pay tax on profits from securities traded on an exchange at the time of realization. The Amendment came into force in 1999. In

the opinion of the tax authorities and the banks, taxing securities on a realization basis does not accord with the nature of the financial institutions' activity.
In light of this, on 6 June 1999 the tax authorities sent the banks a draft proposal to amend section 6 of the said Law, pursuant whereto the financial institutions would be taxed on the basis of the increase in the value of the securities, in accordance with the manner of presenting securities in the financial institutions' financial statements.

In co-ordination with the tax authorities, the Bank operates on the basis of the draft law, and the tax provisions are made accordingly.

3. On 27 June 2006, the Value Added Tax (Tax Rate for Non-Profit Organizations and Financial Institutions) Order, 2006 was published in the government Gazette (*Reshumot*). Following the amendment, the rates of salary tax and profit tax applying to financial institutions were reduced from 17% to 15.5%. The amendment took effect as from 1 July 2006.

   On 25 July 2005, the Knesset passed the Income Tax Ordinance (Amendment No. 147 and Temporary Provision) Law, 2005 (the "Amendment"). The Amendment determines a gradual reduction of the tax rate for companies from 34% in 2005 to 25% from 2010 and thereafter in the following manner: for the 2005 tax year the tax rate was 34%, for 2006 it was 31%, for 2007 it was 29%, for 2008 it will be 27%, for 2009 it will be 26%, and from 2010 and thereafter the tax rate will be 25%.

   The Bank as a "financial institution" for the purposes of the Value Added Tax Law pays profit tax. The rate of profit tax in 2005 – 17%, in 2006 – 16.25% and in 2007 and thereafter – 15.50%. Profit tax constitutes an expense for company tax and therefore the reduction in company tax will result in a reduction of the overall tax rate that applies to the Bank to a lower rate, so that for 2005 the overall tax rate was 43.59%, for 2006 - 40.65%, for 2007 - 38.53%, for 2008 - 36.80%, for 2009 - 35.93 and from 2010 and thereafter the overall tax rate will be 35.06%.

4. On 26 February 2008, the Knesset enacted an amendment to the Income Tax (Adjustments for Inflation) Law, 1985. The amendment restricts the application of the law to the tax years 1985-2007 and lays down transitional provisions regarding the end of the law's application.

   The Bank estimates, based on the capital which is entitled to protection through 31 December 2007, that any change of 1% in the CPI will affect the Group's tax expenses at the rate of some NIS 47 million.

5. Amendment No. 35 to the Value Added Tax Law, enacted by the Knesset on 26 February 2008, determines that the salary tax paid by a financial institution will be recognized as an expense for the purposes of calculating profits tax and applies salary tax to the amount of the employer's share of National Insurance payments.

   The Amendment came into effect on 1 January 2008. During 2008, half of the employer's share of National Insurance Payments will be subject to salary tax, and half of the salary tax which is paid will be recognized as an expense for the purpose of calculating profits tax.

   The Bank estimates that the Amendment to the Law will reduce the Group's net current tax liability in 2008 by some NIS 13 million, and by some NIS 26 million per year beginning from 2009. Further, deferred taxes will be calculated in accordance with the said amendment. The effect of the change on the Financial Statements as at the beginning of 2008 was a decrease in tax expenses over income of some NIS 45 million.

6. See Note 1 to the Financial Statements for further details regarding the Bank's policy for recording deferred taxes.

7. The Bank has been issued with final assessments for the period up to and including the 2004 tax year. The principal consolidated companies have final assessments up to and including the 2002 tax year.

8. See Note 26 to the Financial Statements for further details with regard to the provision for tax of the Bank and subsidiaries, final assessments, accrued losses for tax purposes and differences between the statutory tax rate and the effective tax rate.

Human Resources

Number of Personnel

In 2007, the number of positions in the Group increased by 541, some 4.4%, in relation to the number of positions at the end of 2006. On a yearly average, the number of positions increased by 519 positions, some 4.3%. The increase derived mainly from an increase in the number of positions in the Group in Israel.

Most of the change in the number of the Group's personnel in Israel derives from an increase of 281 positions at the Bank in Israel, which reflects an increase of 374 positions at the Bank, and a decrease in the number of outsourced positions and in overtime hours. There has also been an increase of 138 positions, primarily at the following subsidiaries: Leumi Card, Leumi Mortgage Bank, and the Arab Israel Bank.

There was an increase of 127 overseas positions in the Group, of which 53 were positions at Bank Leumi Romania.

	Positions at Year's End		Yearly Average	
	2007	2006	**2007**	2006
The Bank in Israel	**9,391**	9,110	**9,184**	8,935
Consolidated subsidiaries in Israel	**2,075**	1,937	**1,981**	1,964
Group total in Israel	**11,466**	11,047	**11,165**	10,899
Overseas: Bank branches and representative offices	**82**	87	**83**	92
Consolidated subsidiaries	**1,330**	1,203	**1,271**	1,009
Group total in Israel and overseas	**12,878**	12,337	**12,519**	12,000

* "Position" – means a full time position including specific overtime, working hours of employees from temporary employment agencies and employment of external consultants.

Signing of Collective Agreement Relating to Privatization

On 30 November 2005 a special collective agreement was signed between the Bank's Management and the employees' representatives in consequence of the Bank's privatization process.

The collective agreement secures the implementation of the employee option plan, the employees' right to purchase 3.873% of the Bank's shares that are due to the employees at a discount of 25%, the payment of an advance in the amount of one salary constituting the base for social provisions, on account of the 2005 annual bonus, and the securing of the labor constitution and all the existing collective agreements and arrangements at the Bank for five years commencing 1 January 2006.

The employees for their part undertook in the agreement to maintain harmonious labor relations in all matters relating to the Bank's privatization process.

Employee Option Plan

In February 2006, options were issued to the Leumi employees free of consideration, according to an option plan outline published by the Bank in January 2006.

The outline was issued in accordance with an agreement between the State and the Bank employees in connection with the Bank's privatization process and the sale of the State's holding of the Bank's shares. Half of the said options were exercised by the employees in February 2008, and half of them are exercisable until February 2009.

The cost of the option plan, including the fair value of the options and additional expenses, will amount to some NIS 514 million, to be spread out until February 2008. Salary expenses in the sum of NIS 235 million were recorded in 2006, the sum of NIS 247 million was recorded in 2007 and NIS 32 million will be recorded in 2008, before taxes.

See pages 20-21 and Note 15 to the Financial Statements for further details.

Remuneration System and Salary Structure

The salary and remuneration systems for the Bank's employees are based upon the correlation between the level of remuneration and the position of the employee, and the contribution of the employee to the Bank. The annual remuneration is differential, in accordance with the components of position, personal performance, annual evaluation and personal potential.

Labor and Salary Costs (at the Bank)

	2007	2006	2005
	NIS thousands		
Cost per employee position (excluding bonus)*	**289.3**	308.6	256.8
Cost per employee position (including bonus)*	**340.9**	337.8	286.2
Cost per employee position after neutralizing special salary expenses (excluding bonus)	**263.6**	260.8	256.8
Salary per employee position (excluding bonus)	**180.1**	176.1	174.4
Salary per employee position (including bonus)	**223.2**	200.3	198.5

* Cost per employee position does not include pension expenses for pensioners and costs of voluntary retirement.

Training and Development

The Management of the Bank set itself the goal of improving, through study activities and training, the capabilities of Bank employees and the business units to attain business goals. In this context, employees participated in 60,810 training days in 2007 (compared with 59,167 in 2006). The training activities in 2007 focused on raising the level of professionalism of the employees (with emphasis being placed on core banking areas – credit and investment counseling), their marketing abilities and management skills, all according to the business objectives of the Bank, including comprehensive assimilation and training with regard to compliance for all the Bank's employees. In addition, knowledge management at the Bank and independent learning at the Bank's branches was intensified with the object of making wider use of the knowledge existing in the organization, refining the ability of the employees to study in their units as part of the work routine and increasing the number of those studying at the Bank.

Development of Managers

Implementation of the model for developing managers at Leumi continued in 2007. During 2007, 88% of the managers participated in professional development or skills development programs, compared with 63.1% in 2006

Also, the scope of a mentoring program for managers taking up new positions was significantly expanded, and in accordance with the needs of the units.

At the same time, all the Bank-wide management courses run on a regular basis, as well as professional management courses and courses developed as required by specific units.

Education

The percentage of employees with university education at the Bank is on a continuing upward trend and reached 57.9% of all employees in 2007, compared with 56.0% in 2006, 52.3% in 2004 and 26% in 1995. The percentage of graduates among the managerial staff reached 90.7% in 2007. This increase in the percentage of university graduates is the result of: recruitment of employees with university education, the acquisition of higher education by current bank employees, and the retirement of bank employees who are not university graduates.

Employee Rights

Labor relations between the Bank and its employees in Israel, save for those with personal employment contracts, are primarily based upon a basic collective labor agreement known as the “Labor Constitution” and supplementary collective agreements.
The terms of employment of members of the Bank’s Management and certain other senior employees are regulated by personal employment contracts.

New Employees and Tenure

In 2007 the Bank recruited 769 new employees, of whom 573 are university graduates and 209 employees received tenure. (In 2006, the Bank recruited 753 new employees, of whom 546 were university graduates, and it granted tenure to 117 employees.)

Organizational Culture - Leumi’s Code of Ethics

Leumi, as a large and leading commercial organization which influences the shaping of the social and economic environment in the State, and as an organization that cultivates a unique system of values with its customers, its employees and the community in which it operates, launched its code of ethics, “The Leumi Way”, in 2005.
The code defines the personal and business values that derive from Leumi’s essence and vision, and also the rules of conduct derived from these values. The code was launched by the President and Chief Executive Officer at the presentation ceremony of the Annual Financial Statements and was distributed among all Leumi’s employees. A comprehensive assimilation process among all Leumi’s employees continued in 2007, which will continue over the years to come.

Social Responsibility

Leumi’s first social responsibility report was launched in March 2007, at the presentation ceremony of the Annual Financial Statements. The report has received international recognition from the GRI organization.

Involvement of Employees in the Community

The Management of Leumi views the involvement of employees and managers in the community as a central goal in the area of community involvement. Leumi is proud of the involvement of its employees in the community, and of the continued increase in the number of Bank employees involved in voluntary activities.
Hundreds of employees and managers at Leumi are involved in voluntary activities in various frameworks: instructing "Young Entrepreneurs" groups, accompanying groups preparing for service in the IDF of the "Youth Leading Change" non-profit organization, involvement in matriculation learning centers and assisting families as part of the "Equal Opportunities" initiative.

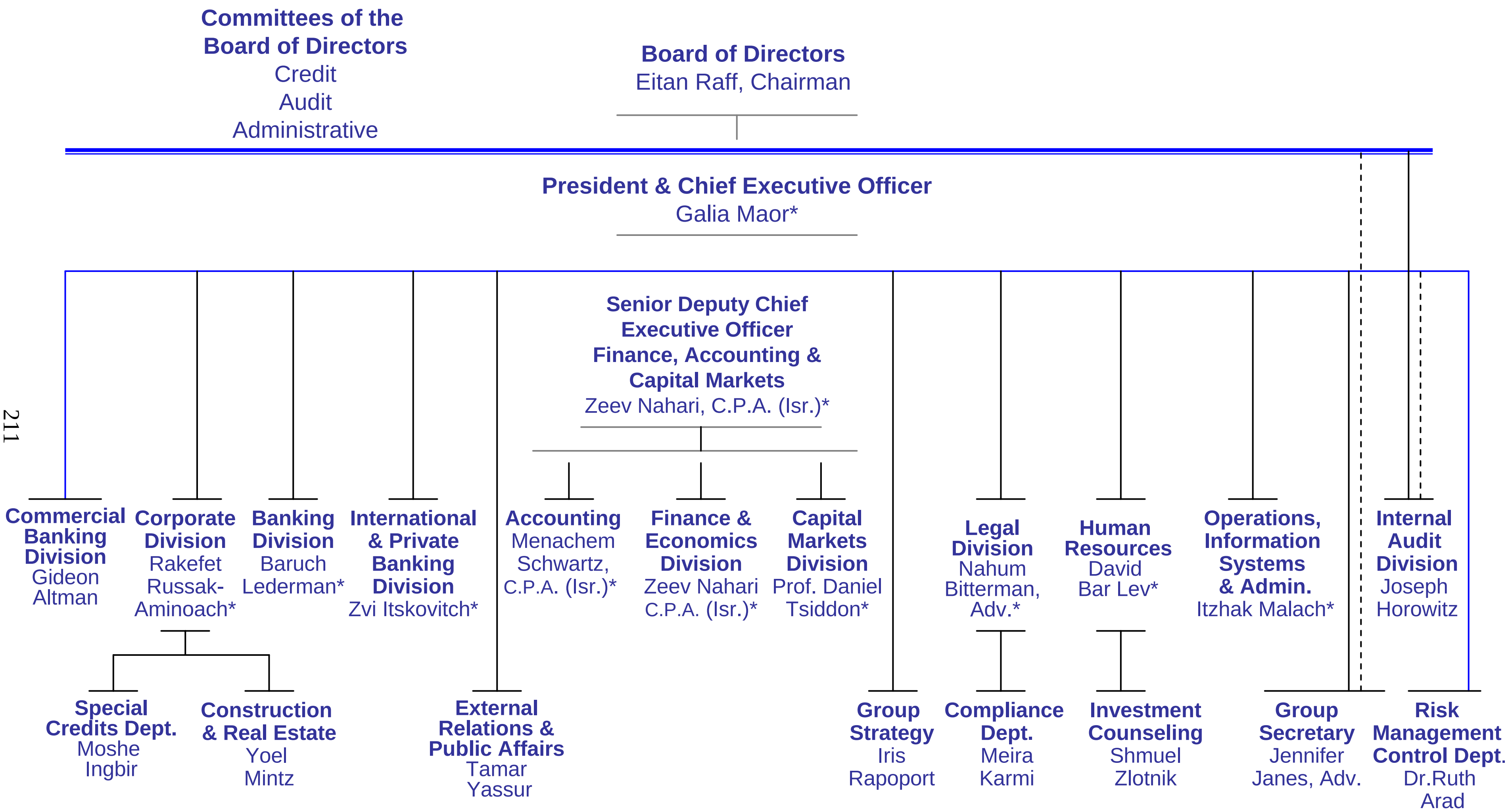
Independent Initiatives – thanks to raised awareness of the subject of contribution to the community at Leumi, branches and units have been initiating independent local projects. In certain areas, employees of branches have joined food distribution operations for families in distress, other employees have adopted help centers and shelters for homeless youth or centers for children from families from low socio-economic backgrounds, homes, such as Beit Noam, for the disabled, and absorption centers for new immigrants.

Positions according to operational segments:

	Average positions in 2007		Average positions in 2006	
	Managerial Staff	**Clerical Staff**	Managerial Staff	Clerical Staff
Households	**1,511**	**5,167**	1,392	5,037
Small businesses	**418**	**1,263**	380	1,182
Corporate banking	**447**	**612**	404	551
Commercial banking	**488**	**870**	529	956
Construction and real estate	**101**	**116**	85	98
Private banking	**324**	**417**	329	449
Financial management – capital markets	**261**	**348**	220	217
Other	**32**	**144**	36	136
Total	**3,583**	**8,936**	3,374	8,626

The calculation of the number of positions according to operational segments is based on the management of personnel according to the Bank's main lines of business, with various adjustments and on the basis of estimates and, *inter alia,* is relative to the total assets managed by the segment. In addition, in calculating the number of positions according to operational segments, employees of head office units, who service all or part of the operational segments of the Bank, have also been taken into account.

Bank Leumi le-Israel B.M. - Organizational Structure



* Member of Management

Organizational Structure (continued)

The Leumi Group's organizational structure, according to business lines and head-office services, as described below, combines the activity of companies in the fields of banking, finance, the capital market and financial services.

In 2007, Leumi announced the following changes in the Bank's Management:

Yona Fogel, Head of the Banking Division and member of the Bank's Management, retired from his positions in the Group on 30 September 2007, after 26 years with the Bank.

Baruch Lederman was appointed Head of the Banking Division and member of the Bank's Management, as from 1 October 2007.

Michael Bar Haim, Head of the Commercial Banking Division and member of the Bank's Management, retired from his positions in the Group on 31 December 2007, after 32 years with the bank.

Gideon Altman was appointed Acting Head of the Commercial Banking Division, as from 1 January 2008.

Responsibility for the Special Credits Department was transferred to Rakefet Russak-Aminoach, Head of the Corporate Division, as from 1 January 2008.

Tamar Yassur was appointed Head of External Relations and Public Affairs, as from 1 June 2007.

Yoel Mintz was appointed Head of the Construction and Real Estate Division, as from 2 August 2007.

Iris Rapoport was appointed Head of Group Strategy, as from 2 September 2007.

Leumi is organized in five business lines that focus on different market sectors, and each business line specializes in the provision of service to a group of customers. This form of organization enables the customers to enjoy a high standard of professional service, diverse distribution channels, products that are adapted to their requirements and fast and flexible decision-making processes.

Following is a description of the responsibility for Leumi's five business lines:

1. **Corporate Division -** responsible for formulating the Group's credit policy, and managing and dealing with the Group's overall credit risks, credit procedures and collateral policy. It is also responsible for designing special transactions, such as project financing in Israel and abroad, financing controlling interest transactions, examining investment plans, and international trade and financing. The Corporate Division manages the activity of Israel's large business customers on the basis of sectoral expertise and synergy between the sectors. This line of business also includes the Construction and Real Estate Division that is responsible for the activity of Israel's large building and contracting companies, with specific expertise and skill in the sphere.

2. **Commercial Banking Division -** manages the activity with regard to middle-market commercial companies, through 25 commercial branches organized on a geographic basis in 4 commercial districts, as well as the principal branch in Tel Aviv. The Division's organizational structure is unique in the Israeli banking system, and provides a "one stop shop" for its comprehensive and extensive services.

3. **Banking Division -** manages the activity of the private customers and small business customers, who receive the full range of services through 182 branches organized in 8 districts on a

geographic basis and by means of a variety of technological/direct distribution channels, including LeumiCall, which provides services through the telephone and internet. The Division is also responsible for the e-business section and the e-venture technological initiatives.

The services and products are adapted to all the customer sectors differentially according to the nature of their banking activity, their characteristics and their needs. The customers of the Division are segmented into the following sectors: the retail sector, "gold banking" and the business banking sector. The Division coordinates the retail operations in the Group, including The Arab Israel Bank, Leumi Mortgage Bank and Leumi Card.

4. **International and Private Banking Division** - is responsible for the banking activity of the Group overseas, and for managing private banking in Israel and worldwide. The activities of all the Bank's units abroad are concentrated in this Division, except for Romania. In addition, the Division includes the private banking centers in Israel for residents and non-residents and the Bank Leumi le-Israel Trust Company Ltd. The Division's activities also include supervision and co-ordination between the Bank in Israel and the overseas units, and the provision of services, at international standards, to wealthy customers. It is also responsible for mergers and acquisitions overseas.

5. **Capital Markets Division** is responsible for managing the Bank's assets in Israeli currency and foreign exchange; management of the nostro; the activity of all the Bank's dealing rooms (Israeli currency, foreign exchange and Israeli and foreign securities); developing innovative financial products and investment products; management of the assets and liabilities of the Bank and management of financial risks; formulation of the Bank's policy on prices, commissions and financial margins; relations with financial institutions abroad; co-ordination of the Bank's capital market services; and customer service for customers active in the capital and financial markets, including institutional customers.

As well as the division between the business lines, the Leumi Group has head office units which provide services to the business lines.

Finance and Economics Division is responsible for the tax planning of the Bank and the Group; the Bank and Group insurance; preparation of the expense budget and monitoring its implementation; coordination of the business plan of the Bank; managing profit centers and financial measurement; monitoring economic developments and preparation of reviews of branches of the economy and economic forecasts.

Accounting is responsible for the management, development and determination of the Bank's accounting guidelines, preparation of the financial statements of the Bank and the Group and preparation of reports to the Bank of Israel.

Human Resources is responsible for the formulation and implementation of the Bank's human resources policy and, within this overall context, for selection and placement of employees, remuneration of employees, salaries, labor relations, development and advancement of employees, banking training - managerial and general, assimilation of the "Leumi Way" code of ethics, internal communications, internal information, social responsibility, care of the individual, organizational counseling and development and employee welfare.

Operations, Information Systems and Administration (*Matam*) is responsible for the computerized, operational and logistical deployment of the Bank and the Group. It enables Leumi's strategy to be implemented and advances the effort to be the leading bank in business and technology. As part of its purpose, it co-ordinates the formulation and determination of the strategy, policy and activity regarding computers, systems, operations, technology, organization and methods, information security, overseas units' operations, real-estate, procurement and security.

Investment Counseling is responsible for the Bank's policy regarding counseling on investment in securities and financial instruments, development of systems in the investments field and research on capital and financial market subjects.

External Relations and Public Affairs is responsible for Bank and Group advertising, for the spokesperson's office and public relations, charitable donations, sponsorships, community relations, and regulatory issues.

Internal Audit Division is responsible for the internal auditing of the Leumi Group. The audit is carried out in accordance with the Audit Law, Bank of Israel directives and generally accepted professional standards. The audit deals, in an independent, impartial manner, with the examination and evaluation of the Group's internal control systems, including: examination of the work and control systems, preservation of the Bank's assets, reduction of exposures, maintenance of the rules of ethics and proper management, the carrying-out of the instructions of the Board of Directors and the Management of the Bank and the Bank's guidelines, and examination of operational efficiency. The Chief Internal Auditor reports to the Chairman of the Board of Directors.

Legal Division is responsible for overall legal counsel to the Bank and its subsidiaries in Israel. Its Head, the Chief Legal Adviser, is responsible for the Group's Chief Compliance Officer.

Compliance Department is responsible for implementing the Bank’s compliance plan regarding consumer directives, and for the implementation of the legislative provisions dealing with the prohibition of money laundering and of financing terrorism. The Compliance Department is also responsible for the Customer Relations Department.

Strategy Department is responsible for the Group’s strategic planning.

Risk Management Control Department is responsible for mapping, identifying and measuring all the risks in the Group and creating an infrastructure for examining the risks inherent in new activities. The department carries out risk control at the Group level in Israel and abroad, and develops methods for measuring and controlling risks, including for calculating economic capital. Furthermore, the department controls and coordinates the risk management policy documents and carries out the loan review process. The preparations for adopting the rules of the Basel Accord in the Group, in accordance with the relevant Bank of Israel directives, are an important part of the department's activity.

Leumi for the Community – Social Involvement

The State of Israel will celebrate the 60^{th} anniversary of its independence in 2008. Leumi will mark the State’s 60^{th} year with a series of events and activities for the general public.

Since its establishment 106 years ago and to this day, Leumi has been active in the community in which it operates, and as part of its perception of its role, the Bank contributes to various institutions and organizations in the areas of education, social welfare, culture, art and health. In recent years, the Bank has placed emphasis on supporting the fields of training and education, and on encouraging entrepreneurship and the development of leadership among young people living in outlying areas.

The Group’s involvement in the community is undertaken in a number of ways:

- Donations through organizations (institutions and non-profit associations), which work to promote social projects that concentrate on education and the welfare of children and young people.

- Involvement by providing sponsorships for educational and cultural activities

- Individual attention to populations in grave distress.

As part of its overall commitment to the community, Leumi encourages its employees to become involved with the community, and provides them with the infrastructure and the opportunity to volunteer and to contribute. Hundreds of employees volunteer for activities undertaken within the framework of “Leumi Tomorrow,” "Young Entrepreneurs," and other projects initiated by the Bank, and these employees serve as models for emulation by the pupils in the various projects. Thanks to raised awareness of the subject of contribution to the community, branches and units have been initiating independent local projects, with the support of Leumi's Management.

“Leumi on the Israel Trail”

Leumi's activities to mark the 60^{th} anniversary of the State’s independence began at the end of September 2007, during the Succoth holiday. Leumi and the Society for the Protection of Nature in Israel signed a sponsorship agreement under which Leumi will provide sponsorship for the Israel Trail (a continuous hiking path that runs the length of Israel, from Mount Hermon to Eilat), through activity called “Leumi on the Israel Trail.” In the context of this activity, the general public is invited to come back and familiarize itself with Israel’s landscapes through the most direct method – hiking trips.

“Leumi Tomorrow - The Centennial Fund for Endowing Israel’s Future Generation”

In 2002, its centenary year, Leumi established “Leumi Tomorrow - The Centennial Fund for Endowing Israel’s Future Generation”. The association invests in educational projects for youth that provide preparation for matriculation examinations and for meaningful service in the Israel Defense Forces. In 2007, more than 15,000 students and pupils from different population sectors throughout the country participated in the fund’s various educational and enrichment programs. "Leumi Tomorrow" supports the “Atidim” ("Futures") association and the “Youth Leading Change” association which develop the level of education and leadership among young people, and the “Equal Opportunities” initiative which provides welfare and assistance to families in distress.

Principal Activities of "Leumi Tomorrow" in 2007:

- **Atidim** – For two years, "Leumi Tomorrow" has had a strategic partnership with “Atidim”– a nation-wide project for realizing the potential of youth throughout the country, with the aim of developing excellence, strengthening the educational infrastructure and empowering the human capital of the outlying areas. During the 2006-2007 academic year, some 12,000 young people took part in the various activity frameworks of the "Friends of Atidim" association.

- **Youth Leading Change -** More than 2,000 pupils participated in all the activity frameworks of the "Youth Leading Change" association, including studies for matriculation in mathematics and English and preparation for the IDF.

- **Access to Higher Education –** 1,022 students from 30 schools from communities in the Negev and Eilat participated in a higher education accessibility program in the Negev, intended for students with academic potential. The students took academic courses at Ben Gurion University and benefited from special tuition in matriculation subjects.

- **Matriculation Takes You Forward -** 460 students took part in the “Matriculation Takes You Forward” project managed by the external studies unit of the University of Haifa, in nine different communities in the North. The students benefited from special tuition for the matriculation examinations in mathematics, English and Hebrew language.

Equal Opportunities Initiative

The "Equal Opportunities" initiative seeks to grant equal opportunities to underprivileged families throughout the country. The initiative is run by Leumi in cooperation with the "Yedioth Ahronoth" newspaper and adopts families, chosen on the recommendation of the Welfare Offices, and grants them extended assistance basket in the areas of education, welfare and individual issues, according to the needs of the families. Contact with the social workers and families is through branch employees.

- On the occasion of Passover 2007, Leumi distributed 1,620 food parcels to needy families, as part of a *kamcha da'pascha* (food for Passover) campaign. This is the third year that the campaign is being conducted through a donation by Leumi with employee participation.
- Before Rosh Hashanah (Jewish New Year) of 2007, gift vouchers were distributed to some 1,400 needy families from all over the country, having a total value of some NIS 500,000.
- On Hannuka, 3,000 gift packages, including menorahs, candles and Hannuka presents were distributed to the families of the student participants in the association's projects, and to new immigrant communities.

Young Israeli Entrepreneurs – Established by Leumi

As an expression of the importance Leumi attaches to the development of entrepreneurship, Leumi has participated in and supported the "Young Entrepreneurs" project since its commencement in Israel in 1991. "Young Entrepreneurs" is an international initiative which involves millions of young people each year from more than one hundred countries throughout the world. Some 4,000 young people from all parts of the country are participating this year as well, in an educational and challenging program, during the course of which they gain experience in establishing and managing a business, while learning the principles of entrepreneurship and business practice. The program's participants originate from all sectors of Israeli society – veteran Israelis, new immigrants and young people from the Arab sector.

Recently, Leumi and "Young Israeli Entrepreneurs" agreed to extend their cooperation for an additional number of years, while enlarging the support budget. This will enable the "Young Israeli Entrepreneurs" organization to continue to develop its educational projects for thousands of additional young people.

Leumi for the Arts - The Leumi Exhibition for Young Artists

As part of the Leumi Group's support of art and culture, and for the second consecutive year, a "secret art" exhibition was held in December 2007 in the lobby of Leumi House in Tel Aviv. Some 200 works of art were on display at the exhibition, most of them by young and unknown artists, alongside works of art by famous and recognized artists. The works were presented without revealing the names of the artists, allowing the public the opportunity of gaining an impression of the pure art.

Some 10,000 art lovers and visitors saw the exhibition over four days, and more than NIS 1 million was spent on purchases of the works of art.

Book Week for Sderot Residents

Leumi is continuing its tradition of supporting the residents of Sderot and of the communities surrounding the Gaza Strip who have been under attack for years. After Sderot residents complained that Israel's annual "Book Week" program had not reached their city due to the publishers' fears of travelling to the region, Leumi raised the gauntlet and organized a special event together with the Steimatzky bookstore chain. All the residents of the city were invited to enjoy the premier books from all the publishers, at subsidized prices.

***Maala* Social Responsibility Index**

Leumi is rated in the top 10 of all the large companies in Israel that are rated by the *Maala* social responsibility index.

Maala's rating examines the large companies in Israel according to their compliance with social responsibility criteria. The rating is based upon detailed criteria in four central areas, out of all the social responsibility spheres of businesses: the environment, business ethics, work environment and human rights and community involvement.

Summary of Leumi's Sponsorships and Donations in 2007

In 2007, the Leumi Group made donations and provided sponsorships for social and community purposes in the amount of some NIS 20.6 million, of which donations amounted to some NIS 17.3 million.

During the past five years (2003-2007), the Leumi Group's contributions and sponsorships for social causes amounted to some NIS 93.7 million.

Set out below is a breakdown of the total donations and sponsorships in 2007 according to various categories:

Education, children and youth	- NIS 9.0 million;
Health	- NIS 1.2 million;
Culture	- NIS 1.1 million;
Community and society	- NIS 9.3 million.

Decisions with regard to the designation and amount of donations are made both by the "Leumi Tomorrow" association and by the Bank's donations committee, whose members are appointed by the President and Chief Executive Officer. Applications for donations are given careful and thorough consideration in accordance with criteria that have been determined in written guidelines and approved by the Board of Directors. Large donations are referred to the Board of Directors for approval.

Internal Auditor

The Chief Internal Auditor, Adv. Joseph Horowitz, has served as the Group's internal auditor since October 1995, after his appointment was approved by the Bank's Audit Committee and Board of Directors on 7 September 1995. The Chief Internal Auditor has considerable experience in internal auditing. He meets the criteria of section 146(b) of the Companies Law, 1999 and the provisions of section 8 of the Internal Audit Law, 1992 (the "Internal Audit Law") and the internal audit employees meet the criteria of section 8 of the Banking Rules (Internal Audit), 1992 (the "Banking Rules").

The Chief Internal Auditor is an employee of the Bank, and this is his only occupation. The Chief Internal Auditor's organizational superior is the Chairman of the Bank's Board of Directors.

The Internal Audit Division has an annual work plan and a multi-year work plan for a period of up to three years. The multi-year plan covers most of the subjects audited, other than a relatively small number of low-risk subjects regarding which audits are carried out every four years. The annual work plan and the multi-year work plan are derived from a mapping of audit subjects which are based, *inter alia*, on the documents detailed in section 3(b) of the Banking Rules. The work plans are derived from a systematic methodology of estimating risks and controls, according to which the frequency of the audit for each subject is established. Thus, regarding subjects with a higher level of risk, audits will be carried out at a frequency of one year. With respect to subjects that involve a lower level of risk, audits will be carried out every two or three years. The proposed annual work plan and multi-year work plan are submitted by the Internal Audit Division and are approved by the Chairman of the Board of Directors and the Audit Committee of the Board of Directors.

The Internal Audit Division's annual work plan and the multi-year work plan allow the Chief Internal Auditor to exercise discretion in deciding to deviate from the plan.

In the context of the audit work, a sample material transactions carried out by the Bank - including the procedures through which they were approved - are examined. For this purpose, material transactions include a material purchase or sale of activity, and "transactions" are as defined in section 270 of the Companies Law and an "extraordinary transaction" – as defined in the Companies Law.

The Internal Audit Division's annual work plan and the multi-year work plan each include a chapter dealing with the annual and multi-year work plans of the material consolidated subsidiaries in Israel (as defined in Notes 1 E and 6 D to the Financial Statements). Employees of the Internal Audit Division serve as internal auditors of the Bank's consolidated subsidiaries in Israel. The process of structuring the consolidated companies' work plans is similar to the process of structuring the work plan of the Bank's Internal Audit Division. Generally, there is reference to the work plans of the internal auditors of the companies included on the equity basis in their financial statements.

At the material foreign subsidiaries, local internal auditors are appointed. The Internal Audit Division supervises the work of the local auditor, as provided in section 1(a)(3) of the Banking Rules. This is done, *inter alia*, through an examination of the local internal audit work plan of the overseas subsidiaries before it is submitted for approval by the audit committee and the board of directors abroad. The Bank's internal work plan includes targeted audits by the Israeli Internal Audit Division of the overseas subsidiaries, and the division of labor between the Israeli and overseas internal auditors is carried out through coordination of the audit subjects between the Israeli and overseas auditors. The internal auditors of the material overseas subsidiaries report to their local audit committees.

The Chief Internal Auditor and his team of employees in the Leumi Group in Israel comprise 105.6 positions on annual average. In addition, local auditors are employed in overseas subsidiaries in 19.7 positions.

The following is the average number of internal auditor positions in the Leumi Group in Israel, including outsourcing:

The Bank	93.3
Subsidiaries in Israel	9.5
Overseas subsidiaries	2.8
Total	105.6

The number of positions is approved by the Audit Committee, based on the annual and the multi-year work plan. The Chief Internal Auditor may, within the framework of the budget, use outsourcing for the execution of work that requires special knowledge or in the event of insufficient staff.

Below are details of all the benefits and amounts paid or in respect of which provisions were recorded for the Chief Internal Auditor during the year 2007, in NIS thousands:

					Loans given on beneficial terms					Securities held	
Salary including bonus	Payment transactions based on shares*	Severance pay, provident funds, pension, supplementary training fund, holidays, jubilee benefits, and national insurance	Additions to reserves for related expenses due to salary changes in the accounting year	Total salary and related expenses**	Balance as at 31 December 2007	Average period until maturity (years)	Benefit provided over the year	Loans granted on regular terms	Other benefits	Shares	Options
2,482	**214**	**315**	**33**	**3,044**	**463**	**2.41**	**40**	**173**	**143**	**40,764**	**84,439**

* Includes the allotment of options issued to all employees.
** Excluding salary tax.

The total payments to the Chief Internal Auditor and the components thereof are submitted to and approved by the Audit Committee.
The Board of Directors believes that the holding of securities by the Chief Internal Auditor and the compensation paid to him do not affect the exercise of his professional discretion.

The Chief Internal Auditor prepares the annual and the multi-year work plan according to the professional standards of the Institute of Internal Auditors in Israel and the international Institute of Internal Auditors (IIA). In addition, the Chief Internal Auditor operates in accordance with the directives and instructions of the Supervisor of Banks.

The Audit Committee and the Board of Directors have noted the Chief Internal Auditor's written declaration that he complies with the requirements laid down in the said accepted professional standards, and that he operates in accordance with the directives and instructions of the Supervisor of Banks. On the basis of this declaration, the Audit Committee and the Board of Directors are satisfied that the Chief Internal Auditor meets all the said requirements.

Generally, upon the issue of written audit reports by the Internal Audit Division, and as part of the ongoing work process, discussions are held with the audited entities (branch managers, district managers or managers of other organizational units) on the audit reports and discussions are also held on material findings with the heads of the divisions and the President and Chief Executive Officer.

Before the meetings of the Audit Committee, the Chairman of the Audit Committee, in consultation with the Chief Internal Auditor, determines which audit reports will be presented in their entirety for discussion at the Audit Committee. Furthermore, lists of all the audit reports issued by the Internal Audit Division in the relevant period, together with a summary of the material findings, are submitted on an ongoing basis for the perusal of all the members of the Audit Committee. They may peruse any audit report they wish and request from the Chairman that it be presented in its entirety for discussion by the Audit Committee. Material audit reports are discussed at the Audit Committee each month, and on sometimes twice a month.
At the end of the first and second halves of the year, the Internal Audit Division submits reports summarizing the audit operations for the relevant periods to the Chairman of the Board of Directors, the President and Chief Executive Officer and the Chairman of the Audit Committee. They include a summary of the material findings for the relevant period, the auditor's recommendations and the audited entity's replies.
In addition, the Internal Audit Division submits an annual report that summarizes the audit operations during the course of the entire year to the Chairman of the Board of Directors, the President and Chief Executive Officer and the Chairman of the Audit Committee, which also includes monitoring of the performance of the annual work plan.

The Chief Internal Auditor's report for the second half of 2006 was submitted to the Audit Committee on 22 March 2007 and was discussed by it on 29 March 2007. The summarizing annual report for 2006 was submitted to the Audit Committee on 10 April 2007 and discussed by it on 15 April 2007.
The annual reports of the Israeli and overseas subsidiaries were submitted on 21 May 2007 and discussed by the Audit Committee on 27 May 2007. The Chief Internal Auditor's report for the first half of 2007 was submitted to the Audit Committee on 24 October 2007 and was discussed by it on 30 October 2007.

The Chief Internal Auditor has been provided with documents and information as specified in section 9 of the Internal Audit Law, and was given access to information, as specified in that section, and he has continuous and direct access to the Bank's information systems, including access to financial data.

The internal auditors in Israel carrying out audits of the subsidiaries in Israel and abroad have been provided with documents and information as specified in section 9 of the Internal Audit Law, and were given access to information, as specified in that section, and have continuous and direct access to the information systems of the subsidiaries in Israel and abroad, including to financial data.

The Board of Directors and the Audit Committee believe that the scope, nature and continuity of the operations and the work plan of the Internal Auditor are reasonable under the circumstances, and that they enable the objects of the Internal Audit at the corporation to be achieved.

Evaluation of Disclosure Controls and Procedures for the Financial Statements

On 15 November 2004, the Supervisor of Banks published a Directive regarding the certification to be attached to the quarterly and annual statements of banking corporations, to be signed by the chief executive officer and chief accountant/treasurer of the bank or the person actually carrying out this task (in Leumi, the Head of the Finance and Economics Division) as from the financial statements for the period ending 30 June 2005. On 18 July 2005, the Supervisor of Banks published an amended text of the certification. The text of the certification in the Directive is based on the directives of the SEC and relates to the requirements of section 302 of the Sarbanes-Oxley (SOX) Act. According to the Supervisor's Directive, the certification is not implemented in accordance with the extensive requirements of section 404 of the SOX Act, which requires the existence of a system of internal controls according to a defined and accepted framework which is far wider in extent than the disclosure controls required to be operated in relation to the Financial Statements to 30 June 2005 and thereafter.

With the assistance of external consultants, the Bank has determined procedures and set up a disclosure committee, headed by the President and Chief Executive Officer of the Bank, and including members of Management and other senior officers in the manner required to fulfill the requirements of the Directive.

The Management of the Bank, together with the President and Chief Executive Officer and the Head of the Finance and Economics Division have evaluated, as at the end of the period covered by this Report, the effectiveness of the disclosure controls and procedures of the Bank. On the basis of this evaluation, the President and Chief Executive Officer of the Bank and the Head of the Finance and Economics Division have concluded that, as at the end of the said period, the disclosure controls and procedures of the Bank are effective for the recording, processing, summarizing and reporting of the information that the Bank is required to disclose in its quarterly financial statements, in accordance with the Directives on reporting to the public of the Supervisor of Banks and at the time required in these Directives.

In the quarter ended 31 December 2007, no material change to the internal controls on financial reporting of the Bank occurred which had a material effect, or which is reasonably expected to have a material effect, on the Bank's internal controls of the financial reporting.

Management's Responsibility for the Internal Control of Financial Reporting (SOX Act 404)

On 5 December 2005, the Supervisor of Banks published a circular which details provisions for the application of the requirements of section 404 of the SOX Act. In section 404, the SEC and the Public Company Accounting Oversight Board determined provisions as to management's responsibility for the internal control over financial reporting and as to the external auditors' opinion with regard to the audit of the internal control over financial reporting.

The Supervisor's directives in the said circular prescribe that:

- banking corporations shall apply the requirements of section 404 and also the SEC's directives that were published pursuant thereto.

- proper internal control requires the existence of a control system in accordance with a defined and recognized framework, and the COSO model meets with the requirements and can be used in order to assess the internal control.

- application of the directive's requirements requires the upgrading and/or establishment of an infrastructure system of internal controls at the bank and the process of developing such systems obliges the bank to prepare and to determine interim stages and targets until the full application thereof.

- the project must be completed by the end of the first half of 2008, so that the external auditors' audit will commence in June 2008 and will be completed by the date of the December 2008 Report.

The Management of the Bank is proceeding to implement the directive at the Bank and subsidiaries, with the cooperation of consultants hired to carry out the project.

Remuneration of Senior Office Holders

For the year ending 31 December 2007

Below are details of all the benefits and amounts paid or in respect of which provisions were recorded in the years 2007 and 2006, to the Chairman of the Board of Directors and to the recipients of the five highest salaries among the senior office holders of the Bank.

2007										
						Loans given on beneficial terms (4)				
	Salary including bonus	Payment transactions based on shares*	Severance pay, provident funds, pension, supplementary training fund, holidays, jubilee benefits and national insurance	Additions to reserves for related expenses due to salary changes in the accounting year	Total salary and related expenses**	Balance as at 31 December 2007	Average period until maturity (years)	Benefit provided over the year	Loans granted on regular terms	Other benefits
	NIS thousands									
Mr. E. Raff (1)	**5,545**	**311**	**460**	**21**	**6,337**	**614**	**2.58**	**52**	**200**	**89**
Mrs. G. Maor (2)	**8,089**	**397**	**458**	**111**	**9,055**	**839**	**2.50**	**72**	**28**	**139**
Mr. Z. Nahari (3)	**4,912**	**260**	**447**	**76**	**5,695**	**557**	**2.52**	**47**	**1,440**	**148**
Ms. R. Russak-Aminoach(3)	**3,378**	**214**	**415**	**8**	**4,015**	**733**	**4.49**	**47**	**272**	**80**
Mr. D. Bar Lev (3)	**3,183**	**214**	**332**	**27**	**3,756**	**535**	**3.09**	**45**	**20**	**144**
Mr. Z Itskovitch (3)	**2,983**	**214**	**367**	**25**	**3,589**	**648**	**5.14**	**53**	**244**	**148**

* Includes allotment of options which were allotted to all employees.
** Does not include salary tax.

(1) The amount includes NIS 4,000 thousand in respect of a bonus requiring the approval of the General Meeting of Shareholders.

(2) The personal employment contract of the President and Chief Executive Officer was amended such that the Bank undertook to employ her for at least three years, until February 2010, in order to ensure managerial stability for a period of at least three years. The maximum amount of the additional expense to the Bank, were the President and Chief Executive Officer dismissed immediately, on 1 January 2008 was NIS 3,273 thousand (the "Maximum Expense Amount”). The Maximum Expense Amount was calculated for the remaining two year period, and gradually decreases to zero as the period during which the President and Chief Executive Officer continues to work at the Bank elapses, such that at the end of two years, the Bank will have no additional expense. The Maximum Expense Amount is before tax and includes salary tax. It should be further noted that the Board of Directors has stated that it does not intend to dismiss the President and Chief Executive Officer and therefore no provision in respect of the amendment of the President and Chief Executive Officer's contract is required.
See Note 15 B(4)(a) to the Financial Statements for further details.

(3) In the years 1994-2007 the Bank signed personal employment contracts with certain senior employees of the Bank, including members of Management who did not previously have personal contracts. The personal contracts of the Management members were amended with effect from 31 December 2003 and from August 2006. See Note 15 B(4)(b) to the Financial Statements for further details.
The amount of the Bank's maximum additional expense if the employment of all said employees were terminated immediately would amount to NIS 355 million (NIS 359 million in 2006). These amounts are before tax and include salary tax on the pension obligation. Since it is not reasonable

that all the said employees will be dismissed immediately, a global provision of 25% of the above sum in the amount of NIS 91 million (NIS 90 million in 2006) was made. These sums also relate to the members of Management (excluding the Chief Executive Officer).

Following the amendment to the personal contracts of the Management members, as set forth in Note 15 B(4)(b) to the Financial Statements, a specific attribution to the Management members was made out of the said provision, the balance whereof totaled NIS 10 million as of 31 December 2007 (31 December 2006 – NIS 13 million).

(4) Mainly loans granted to all the employees to buy shares of the Bank pursuant to the 2006 outline and an extension of loans given in the past under the 1998 and 2002 prospectuses.

(5) The Directors and other officers have been insured by the Bank under directors' and other officers' liability insurance policies covering the Bank and its consolidated companies. The relative premium paid is not included in the above tables, inasmuch as it is insignificant; the total premium amounted to NIS 5,781 thousand and relates to all officers in the insured group.

(6) In March 2008, the Bank's Audit Committee, followed by the Bank's Board of Directors, approved the granting of bonuses in respect of 2007, to the Chairman of the Board of Directors, the President and Chief Executive Officer, each member of Management and the Chief Internal Auditor, in different amounts, taking into account, *inter alia*, the net return on shareholders' equity of the net operating profit and the contribution of each of them to the achievement of said return.

The amount of the bonus to the Chairman of the Board of Directors, as mentioned, was approved by the Audit Committee and the Board of Directors of the Bank, and are still subject to the approval of the General Meeting of the Bank.

For further details see Note 15 to the Financial Statements.

2006

							Loans given on beneficial terms (4)				
	Salary including bonus	Payment transactions based on shares*	Severance pay, provident funds, pension, supplementary training fund, holidays, jubilee benefits and national insurance	Additions to reserves for related expenses due to salary changes in the accounting year	Additions to reserves derived from updating of mortality tables	Total salary and related expenses**	Balance as at 31 December 2006	Average period until maturity (years)	Benefit provided over the year	Loans granted on regular terms	Other benefits
	NIS thousands										
Mr. E. Raff	4,302	498	444	25	-	5,269	690	3.58	-	169	72
Mrs. G. Maor	5,604	636	716	543	927	8,426	973	3.17	8	-	118
Mr. Z. Nahari	3,246	416	291	285	-	4,238	645	3.14	6	1,430	131
Mr. Z Itskovitch	2,598	343	387	447	130	3,905	750	5.83	11	237	121
Mr. Y. Fogel	2,488	343	537	244	30	3,642	621	3.68	11	3	101
Mr. I. Malach	2,511	343	481	175	70	3,580	792	5.02	18	250	117

* Includes allotment of options, shares sold to employees by the State of Israel and the value of the benefit of the loans to finance purchase of the shares.

** Does not include salary tax.

2006									
						Loans given on beneficial terms (4)			
	Salary including bonus	Payment transactions based on shares	Severance pay, provident funds, pension, supplementary training fund, holidays, jubilee benefits and national insurance	Additions to reserves for related expenses due to salary changes in the accounting year	Total salary and related expenses	Balance as at 31 December 2006	Average period until maturity (years)	Benefit provided over the year	Other benefits
	NIS thousands								
Dr. E. Shapira	2,314	372	3,480	850	7,016	739	3.22	8	122
Mr. D. Gilboa	2,051	343	372	878	3,644	593	3.32	9	141

(1) Dr. Ehud Shapira, Senior Deputy Chief Executive Officer of Leumi and Acting CEO in the absence of the President and Chief Executive Officer, Head of Corporate and International Banking and Manager of Credit Risks of the Bank, retired from his positions in the Group on 30 June 2006. The above amount includes a NIS 3.6 million provision in respect of an actuarial pension obligation arising from the terms of his retirement, pursuant to his personal employment contract.

(2) Mr. D. Gilboa, Head of the Investments Division and member of the Bank's Management, retired from his position with the Bank on 31 August 2006.

Auditors' Fees (1)(2)(3)

	Consolidated		Bank	
	2007	2006	**2007**	2006
	NIS thousands			
For auditing activity: (4)				
Joint auditors	**16,133**	20,238*	**4,100**	4,552*
Other auditors	**3,283**	6,340	**85**	68
Total	**19,416**	26,578	**4,185**	4,620
For audit related services: (5)(6)				
Joint auditors	**2,103**	1,973	**1,998**	1,741
Other auditors	**-**	-	**-**	-
For tax services: (5)				
Joint auditors	**1,483**	1,755	**556**	503
Other auditors	**177**	643	**-**	-
For other services:				
Joint auditors	**5,405**	1,769	**4,806**	1,371
Other auditors	**-**	157	**-**	-
Total	**9,168**	6,297	**7,359**	3,615
Total auditors' fees	**28,584**	32,875	**11,544**	8,235
Joint auditors' fees from other engagements (7)	-	-	-	-

* Includes special audit.

(1) Report of the Board of Directors to the Annual General Meeting on the auditors' fees in respect of audit and additional services, under sections 165 and 167 of the Companies Law, 1999.

(2) Auditors' fees include payments to partnerships and corporations under their control and also payments required by the VAT Law.

(3) Including fees paid and accumulated fees.

(4) Auditing of annual financial statements and review of interim reports.

(5) Provided services related to prospectuses and tax advice.

(6) Audit related fees, including mainly: prospectuses, special certificates, comfort letters, forms and reports to authorities to which the signature of the auditors is required and audit of businesses purchased during the year.

(7) As reported by the auditors pursuant to section 4 of the directives relating to a conflict of interests and impairment of independence in consequence of the auditors' other engagements, and included above.

Board of Directors

Below are the names of the Directors, their principal occupations and their positions in the Bank Leumi Group and in other bodies:

Name of Director	
Eitan Raff **Ramat Gan**	Chairman of the Board of Directors of the Bank and its subsidiaries, Bank Leumi USA, Bank Leumi le-Israel Corporation, Bank Leumi (UK) plc and Leumi & Co. Investment House Ltd. Director, Development Corporation for Israel, New York, Verifone Holdings, Inc. and Hadassah Medical Organization. Director and Financial Consultant, Wolfson Clore Mayer Corp. Ltd. and its subsidiaries.
Doron Cohen **Reut**	CEO, Co-Op Blue Square Services Cooperative Ltd., Economic and Business Consulting. Director and Owner, Trigger D.C. Ltd. and Trigger D.C. Holdings Ltd. Shareholder, Romika Investments Ltd. Director, Harel Insurance Investments & Financial Services Ltd. and Consumers Cooperative Fund Ltd.
Meir Dayan* **Raanana**	Economist, International Business Consulting. External Director on the Board of Directors of the Bank Director, Real Estate Participations in Israel Ltd., Migdal Shalom Mayer Ltd., and The Hebrew University's Assets Ltd.
Moshe Dovrat **Tel Aviv**	Company Director. CEO, Director and Owner of Beit Meniv Funding Ltd. and Dovrat (M.H.) Investments and Business Intitiatives Ltd. Director and Shareholder in Beit Meniv Israel Ltd. Chairman of the Board of Directors of Kibbutz Kfar Blum Tourism. Member of Management of Kfar Blum Holdings – Agricultural Cooperative Society Ltd.
Zipora Gal Yam* **Maalot - Tarhisha**	Economic Consultant, Company Director. External Director, HBL – Hadasit Bio-Holdings Ltd. and Direct Insurance – Financial Investments Ltd.
Prof. Arieh Gans* **Ramat Gan**	Professor of Accounting, Tel Aviv University and Company Director. Director, CEO and Owner of A. Gans Management Services and Consulting Ltd. Director, Middle East Tubes Corporation Ltd.
Prof. Israel Gilead* **Mevasseret Tzion**	Professor of Law, The Hebrew University of Jerusalem. External Director on the Board of Directors of the Bank. Member of the Public Commission pursuant to the Appointment of Managers and Administrations for Pension Fund Arrangements Law. Chairman of the Executive Committee of the National Center for Testing and Evaluation (the Psychometric Exam).
Yaacov Goldman, **C.P.A. (Isr.)** **Hod Hasharon**	C.P.A. (Isr.), Business Consultant and Company Director. Director, CEO and Shareholder, Maanit-Goldman Management and Investments (2002) Ltd. Director and Shareholder, Sigma Capital Partners Company Ltd. Chairman of the Board of Directors, A.T.G.A. Medical Ltd. External Director, Elron Electronic Industries Ltd., Isrotel Ltd. and Negev Ceramics Ltd. Director, Mer Telemanagement Solutions Ltd., Golden House Ltd., Renewable Resources Ltd., Tagor Capital Ltd., Renewed Water Minerals Ltd., Design & Performance (Cyprus) Limited and Recursos Renobables Hidricos S.L. Professional Secretary, The Peer Review Institute of the Israeli Institute of Certified Public Accountants.

* External Director pursuant to Directive 301 of the Supervisor of Banks.

Name of Director	
Rami Avraham Guzman* **Ramat Gan**	Company Director, Consultant to Public/Government Companies and Institutions. Director and Shareholder, Rami Guzman Initiatives and Consulting Ltd. Director, Adamind Ltd., Afcon Electro Mechanics Ltd. and Ampa Capital Ltd. Consultant, A.M.S. Electronics Ltd. and Metrolight Ltd. Member of Advisory Committee, Micromedic Technologies Ltd. Member of Investment Committee, Israel Infrastructure Fund I-A, L.P., Israel Infrastructure Fund I-B, L.P., Israel Infrastructure Fund I-C, L.P. and Israel Infrastructure Management 1 Ltd. Member of Credit Committee, B.S.S.CH. – The Israeli Credit Insurance Company Ltd.
Zvi Koren **Jerusalem**	Economic Consultant. Director and Shareholder, Teconomy Ltd. External Director, Boymelgreen Capital Ltd. and E-Sim Ltd.
Adv. Jacob Mashaal **Moshav Neve Yaraq**	Company Manager. Chairman of the Board of Directors, CEO and Owner, IBECO Ltd. and J. Mashaal & Sons Entrepreneurs Ltd. Chairman of the Board of Directors, CEO and Shareholder, A.V.M.S. Investments Ltd. and Lev Afek Ltd. Member of Management Committee, Moshav Neve Yaraq Ltd.
Vered Raichman **Kibbutz Glil-Yam**	Owner and CEO, Tzealot Management Ltd. External Director, Shrem, Fudim, Kelner & Co. Ltd. and Aryt Industries Ltd. Chairman of the Board of Directors, Eden Agricultural Cooperative Society Ltd. Director, Toam Import and Export Agricultural Cooperative Society Ltd. and Kibbutzim of the United Kibbutz Movement Fund Agricultural Cooperative Society Ltd. Member of the Investment Committee, Tene Investment in the Kibbutz Industry Fund Limited Partnership.
Prof. Efraim Sadka* **Tel Aviv**	The Henry Kaufman Professor of International Capital Markets, Tel Aviv University. Visiting Professor, The College of Management Rishon Letzion. Chairman of the Executive Board, The Pinhas Sapir Center for Development, Tel Aviv University. Chairman of the Supervisory Board of Poalim Real Estate Fund. Editor, The Economic Quarterly (The Journal of the Israel Economic Association) and international professional journals. Economic Consultant.
Nurit Segal **Tel Aviv**	Business and Economic Consulting, Company Director. Director, Aspen Building and Development Ltd. and Aspen Real Estate Ltd.
Moshe Vidman **Jerusalem**	Company Manager, Representative of Revlon in Israel. Owner, Moshe Vidman Ltd. and Moshe Vidman Holdings (2004) Ltd. External Director, Partner Communications Ltd. Chairman of the Board of Directors, Gibor Sport Active Wear (G.S.A.W) Ltd. Member of the Management Committee of The Hebrew University of Jerusalem, Chairman of the Board of Directors, The Hebrew University's Assets Ltd. and Chairman of the Funds Committee. Director, The Israel Corporation Ltd and subsidiaries: The Israel Corporation – Technologies (Ictech) Ltd., Israel Chemicals Ltd., The Dead Sea Works Ltd. and Rotem Ampert Negev Ltd. Director, Ofer Bros. Properties (1957) Ltd., Jafora Ltd., Jafora-Tabori Ltd., Melisron Ltd., Rosebud Medical Ltd. and Alrov Properties & Lodgings Ltd.

* External Director pursuant to Directive 301 of the Supervisor of Banks.

Report on Directors with Accounting and Financial Expertise

Pursuant to the provisions of the Companies Law and the regulations enacted thereunder, the Board of Directors of the Bank has resolved that at least 3 directors with "accounting and financial expertise", will serve on the Board of Directors of the Bank at all times. This minimum number will allow the Board of Directors to comply with the requirements imposed upon it pursuant to the law and the statutory documents (by-law), and in particular with regard to its responsibility for examination of the financial position of the Bank and the preparation of the Financial Statements.

In determining the said minimum number, the Board of Directors considered the size of the Bank, the complexity of its activities and the range of risks involved therein, and the systems and procedures in place at the Bank, such as control, risk management, compliance, internal audit and the audit of the external auditors. It was also taken into account that all of the members of the Board of Directors comply with the qualification requirements to serve as a director of the Bank pursuant to the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993, and Proper Banking Management Directive No. 301 of the Banking Supervision Department.

At least 3 directors who comply with the definition of a "director with accounting and financial expertise" will participate in the discussions regarding the Financial Statements and their approval, such discussions being held in the plenary of the Board of Directors.
There are currently 15 directors serving on the Board of Directors, the legal quorum for its discussions being 8 directors.
In addition, pursuant to the directives of the Bank of Israel, the Board of Directors determined that at least 2 "directors with accounting and financial expertise" will serve on the Audit Committee of the Board of Directors at all times.
There are currently 9 directors serving on the Audit Committee, the legal quorum for its discussions being 5 directors.
All the directors serving on the Board of Directors and Audit Committee comply with the definition of a director with accounting and financial expertise, as detailed above and as follows:

Name of Director	Facts that qualify the Director as having Accounting and Financial Expertise
Eitan Raff	Chairman of the Board of Directors of the Bank and a number of its subsidiary companies since 1995. B.A. in Economics and Political Science and M.B.A., The Hebrew University of Jerusalem. Held various positions with the Ministry of Finance 1966-1983, including Accountant-General. Deputy Chairman of the Board of Directors of the Industrial Development Bank of Israel Ltd., 1979-1983; Chairman of the Board of Directors of Maritime Bank of Israel Ltd., 1992-1998; CEO of Wolfson Clore Mayer Corp. Ltd., 1992-1998, member of the Board of Directors and Financial Consultant of the company since 1987; Member of the Board of Directors of "Yozma" Venture Capital Government Corporation, 1993-April 1995; Chairman of the Board of Directors of Leumi Insurance Holdings Ltd. (currently Migdal Insurance and Financial Holdings Ltd.), 1997-1998 and a Director of the company, 2005-2006. Chairman of the board of directors and director of various companies.
Doron Cohen	B.A. in Economics and Business Administration and M.B.A. specializing in Finance, The Hebrew University of Jerusalem. Held various positions with the Budget Department of the Ministry of Finance, 1988-1993. Held various positions with the Government Corporations Authority, 1995-2000, including Director-General of the Authority. CEO of Co-Op Blue Square Services Cooperative Ltd. since 2000. Director of Mercantile Discount Bank Ltd., 2000-2006. Director of various companies. Economic and business consulting

Name of Director	Facts that qualify the Director as having Accounting and Financial Expertise
Meir Dayan*	External Director on the Board of Directors of the Bank. B.A. in Economics and Political Science and M.B.A. specializing in Finance, The Hebrew University of Jerusalem. Held various economic positions with the Ministry of Finance in Israel and the USA, 1970-1989. Director, Member of Management Committee, Chairman of the Balance Sheet Committee and Member of the Audit Committee of the Bank of Jerusalem Ltd., 1990-2001; CEO of I.C.C.-Israel Capital Corporation Ltd., 1993-2001; Chairman of the Board of Directors and Chairman of the Management Committee of Inventech Investment Company Ltd., 1993-2001; Director and Member of the Audit Committee of Nova Measuring Instruments Ltd., 1993-2001; Director of Maalot - The Israel Securities Rating Company Ltd., 2002-2003. Chairman of the board of directors, director and CEO of various companies.
Moshe Dovrat	B.A. in Economics and Political Science and M.B.A., The Hebrew University of Jerusalem. Held various economic positions with the Bank of Israel and Ministry of Finance, 1968-1975; Vice President of an industrial company, 1975-1980; Head of Foreign Currency Investments and Deposits Department of Bank Hapoalim, 1980-1985; held various economic positions with the Ministry of Economics and Planning, including Director-General of the Ministry, 1985-1989; Head of Economic Department of Clalit Health Services, 1989-1992; Head of the Investment Center of the Ministry of Industry, Trade and Labor, 1992-1996. Chairman of the board of directors, director and member of investment committees, and CEO of various companies.
Zipora Gal Yam*	B.A. in Economics and Philosophy, The Hebrew University of Jerusalem. Held various economic positions with the Ministry of Finance, 1992-2001, including Head of the Economic and State Revenue Department and a member of management. Director and Chairman of the Finance Committee of Zim, 1993-1999. Senior economist in the Research Department of the Bank of Israel, 1974-1991. Director of various companies.
Prof. Arieh Gans*	C.P.A. (Isr.), B.A. in Accounting, The Hebrew University of Jerusalem (Tel Aviv Branch), Professor of Accounting, Tel Aviv University. Held various accounting positions with Koor Industries Ltd., 1988-1994, including Vice President Accounting and Control and Head of the Accounting Division. Kesselman & Kesselman, Certified Public Accountants (Isr.), 1961-1977. Member of various committees of the Israeli Institute of Certified Public Accountants, the Israeli Accounting Standards Board and Senior Examiner of the Accountants Council. Director of various companies.
Prof. Israel Gilead*	External Director on the Board of Directors of the Bank. B.A. in Law and Economics and Doctorate in Law, The Hebrew University of Jerusalem. External Director and Chairman of the Audit Committee of Atzmauth Mortgage & Development Bank, 1987-1994. External Director and member of the Audit Committee of provident and supplementary training funds of Bank Yahav, 1996-2002; Member of the Investment Committee of Bank Yahav, 1996-2002; Director of Modus Selective Investment Portfolio Management (part of the First International Bank Group), 2003. Dean of the Faculty of Law of The Hebrew University of Jerusalem, 1999-2002.

* Member of the Audit Committee

Name of Director	Facts that qualify the Director as having Accounting and Financial Expertise
Yaacov Goldman, C.P.A. (Isr.)*	C.P.A. (Isr.), B.A. in Accounting and Economics, Tel Aviv University. Senior Partner PricewaterhouseCoopers, Certified Public Accountants (Isr.), January 1991 – August 2000; held various audit management positions in the firm, November 1981 – December 1990. Since September 2000, manager and director of various companies. Professional Secretary, The Peer Review Institute of the Israeli Institute of Certified Public Accountants
Rami Avraham Guzman*	B.A. in Economics and Political Science and M.A. in Business Administration and Public Administration, The Hebrew University of Jerusalem. Research Fellow in Operations Research, Systems Management and Computers, Stanford University and Stanford Research Institute. Held various economic positions with the Ministry of Finance, 1962-1969, 1971-1977. Vice President Finance and Economics of Electro-Chemical Industries Frutarom, 1977-1982; Vice President Finance of Elscint Ltd., 1982-1983; CEO of Dikla Holdings Ltd., 1983-1985; Director of Finance of Motorola Communications Ltd. and Motorola Israel Ltd., 1985-2004; Vice President of Motorola Inc., 2001-2005. Chairman of the board of directors and director of various companies.
Zvi Koren*	B.A. in Economics and Statistics and M.B.A. specializing in Accounting, The Hebrew University of Jerusalem. Held various economic positions in a number of government ministries, including Economic Consul in Australia and New Zealand and Deputy Director-General for Finance of the Ministry of Industry and Trade, 1962-1984; Economic and Trade Consul in Boston, USA, 1989-1990; Director-General of the Ministry of Industry and Trade, 1990-1992. CEO of various companies. Previously a Director of Bank Hapoalim B.M. (Director and Member of the Balance Sheet Committee) and the Industrial Development Bank of Israel Ltd. Director, chairman or member of audit committee, and member of balance sheet committee of various companies
Adv. Jacob Mashaal	B.A. in Economics and Statistics, B.A. in Law and M.B.A., The Hebrew University of Jerusalem. Held various economic positions in a number of government ministries, 1957-1964; CEO of "Maniv" Investments Ltd., 1964-1969; Deputy Head of the Banking Department of the Bank of Israel, 1969-1973; dissolution of Bank Eretz Yisrael Britania – appointed receiver and administrator to most of the companies in the group, 1974-1980; Deputy President – Finance and Head of Finance Division of Supersol Ltd., 1982-1991. Member of Management Committee, Moshav Neve Yaraq Ltd. since 2003.
Vered Raichman	B.A. in Agricultural Economics, The Hebrew University of Jerusalem. Treasurer of Kibbutz Glil-Yam, 1982-1984; Treasurer of the United Kibbutz Movement Fund, 1985-1986; Management of the United Kibbutz Movement Fund, 1987-1989. Operations Manager of Madgal Glil-Yam, 1990-1997; CEO of the enterprise, 1997 – February 2005. External director and director of various companies.
Prof. Efraim Sadka*	B.A. in Economics and Statistics, Tel Aviv University. Ph.D. in Economics, Massachusetts Institute of Technology. Professor of Economics, Tel Aviv University. Member of various professional and public committees, including the Professional Board of the Israeli Accounting Standards Board, the Committee for Examination of a Corporate Governance Code (the Goshen Committee), the Rabinowitz Committee for Income Tax Reform, the Fogel Committee for Pension Reform and the Steinberg Committee for Direct Tax Reform in the Presence of Inflation. Chairman of the Board of Directors of Housing and Construction Holdings Ltd., 1989-1995; Chairman of the Board of Directors of K.G.M. Pension Fund, 1996-2000. Member and chairman of various boards of directors.

* Member of the Audit Committee

Name of Director	Facts that qualify the Director as having Accounting and Financial Expertise
Nurit Segal	B.A. in Economics and Statistics, The Hebrew University of Jerusalem; M.Sc. in Operations Research, Case Western Reserve University, Cleveland, Ohio. Held various economic positions at Bank Hapoalim B.M., 1969 – January 1999, including membership of the boards of directors of various companies on behalf of Bank Hapoalim, including positions as chairman or member of balance sheet and audit committees.
Moshe Vidman*	B.A. in Economics and Political Science and M.B.A. specializing in Finance, The Hebrew University of Jerusalem. Held various economic positions in the Ministry of Education and Culture and the Ministry of Finance, 1965-1983, including Deputy Accountant-General. CEO of Aryt Optical Industries Ltd., 1983-1989; CEO of Revlon (Israel) Ltd., 1990-2001; Representative of Revlon in Israel. Permanent Acting Chairman of the Board of Directors and of the Audit Committee and Chairman of the Credit Committee, Mercantile Bank Ltd., 1993-2003. Chairman of the board of directors and/or director of various companies.

Changes to the Board of Directors

During 2007 and up till the publication of the Report, the following changes have taken place in the composition of the Board of Directors:
At the General Meeting held on 20 May 2007, Mr. Moshe Dovrat was elected as a new Director, in place of Mr. Shlomo Yanai who resigned from the Board of Directors on 18 February 2007.

On 17 January 2008, the Special General Meeting elected Prof. Israel Gilead as an External Director for an additional period of three years, as from 1 February 2008.

During 2007 the Board of Directors held 41 plenary meetings and 123 committee meetings.

Eitan Raff

Chairman of the Board of Directors

Galia Maor

30 March 2008 — President and Chief Executive Officer

* Member of the Audit Committee

The following exhibits include detailed financial information by subjects, sectors and periods:

Consolidated Balance Sheets as at Year Ends 2003-2007

Exhibit A:

	31 December				
	2007	2006	2005	2004	2003
	Reported amounts (a)				Adjusted Amounts (b)
	NIS millions				
Assets					
Cash and deposits with banks	**42,329**	47,609	35,381	30,033	23,763
Securities	**47,169**	46,375	47,825	43,543	40,262
Securities borrowed or purchased under agreement to resell	**655**	-	-	-	-
Credit to the public	**198,557**	183,800	(c) 180,881	174,367	172,175
Credit to governments	**642**	1,020	848	963	1,129
Investments in companies included on the equity basis	**1,873**	1,251	2,064	1,754	1,361
Buildings and equipment	**3,276**	3,056	2,843	2,668	2,612
Other assets	**7,650**	6,230	(c) 6,277	7,203	8,041
Total assets	**302,151**	289,341	276,119	260,531	249,343
Liabilities and equity capital					
Deposits of the public	**238,045**	231,823	221,828	209,652	203,586
Deposits from banks	**6,139**	5,241	4,347	5,655	4,557
Deposits from governments	**1,198**	2,146	2,225	3,025	2,903
Securities loaned or sold under agreement to repurchase	**231**	-	-	-	-
Debentures, bonds and subordinated notes	**19,248**	15,622	17,253	11,256	10,613
Other liabilities	**17,636**	16,866	(c) 14,261	15,681	13,213
Total liabilities	**282,497**	271,698	259,914	245,269	234,872
Minority interest	**105**	152	205	276	258
Shareholders' equity	**19,549**	17,491	16,000	14,986	14,213
Total liabilities and equity capital	**302,151**	289,341	276,119	260,531	249,343

(a) Inflationary adjustment ceased as of the basis of the index of December 2003.
(b) Amounts adjusted for the effect of inflation on the basis of the index of December 2003.
(c) Restated.

Consolidated Statements of Profit and Loss for the Years 2003-2007

Exhibit B:

	For the year ended 31 December				
	2007	2006	2005	2004	2003
	Reported amounts (a)				Adjusted amounts (b)
	NIS millions				
Net interest income before provision for doubtful debts	**7,648**	6,922	6,629	6,359	5,975
Provision for doubtful debts	**407**	933	1,426	1,514	1,883
Net interest income after provision for doubtful debts	**7,241**	5,989	5,203	4,845	4,092
Operating and other income					
Operating commissions	**3,350**	(d) 3,013	(d) 2,819	2,718	2,507
Profits from investments in shares, net	**461**	128	43	43	24
Other income	**411**	740	865	642	685
Total operating and other income	**4,222**	3,881	3,727	3,403	3,216
Operating and other expenses					
Salaries and related expenses	**4,218**	4,552	3,627	3,248	3,370
Building and equipment maintenance and depreciation	**1,274**	1,220	1,168	1,079	1,072
Other expenses	**1,445**	(d) 1,495	(d) 1,285	1,161	1,161
Total operating and other expenses	**6,937**	7,267	6,080	5,488	5,603
Operating profit before taxes in reported amounts	**4,526**	2,603	2,850	2,760	1,705
Inflationary erosion and adjustments	**-**	-	-	-	(c) 135
Operating profit before taxes	**4,526**	2,603	2,850	2,760	(b) 1,840
Provision for taxes on operating profit	**1,722**	1,320	1,193	1,244	(b) 824
Operating profit after taxes	**2,804**	1,283	1,657	1,516	(b) 1,016
Group's equity in after-tax operating profits of companies included on equity basis, net of related tax effect	**184**	171	378	410	(b) 152
Minority interest in after-tax operating (profits) losses of subsidiaries	**(4)**	-	24	(22)	(b) (9)
Net operating profit	**2,984**	1,454	2,059	1,904	(b) 1,159
Cumulative effect of change in accounting method at the beginning of the year	**-**	-	-	(32)	-
After-tax profit (loss) from extraordinary items	**373**	2,080	77	(8)	(b) (14)
Net profit	**3,357**	3,534	2,136	1,864	(b) 1,145

(a) Inflationary adjustment ceased as of the basis of the index of December 2003. The data for the year 2003 - Inflationary adjustment ceased as of the index of December 2002.

(b) Amounts adjusted for the effect of inflation on the basis of the index of December 2003.

(c) Inflationary erosion and adjustments of income and expenses that were included in the operating profit before taxes in reported amounts after the effect of inflation based on the index of December 2003.

(d) Restated

Consolidated Statements of Profit and Loss for the Years 2003-2007 (cont'd)

Exhibit B (cont'd):

	For the year ended 31 December				
	2007	2006	2005	2004	2003
	Reported amounts (a)				Adjusted amounts (b)
	NIS				
Earnings per share					
Basic earnings:					
Net operating profit	**2.11**	1.03	1.46	1.35	0.82
Cumulative effect of change in accounting method at the beginning of the year	**-**	-	-	(0.02)	-
After-tax profit (loss) from extraordinary items	**0.26**	1.47	0.05	(0.01)	(0.01)
Net profit	**2.37**	2.50	1.51	1.32	0.81
Diluted earnings:					
Net operating profit	**2.08**	1.03	1.46	1.35	0.82
Cumulative effect of change in accounting method at the beginning of the year	**-**	-	-	(0.02)	-
After-tax profit (loss) from extraordinary items	**0.26**	1.47	0.05	(0.01)	(0.01)
Net profit	**2.34**	2.50	1.51	1.32	0.81

(a) Inflationary adjustment ceased as of the basis of the index of December 2003.
(b) Amounts adjusted for the effect of inflation on the basis of the index of December 2003.

Rates of Financing Income and Expenses - on a Consolidated Basis (a)
Reported amounts

Exhibit C:

	2007				2006			
			Rate of income (expenses)				Rate of income (expenses)	
	Average balance (b)	Financing Income (expense)	excluding the effect of derivatives	including the effect of derivatives (e)	Average balance(b)	Financing income (expense)	excluding the effect of derivatives	including the effect of derivatives(e)
	(NIS millions)		%	%	(NIS millions)		%	%
Israeli currency - unlinked								
Assets (c)(d)	**96,072**	**5,755**	**5.99**		(i) 88,412	6,050	6.84	
Effect of embedded and ALM derivatives (e)	**35,493**	**579**			15,725	639		
Total assets	**131,565**	**6,334**		**4.82**	104,137	6,689		6.42
Liabilities (d)	**101,084**	**(3,010)**	**(2.98)**		(i) 87,944	(3,288)	(3.74)	
Effect of embedded and ALM derivatives (e)	**21,539**	**(40)**			6,838	(68)		
Total liabilities	**122,623**	**(3,050)**		**(2.49)**	94,782	(3,356)		(3.54)
Interest margin			**3.01**	**2.33**			3.10	2.88
Israeli currency - linked to the CPI								
Assets (c)(d)	**58,314**	**4,549**	**7.80**		56,562	2,848	5.04	
Effect of embedded and ALM derivatives (e)	**602**	**45**			230	10		
Total assets	**58,916**	**4,594**		**7.80**	56,792	2,858		5.03
Liabilities (d)	**42,793**	**(2,978)**	**(6.96)**		46,990	(1,950)	(4.15)	
Effect of embedded and ALM derivatives (e)	**8,202**	**(658)**			4,105	(141)		
Total liabilities	**50,995**	**(3,636)**		**(7.13)**	51,095	(2,091)		(4.09)
Interest margin			**0.84**	**0.67**			0.89	0.94
Foreign currency – (including Israeli currency linked to foreign currency)								
Assets (c)(d)	**123,909**	**(1,227)**	**(0.99)**		119,860	(1,133)	(0.95)	
Effect of derivatives(e):								
Hedging derivatives	**4,516**	**288**			4,618	176		
Embedded derivatives and ALM	**64,136**	**(3,911)**			50,550	(1,864)		
Total assets	**192,561**	**(4,850)**		**(2.52)**	175,028	(2,821)		(1.61)
Liabilities (d)	**119,327**	**3,500**	**2.93**		114,812	2,544	2.22	
Effect of derivatives(e):								
Hedging derivatives	**4,294**	**(273)**			4,527	(207)		
Embedded derivatives and ALM	**70,257**	**3,916**			55,136	2,543		
Total liabilities	**193,878**	**7,143**		**3.68**	174,475	4,880		2.80
Interest margin			**1.94**	**1.16**			1.27	1.19

See footnotes on page 239 below.

Note - Full details of the rates of financing income and expenses in each sector, by the various balance sheet categories, are available on request.

Rates of Financing Income and Expenses - on a Consolidated Basis(a) (cont'd)
Reported amounts

Exhibit C (cont'd):

	For the year ended 31 December							
	2007				2006			
			Rate of income (expenses)				Rate of income (expenses)	
	Average balance (b)	**Financing Income (expense)**	**excluding the effect of derivatives**	**including the effect of derivatives (e)**	Average balance(b)	Financing income (expense)	excluding the effect of derivatives	including the effect of derivatives(e)
	(NIS millions)		**%**	**%**	(NIS millions)		%	%
Total:								
Monetary assets generating interest income (d) (f)	**278,295**	**9,077**	**3.26**		264,834	7,765	2.93	
Effect of derivatives (e):								
Hedging derivatives	**4,516**	**288**			4,618	176		
Embedded derivatives and ALM	**100,231**	**(3,287)**			66,505	(1,215)		
Total assets	**383,042**	**6,078**		**1.59**	335,957	6,726		2.00
Total monetary liabilities generating interest expenses (d)	**263,204**	**(2,488)**	**(0.95)**		249,746	(2,694)	(1.08)	
Effect of derivatives (e):								
Hedging derivatives	**4,294**	**(273)**			4,527	(207)		
Embedded derivatives and ALM	**99,998**	**3,218**			66,079	2,334		
Total liabilities	**367,496**	**457**		**0.12**	320,352	(567)		(0.18)
Interest margin			**2.31**	**1.71**			1.85	1.82
In respect of options		**90**				(42)		
In respect of other derivatives (excluding options, hedging derivative instruments, ALM derivative and embedded derivatives which have been separated (e))		**(15)**				(12)		
Financing commissions and other financing income (g)		**1,038**				817		
Net interest income before provision for doubtful debts		**7,648**				6,922		
Provision for doubtful debts (including general and Supplementary provision)		**(407)**				(933)		
Net interest income after provision for doubtful debts		**7,241**				5,989		
Total:								
Monetary assets generating interest income (d)(f)	**278,295**				264,834			
Assets derived from derivative instruments (h)	**4,341**				3,674			
Other monetary assets (d)	**3,934**				3,643			
General provision and supplementary provision for doubtful debts	**(989)**				(1,061)			
Total monetary assets	**285,581**				271,090			
Total:								
Monetary liabilities generating interest expenses (d)	**263,204**				249,746			
Liabilities derived from derivative instruments (h)	**4,161**				3,428			
Other monetary liabilities (d)	**8,355**				6,996			
Total monetary liabilities	**275,720**				260,170			
Total monetary assets exceed monetary liabilities	**9,861**				10,920			
Non-monetary assets	**10,239**				7,976			
Non-monetary liabilities	**782**				1,350			
Total capital resources	**19,318**				17,546			

See footnotes on next page.

Note - Full details of the rates of financing income and expenses in each sector, by the various balance sheet categories, are available on request.

Rates of Financing Income and Expenses - on a Consolidated Basis (a) (cont'd)

Exhibit C (cont'd):

Footnotes:

(a) The data in this exhibit are before and after the effect of derivative instruments (including the effect of off-balance sheet derivative instruments).

(b) Based on monthly opening balances, and quarterly opening balances in foreign subsidiaries, except for the unlinked Israeli currency sector in which the average balance is based on daily figures, and after deduction of the average balance sheet balance of the specific provision for doubtful debts.

(c) The average balance of unrealized profits (losses) from adjustments to fair value of debentures held for trading and of the profits (losses) from available for sale debentures, which are included in the shareholders' equity under accumulated other comprehensive income in the item of "Adjustments in respect of presentation of securities available for sale at fair value" in the amount of NIS 157 million in the unlinked Israeli currency sector (2006 – NIS 68 million), NIS 98 million in the index-linked Israeli currency sector (2006 – NIS 1 million) and NIS 23 in the foreign currency sector including Israeli currency linked to foreign currency (2006 – NIS (162) million), has been deducted from (added to) the average balance of the assets.

(d) Excluding derivative instruments.

(e) Hedging derivative instruments (excluding options), embedded derivatives that have been separated, and ALM derivatives which constitute part of the Bank's asset and liability management system.

(f) The average balance of unrealized profits (losses) from adjustments to fair value of debentures held for trading and available for sale has been deducted from (added to) the average balance of the assets, in the amount of NIS 278 million in the various sectors for the year (2006 – NIS (93) million).

(g) Includes profits and losses on sales of investments in debentures and adjustments to fair value of debentures held for trading.

(h) Average balance of derivative instruments (does not include average of off-balance sheet derivative instruments).

(i) Restated following implementation of the Supervisor of Banks' Circular in the matter of credit card companies. In accordance with the Circular, the items of credit to the public and other liabilities have been restated and shown under open credit card transactions which were presented in the past as off-balance sheet financial instruments

Rates of Financing Income and Expenses - on a Consolidated Basis (a) (cont'd) Nominal U.S. $

Exhibit C (cont'd):

	2007				2006			
			Rate of income (expenses)				Rate of income (expenses)	
	Average Balance (b)	Financing income (expense)	excluding the effect of derivatives	including the effect of Derivatives (e)	Average balance(b)	Financing income (expense)	excluding the effect of derivatives	including the effect of derivatives(e)
	(U.S.$ millions)		%	%	(U.S.$ millions)		%	%
Local operations (including Israeli currency linked to foreign currency)								
Assets (c) (d)	**19,289**	**1,069**	**5.54**		17,156	901	5.25	
Effect of derivatives(e):								
Hedging derivatives	**1,093**	**70**			1,030	40		
Embedded derivatives and ALM	**15,510**	**56**			11,231	(1)		
Total assets	**35,892**	**1,195**		**3.33**	29,417	940		3.20
Liabilities (d)	**19,044**	**(749)**	**(3.93)**		16,732	(568)	(3.40)	
Effect of derivatives(e):								
Hedging derivatives	**1,039**	**(66)**			1,010	(47)		
Embedded derivatives and ALM	**16,961**	**(67)**			12,224	6		
Total liabilities	**37,044**	**(882)**		**(2.38)**	29,966	(609)		(2.03)
Interest margin			**1.61**	**0.95**			1.85	1.17
Foreign currency - foreign operations (integrated operations)								
Assets (c) (d)	**10,620**	**963**	**9.06**		9,524	510	5.36	
Effect of embedded and ALM derivatives (e)	**52**	**23**			49	16		
Total assets	**10,672**	**986**		**9.23**	9,573	526		5.50
Liabilities(d)	**9,789**	**(691)**	**(7.06)**		8,834	(347)	(3.93)	
Effect of embedded and ALM derivatives (e)	**72**	**-**			80	-		
Total liabilities	**9,861**	**(691)**		**(7.01)**	8,914	(347)		(3.89)
Interest margin			**2.00**	**2.22**			1.43	1.61
Total								
Monetary assets in foreign currency generating financing income (c)(d)	**29,909**	**2,032**	**6.79**		26,680	1,411	5.29	
Effect of derivatives(e):								
Hedging derivatives	**1,093**	**70**			1,030	40		
Embedded derivatives and ALM	**15,562**	**79**			11,280	15		
Total assets	**46,564**	**2,181**		**4.68**	38,990	1,466		3.76
Monetary liabilities in foreign currency generating financing expense (d)	**28,833**	**(1,440)**	**(4.99)**		25,566	(915)	(3.58)	
Effect of derivatives(e):								
Hedging derivatives	**1,039**	**(66)**			1,010	(47)		
Embedded derivatives and ALM	**17,033**	**(67)**			12,304	6		
Total liabilities	**46,905**	**(1,573)**		**(3.35)**	38,880	(956)		(2.46)
Interest margin			**1.80**	**1.33**			1.71	1.30

See footnotes on next page.

Rates of Financing Income and Expenses - on a Consolidated Basis (cont'd)
Nominal U.S.$

Exhibit C (cont'd):

Footnotes:

(a) The data in this exhibit are before and after the effect of derivative instruments (including the effect of off-balance sheet derivative instruments).

(b) Based on monthly opening balances and quarterly opening balances in foreign subsidiaries, and after deduction of the average balance sheet balance of the specific provision for doubtful debts.

(c) The average balance of unrealized profits (losses) from adjustments to fair value of debentures held for trading and available for sale has been deducted from the average balance of the assets, in the amount of US$ 6 million (2006 – US$ (36) million).

(d) Excluding derivative instruments.

(e) Hedging derivative instruments (excluding options), embedded derivatives which have been separated, and ALM derivatives that constitute part of the Bank's asset and liability management system.

Note - Full details of the rates of financing income and expenses in each sector, by the various balance sheet categories, are available on request.

Analysis of Exposure to Interest Rate Fluctuations - on a Consolidated Basis

Exhibit D:

	31 December 2007												31 December 2006	
	On demand up to one month	**One month to three months**	**Three months to one year**	**One year to three years**	**Three years to five years**	**Over five years to ten years**	**Over ten years to Twenty Years**	**Over twenty years**	**Without fixed maturity (a)**	**Total**	**Internal yield rate**	**Average maturity**	Internal yield rate	Average maturity
	Reported amounts												Reported amounts	
	NIS millions										**%**	**Years**	%	Years
Israeli currency - unlinked														
Total assets	**82,662**	**4,434**	**4,858**	**4,882**	**1,872**	**2,070**	**207**	**-**	**1,585**	**102,570**	**6.29**	**0.42**	6.14	0.42
Total liabilities	**83,409**	**5,471**	**11,863**	**3,870**	**656**	**373**	**194**	**73**	**315**	**106,224**	**3.25**	**0.29**	4.11	0.26
Difference	**(747)**	**(1,037)**	**(7,005)**	**1,012**	**1,216**	**1,697**	**13**	**(73)**	**1,270**	**(3,654)**	**3.04**	**0.13**	2.03	0.16
Effect of future transactions and special commitments	**4,805**	**(458)**	**5,717**	**872**	**(60)**	**(54)**	**-**	**-**	**-**	**10,822**				
Exposure to interest rate fluctuations in the sector	**4,058**	**(1,495)**	**(1,288)**	**1,884**	**1,156**	**1,643**	**13**	**(73)**	**1,270**	**7,168**				
Accumulated exposure in the sector	**4,058**	**2,563**	**1,275**	**3,159**	**4,315**	**5,958**	**5,971**	**5,898**	**7,168**	**7,168**				
Israeli currency – linked to the CPI														
Total assets	**2,818**	**2,900**	**12,963**	**17,617**	**9,909**	**11,120**	**3,225**	**82**	**86**	**60,720**	**5.58**	**3.51**	5.46	3.67
Total liabilities	**939**	**2,069**	**10,336**	**11,049**	**9,046**	**11,154**	**2,606**	**17**	**63**	**47,279**	**4.31**	**3.84**	4.84	3.65
Difference	**1,879**	**831**	**2,627**	**6,568**	**863**	**(34)**	**619**	**65**	**23**	**13,441**	**1.27**	**(0.33)**	0.62	0.02
Effect of future transactions and special commitments	**(579)**	**(891)**	**(4,346)**	**(980)**	**(932)**	**(2,307)**	**-**	**-**	**-**	**(10,035)**				
Exposure to interest rate fluctuations in the sector	**1,300**	**(60)**	**(1,719)**	**5,588**	**(69)**	**(2,341)**	**619**	**65**	**23**	**3,406**				
Accumulated exposure in the sector	**1,300**	**1,240**	**(479)**	**5,109**	**5,040**	**2,699**	**3,318**	**3,383**	**3,406**	**3,406**				
Foreign currency (b)														
Total assets	**62,866**	**34,472**	**12,699**	**5,362**	**3,452**	**1,796**	**559**	**90**	**269**	**121,565**	**4.15**	**0.54**	4.30	0.61
Total liabilities	**71,765**	**27,403**	**18,085**	**3,347**	**977**	**1,445**	**18**	**2**	**180**	**123,222**	**3.14**	**0.35**	3.24	0.48
Difference	**(8,899)**	**7,069**	**(5,386)**	**2,015**	**2,475**	**351**	**541**	**88**	**89**	**(1,657)**	**1.01**	**0.19**	1.06	0.13
Effect of future transactions and special commitments	**(8,849)**	**(4,783)**	**(8,035)**	**368**	**797**	**3,645**	**-**	**-**	**-**	**(787)**				
Exposure to interest rate fluctuations in the sector	**(17,748)**	**2,286**	**2,649**	**2,383**	**3,272**	**3,996**	**541**	**88**	**89**	**(2,444)**				
Accumulated exposure in the sector	**(17,748)**	**(15,462)**	**(12,813)**	**(10,430)**	**(7,158)**	**(3,162)**	**(2,621)**	**(2,533)**	**(2,444)**	**(2,244)**				

See footnotes on next page.

Analysis of Exposure to Interest Rate Fluctuations - on a Consolidated Basis

Exhibit D:

	31 December 2007												31 December 2006	
	On Demand up to one Month	**One Month to three Months**	**Three Months To one year**	**One year to three Years**	**Three years to five years**	**Over five years to ten years**	**Over ten years to twenty years**	**Over twenty years**	**Without fixed maturity (a)**	**Total**	**Internal yield rate**	**Average maturity**	**Internal yield rate**	**Average maturity**
	Reported amounts												**Reported amounts**	
	NIS millions										**%**	**Years**	**%**	**Years**
Total exposure to interest rate fluctuations														
Total assets (c)	**148,346**	**41,806**	**30,520**	**27,861**	**15,233**	**14,986**	**3,991**	**172**	**13,436**	**296,351**		**1.14**		1.18
Receivables in respect of open credit card transactions										**5,800**				
Total liabilities (c)	**156,113**	**34,943**	**40,284**	**18,266**	**10,679**	**12,972**	**2,818**	**92**	**1,646**	**277,813**		**0.95**		0.97
Payables in respect of open credit card transactions										**4,684**				
Difference	**(7,767)**	**6,863**	**(9,764)**	**9,595**	**4,554**	**2,014**	**1,173**	**80**	**11,790**	**19,654**		**0.19**		0.21
Effect of future transactions and special commitments	**(4,623)**	**(6,132)**	**9,406**	**260**	**(195)**	**1,284**	**-**	**-**	**-**	**-**				
Total exposure to interest rate fluctuations	**(12,390)**	**731**	**(358)**	**9,855**	**4,359**	**3,298**	**1,173**	**80**	**11,790**	**19,654**				
Total accumulated exposure	**(12,390)**	**(11,659)**	**(12,017)**	**(2,162)**	**2,197**	**5,495**	**6,668**	**6,748**	**18,538**	**19,654**				

(a) The figures in the "without fixed maturity" column are the non-discounted figures as stated in the balance sheet, including overdue balances in the amount of NIS 610 million.
(b) Local operations, including Israeli currency linked to foreign currency and integrated operations abroad.
(c) Including non-monetary assets in the "without fixed maturity" column.

General notes:
(1) Full details of the effect of changes in the interest rates in each sector, by the various balance sheet categories, are available on request.
(2) In this table, the data for each period represent the present value of the future cash flows discounted at the internal rate of return of the balance sheet category. The capitalized future cash flows, as stated, include interest to be accrued up to the earlier of repayment date or the date of change of the interest.
(3) The effect of hedging transactions is included in total assets or total liabilities, as relevant.

Credit to the Public - Risk by Economic Sector - on a Consolidated Basis
Reported amounts

Exhibit E:

	31 December 2007				
	Balance sheet credit risk (a)	Off-balance sheet credit risk (b)	Total credit risk	Addition for the year to the specific provision for doubtful debts	Balance of problematic debts (c)
	NIS millions				
Activities of borrowers in Israel					
Agriculture	**2,135**	**365**	**2,500**	**(17)**	**272**
Industry	**23,013**	**14,411**	**37,424**	**149**	**2,636**
Construction and real estate	**30,335**	**16,905**	**47,240**	**97**	**4,424**
Electricity and water	**1,399**	**220**	**1,619**	**-**	**10**
Commerce	**15,615**	**4,130**	**19,745**	**88**	**1,191**
Hotels and restaurants	**4,127**	**457**	**4,584**	**18**	**1,611**
Transport and storage	**4,082**	**1,078**	**5,160**	**8**	**493**
Communications and computer services	**4,305**	**1,560**	**5,865**	**20**	**362**
Financial services	**16,815**	**5,172**	**21,987**	**(135)**	**598**
Other business services	**5,253**	**1,399**	**6,652**	**18**	**191**
Public and community services	**5,595**	**1,278**	**6,873**	**2**	**369**
Private individuals - loans for housing	**36,839**	**2,170**	**39,009**	**50**	**989**
Private individuals - other	**21,090**	**22,789**	**43,879**	**165**	**1,187**
Total	**170,603**	**71,934**	**242,537**	**463**	**14,353**
Credit risk included within the various economic sectors:					
Settlement movements (d)	**3,296**	**619**	**3,915**	**(23)**	**531**
Local authorities (e)	**3,334**	**134**	**3,468**	**(2)**	**153**
Activities of borrowers abroad					
Agriculture	**63**	**28**	**91**	**-**	**-**
Industry	**6,718**	**3,475**	**10,193**	**(1)**	**393**
Construction and real estate	**4,759**	**2,482**	**7,241**	**5**	**155**
Electricity and water	**279**	**435**	**714**	**-**	**3**
Commerce	**8,374**	**4,482**	**12,856**	**6**	**336**
Hotels and restaurants	**1,159**	**14**	**1,173**	**-**	**-**
Transport and storage	**513**	**286**	**799**	**-**	**12**
Communications and computer services	**259**	**478**	**737**	**18**	**23**
Financial services	**14,838**	**5,335**	**20,173**	**56**	**54**
Other business services	**1,709**	**800**	**2,509**	**1**	**47**
Public and community services	**1,105**	**348**	**1,453**	**-**	**9**
Private individuals	**3,441**	**1,002**	**4,443**	**8**	**89**
Total	**43,217**	**19,165**	**62,382**	**93**	**1,121**

(a) Including credit to the public in the amount of NIS 199,315 million, investments in debentures of the public in the amount of NIS 12,435 million and other assets in respect of derivative instruments which represent transactions of the public in the amount of NIS 2,070 million.

(b) Credit risk on off-balance sheet financial instruments as calculated for the purpose of per borrower credit limitations.

(c) Balances of problematic debt net of credit covered by collateral allowed as a deduction for purposes of individual and group borrower limits, including off-balance sheet risk components.

(d) Kibbutzim and moshavim, regional and national organizations and corporations controlled by the settlement movement.

(e) Including corporations under their control.

Note - Balances of credit risk, off balance sheet credit risk and balances of problematic debts are stated net of specific provisions for doubtful debts.

Credit to the Public - Risk by Economic Sector - on a Consolidated Basis (cont'd)
Adjusted Amounts

Exhibit E (cont'd):

	31 December 2006				
	Balance sheet credit risk (a)	Off-balance sheet credit risk (b)	Total credit risk	Addition for the year to the specific provision for doubtful debts	Balance of problematic debts (c)
	NIS millions				
Activities of borrowers in Israel					
Agriculture	1,924	338	2,262	(36)	449
Industry	19,967	13,146	33,113	127	3,195
Construction and real estate	28,122	14,338	42,460	215	6,375
Electricity and water	1,834	583	2,417	(10)	9
Commerce	15,093	3,601	18,694	78	1,912
Hotels and restaurants	4,228	447	4,675	(11)	1,749
Transport and storage	3,947	992	4,939	42	710
Communications and computer services	5,520	1,494	7,014	138	554
Financial services	14,750	4,325	19,075	11	861
Other business services	4,844	1,163	6,007	15	335
Public and community services	5,781	929	6,710	4	596
Private individuals - loans for housing	33,704	1,484	35,188	191	1,384
Private individuals - other	18,283	19,620	37,903	140	1,293
Total	157,997	62,460	220,457	904	19,422
Credit risk included within the various economic sectors:					
Settlement movements (d)	3,322	641	3,963	-	615
Local authorities (e)	3,299	152	3,451	-	275
Activities of borrowers abroad					
Agriculture	79	29	108	-	-
Industry	6,124	3,849	9,973	16	139
Construction and real estate	4,692	1,268	5,960	(1)	641
Electricity and water	165	89	254	-	-
Commerce	7,401	5,240	12,641	8	146
Hotels and restaurants	1,205	47	1,252	-	1
Transport and storage	721	250	971	(3)	17
Communications and computer services	258	582	840	-	3
Financial services	12,940	5,773	18,713	9	8
Other business services	1,425	616	2,041	2	7
Public and community services	1,143	231	1,374	4	22
Private individuals	2,815	1,256	4,071	15	80
Total	38,968	19,230	58,198	50	1,064

(a) Including credit to the public in the amount of NIS 184,696 million, investments in debentures of the public in the amount of NIS 10,652 million and other assets in respect of derivative instruments which represent transactions of the public in the amount of NIS 1,617 million.

(b) Credit risk on off-balance sheet financial instruments as calculated for the purpose of per borrower credit limitations.

(c) Balances of problematic debt net of credit covered by collateral allowed as a deduction for purposes of individual and group borrower limits, including off-balance sheet risk components.

(d) Kibbutzim and moshavim, regional and national organizations and corporations controlled by the settlement movement.

(e) Including corporations under their control.

Note - Balances of credit risk, off balance sheet credit risk and balances of problematic debts are stated net of specific provisions for doubtful debts.

Multi-quarter data
Condensed Consolidated Balance Sheets as at the End of Each Quarter of the Years 2007 and 2006
Reported amounts

Exhibit F:

Year	2007				2006			
Quarter	4	3	2	1	4	3	2	1
	NIS millions				NIS millions			
Assets								
Cash and deposits with banks	**42,329**	**45,661**	**45,282**	**45,281**	47,609	39,651	34,335	35,568
Securities	**47,169**	**46,355**	**45,323**	**47,211**	46,375	45,869	47,787	48,365
Securities borrowed or purchased under agreements to resell	**655**	**246**	**320**	**108**	-	-	-	-
Credit to the public	**198,557**	**196,327**	**193,944**	**185,848**	183,800	180,448	181,941	181,458
Credit to governments	**642**	**701**	**750**	**781**	1,020	905	691	808
Investments in companies included on equity basis	**1,873**	**1,855**	**1,765**	**1,781**	1,251	1,237	1,224	1,255
Buildings and equipment	**3,276**	**3,226**	**3,163**	**3,120**	3,056	3,020	2,951	2,894
Other assets	**7,650**	**7,636**	**6,432**	**6,159**	6,230	6,276	7,017	6,146
Total assets	**302,151**	**302,007**	**296,979**	**290,289**	289,341	277,406	275,946	276,494
Liabilities and equity capital								
Deposits of the public	**238,045**	**236,929**	**236,521**	**226,861**	231,823	221,996	219,372	221,807
Deposits from banks	**6,139**	**10,197**	**8,462**	**13,320**	5,241	5,453	6,258	4,423
Deposits from governments	**1,198**	**1,632**	**1,519**	**1,905**	2,146	2,239	1,796	2,173
Debentures, bonds and subordinated notes	**231**	**185**	**64**	**116**	-	-	-	-
Other liabilities	**19,248**	**16,872**	**16,618**	**15,803**	15,622	16,050	17,022	16,889
Securities loaned or sold under agreements to repurchase	**17,636**	**15,540**	**14,031**	**13,633**	16,866	12,997	13,993	13,767
Total liabilities	**282,497**	**281,355**	**277,215**	**271,638**	271,698	258,735	258,441	259,059
Minority interest	**105**	**121**	**116**	**152**	152	150	154	152
Shareholders' equity	**19,549**	**20,531**	**19,648**	**18,499**	17,491	18,521	17,351	17,283
Total liabilities and equity capital	**302,151**	**302,007**	**296,979**	**290,289**	289,341	277,406	275,946	276,494

Multi-quarter data
Condensed Consolidated Statements of Profit and Loss for Each Quarter of the Years 2007 and 2006
Reported Amounts

Exhibit G:

Year	2007				2006			
Quarter	4	3	2	1	4	3	2	1
	NIS millions				NIS millions			
Net interest income before provision for doubtful debts	**1,781**	**2,265**	**1,809**	**1,793**	1,763	1,718	1,796	1,645
Provision for doubtful debts	**279**	**79**	**38**	**11**	265	282	185	201
Net interest income after provision for doubtful debts	**1,502**	**2,186**	**1,771**	**1,782**	1,498	1,436	1,611	1,444
Operating and other income								
Operating commissions	**863**	**834**	**826**	**(a) 827**	(a) 794	(a) 736	(a) 738	(a) 745
Profits from investments in shares, net	**227**	**9**	**143**	**82**	28	14	82	4
Other income	**102**	**66**	**162**	**81**	161	188	197	194
Total operating and other income	**1,192**	**909**	**1,131**	**990**	983	938	1,017	943
Operating and other expenses								
Salaries and related expenses	**1,083**	**1,104**	**1,004**	**1,027**	982	1,129	1,252	1,189
Building and equipment maintenance and depreciation	**354**	**(a) 317**	**(a) 307**	**296**	333	303	297	287
Other expenses	**427**	**(a) 364**	**(a) 345**	**(a) 309**	(a) 461	(a) 353	(a) 333	(a) 348
Total operating and other expenses	**1,864**	**1,785**	**1,656**	**1,632**	1,776	1,785	1,882	1,824
Operating profit before taxes	**830**	**1,310**	**1,246**	**1,140**	705	589	746	563
Provision for taxes on operating profit	**355**	**471**	**376**	**520**	339	343	398	240
Operating profit after taxes	**475**	**839**	**870**	**620**	366	246	348	323
Group's equity in after-tax operating profits of companies included on equity basis, net of related tax effect	**38**	**62**	**45**	**39**	28	45	20	78
Minority interest in after-tax operating (profits) losses of subsidiaries	**(1)**	**-**	**(2)**	**(1)**	(3)	5	(1)	(1)
Net operating profit	**512**	**901**	**913**	**658**	391	296	367	400
After-tax profit from extraordinary items	**5**	**109**	**-**	**259**	683	674	11	712
Net profit for the period	**517**	**1,010**	**913**	**917**	1,074	970	378	1,112

(a) Restated.

Multi-quarter data (cont'd)
Condensed Consolidated Statements of Profit and Loss for Each Quarter of the Years 2007 and 2006
Reported Amounts

Exhibit G (cont'd):

Year	2007				2006			
Quarter	4	3	2	1	4	3	2	1
	NIS				NIS			
Earnings per share								
Basic earnings per share:								
Net operating profit	**0.35**	**0.64**	**0.65**	**0.47**	0.28	0.21	0.26	0.28
After-tax profit from extraordinary items	**-**	**0.08**	**-**	**0.18**	0.48	0.48	0.01	0.50
Net profit for the period	**0.35**	**0.72**	**0.65**	**0.65**	0.76	0.69	0.27	0.78
Diluted earnings per share:								
Net operating profit	**0.34**	**0.62**	**0.65**	**0.47**	0.28	0.21	0.26	0.28
After-tax profit from extraordinary items	**-**	**0.08**	**-**	**0.18**	0.48	0.48	0.01	0.50
Net profit for the period	**0.34**	**0.70**	**0.65**	**0.65**	0.76	0.69	0.27	0.78

Classification of Loan Balances to Less Developed Countries (LDC) by Geographical Area of Final Risk Reported Amounts

Exhibit H:

	2007			2006		
	Loans (a)	**Off-balance sheet credit risk (b)**	**Total**	Loans (a)	Off-balance sheet credit risk (b)	Total
	NIS millions			NIS millions		
Asia	**-**	**38**	**38**	-	38	38
Eastern Europe	**383**	**187**	**570**	96	99	195
Africa	**-**	**-**	**-**	-	5	5
South America	**19**	**62**	**81**	-	39	39
Total	**402**	**287**	**689**	96	181	277

(a) After the deduction of the specific provision for doubtful debts.

(b) Credit risk on off-balance sheet financial instruments as calculated for the purpose of per borrower credit limitations.

Certification

I, Galia Maor, certify that:

1. I have reviewed the Annual Report of Bank Leumi le-Israel B.M. (the "Bank") for 2007 (the "Report").

2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to prevent the statements included therein from being, in light of the circumstances under which such statements were made, misleading with respect to the period covered by the Report.

3. Based on my knowledge, the Financial Statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and changes in shareholders' equity and cash flows of the Bank as of, and for, the periods presented in the Report.

4. I and the Bank's other certifying officers are responsible for establishing and maintaining the disclosure controls and procedures required for the Bank's Report and have:

   (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank, including its consolidated corporations, is made known to us by others within the Bank and those corporations, particularly during the period in which the Report is being prepared;

   (b) evaluated the effectiveness of the Bank's disclosure controls and procedures and presented our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report, based on our evaluation; and

   (c) disclosed in the Report any change in the Bank's internal control over financial reporting that occurred during the fourth quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and

5. I and the Bank's other certifying officers have disclosed to the Joint External Auditors, the Board of Directors and the Audit Committee of the Board of Directors, based on our most recent evaluation of internal control over financial reporting:

   (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and

   (b) any fraud, whether or not material, that involves Management or other employees who have a significant role in the Bank's internal control over financial reporting.

The above does not prejudice my responsibility or the responsibility of any other person, pursuant to any law.

30 March 2008

Galia Maor
President and Chief Executive Officer

Certification

I, Zeev Nahari, certify that:

1. I have reviewed the Annual Report of Bank Leumi le-Israel B.M. (the "Bank") for 2007 (the "Report").

2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to prevent the statements included therein from being, in light of the circumstances under which such statements were made, misleading with respect to the period covered by the Report.

3. Based on my knowledge, the Financial Statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and changes in shareholders' equity and cash flows of the Bank as of, and for, the periods presented in the Report.

4. I and the Bank's other certifying officers are responsible for establishing and maintaining the disclosure controls and procedures required for the Bank's Report and have:

   (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank, including its consolidated corporations, is made known to us by others within the Bank and those corporations, particularly during the period in which the Report is being prepared;

   (b) evaluated the effectiveness of the Bank's disclosure controls and procedures and presented our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report, based on our evaluation; and

   (c) disclosed in the Report any change in the Bank's internal control over financial reporting that occurred during the fourth quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and

5. I and the Bank's other certifying officers have disclosed to the Joint External Auditors, the Board of Directors and the Audit Committee of the Board of Directors, based on our most recent evaluation of internal control over financial reporting:

   (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and

   (b) any fraud, whether or not material, that involves Management or other employees who have a significant role in the Bank's internal control over financial reporting.

The above does not prejudice my responsibility or the responsibility of any other person, pursuant to any law.

30 March 2008

Zeev Nahari
Senior Deputy Chief Executive Officer
Head of Finance and Economics Division

Board of Directors and Management Report on Responsibility for the Annual Report

The Annual Report was prepared by the Management of the Bank, which is responsible for its fairness. This report includes financial statements prepared in accordance with generally accepted accounting and reporting principles provided by the directives and guidelines of the Supervisor of Banks, additional data prepared in accordance therewith and other data.
The preparation of periodic financial statements also requires the preparation of estimates for purposes of determining certain amounts and items in the statements. These estimates are prepared by the Management in accordance with its best judgment.

In order to ensure the fairness of the Bank's financial report, the Bank's Management uses a comprehensive internal auditing system, the purpose of which to ensure that all transactions of the Bank are conducted based on proper authorizations, that the Bank's assets are fully protected and secured, and that the accounting figures constitute a reliable basis for the preparation of the financial statements. The internal auditing system is limited by its nature, as it does not provide absolute certainty, but rather reasonable certainty, with respect to its ability to discover and prevent mistakes and irregular acts. The principle of reasonable certainty is based on the awareness that decisions concerning the amount of resources to be invested in the operation of the auditing methods must, by reason of the nature of things, take into account the benefit of operating these procedures.

The Bank's Board of Directors, which is responsible for the preparation and approval of the financial statements in accordance with section 92 of the Companies Law, establishes the accounting policy, supervises its implementation, determines the structure of the internal audit system and oversees its functioning. The President and Chief Executive Officer is responsible for the ongoing management of the Bank's affairs within the framework of the policy established by the Board of Directors and subject to its instructions. The Bank's Management acts according to the policy established by the Board of Directors. The Board of Directors, by means of its committees, holds ongoing meetings with the Bank's Management, the Chief Auditor and the Joint Auditors of the Bank, in order to review the scope and results of their work.

The Joint Auditors of the Bank, Kost Forer Gabbay & Kasierer and Somekh Chaikin, audited the Bank's annual financial statements in accordance with accepted auditing standards, including standards prescribed by the Auditors Regulations (Manner of Auditor's Performance) 5733-1973, and certain auditing standards that were published by the American Institute of Certified Public Accountants and the implementation of which in audit of banking institutions was required in guidelines of the Supervisor of Banks. The objective of the audit is to enable the auditors to express an opinion regarding the extent to which these financial statements reflect, in accordance with accepted accounting and reporting principles provided by the directives and guidelines of the Supervisor of Banks, the financial condition of the Bank, the results of its activity, and changes in its shareholders' equity and its cash flows. In accordance with section 170 of the Companies Law, the Joint Auditors are responsible to the Bank and its shareholders for that stated in their opinion concerning the financial statements. The Joint Auditors' Report is attached to the annual financial statements.

In addition, the information in the Directors' Report and the Management Review (hereinafter: the "accompanying data") was provided to the Joint Auditors for their examination, so that they could notify the Bank if a material discrepancy exists between the data in the financial statements and the accompanying data, or if the accompanying data include information that does not materially conform with the facts or other information that came to the attention of the Joint Auditors during their audit. Notification as aforesaid was not received from the Joint Auditors. The Joint Auditors did not adopt procedures for this purpose in addition to those that they are required to adopt for purposes of auditing the financial statements.

Eitan Raff
Chairman of the Board of Directors

Galia Maor
President and Chief Executive Officer

Zeev Nahari
Senior Deputy Chief Executive Officer
Head of Finance and Economics Division

30 March, 2008

Ernst & Young

■ **Kost Forer Gabbay & Kasierer**
3 Aminadav Tel-Aviv

KPMG

Somekh Chaikin

Report of the Joint Auditors to the Shareholders of
Bank Leumi le-Israel B.M.

We have audited the accompanying consolidated balance sheets of Bank Leumi le-Israel B.M. ("the Bank") and its subsidiaries ("the Group") as at 31 December 2007 and 2006, and the related consolidated statements of profit and loss, changes in shareholders' equity and cash flows, for each of the three years the last of which ended 31 December 2007. These financial statements are the responsibility of the Bank's Board of Directors and of its Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of the foreign subsidiaries, whose assets constitute approximately 2% of the total consolidated assets both as at 31 December 2007 and 2006, and whose net interest income before provision for doubtful debts constitutes approximately 2%, approximately 2%, approximately 7% of the total consolidated interest income before provision for doubtful debts for the years ended 31 December 2007, 2006, and 2005, respectively. The financial statements of those subsidiaries were audited by other auditors whose reports thereon have been furnished to us and our opinion, insofar as it relates to amounts emanating from the financial statements of such subsidiaries, is based on the reports of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards, including standards prescribed by the Auditors Regulations (Manner of Auditor's Performance), 5733-1973 and certain auditing standards implementation of which in audit of banking institutions was required in guidelines of the Supervisor of Banks. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors and by Management of the Bank, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Bank and its subsidiaries as at 31 December 2007 and 2006, and the consolidated results of operations, changes in shareholders' equity and cash flows of the Group for each of the three years the last of which ended 31 December 2007, in conformity with generally accepted accounting principles. Furthermore, the consolidated financial statements have, in our opinion, been prepared in accordance with the directives and guidelines of the Supervisor of Banks.

As explained in Note 1B, the financial statements are stated in reported amounts, in accordance with the accounting standards of the Israel Accounting Standards Board and the directives of the Supervisor of Banks.

Without qualifying our above opinion we draw attention to that stated in Note 18.I.(2) and (4), regarding claims against the Bank and against a subsidiary, including applications for their approval as class actions, and that stated in Note 18.Q. and R. regarding claims and uncertainties in connection with companies included on equity basis. The Bank is unable to estimate the implications of the above-mentioned matters on the Bank, if any, on its financial position and operating results, and whether or not they will be material.

Kost Forer Gabbay & Kasierer	**Somekh Chaikin**
Certified Public Accountants (Isr.)	Certified Public Accountants (Isr.)

Joint Auditors

30 March, 2008

Consolidated Balance Sheets as at 31 December 2007

Reported Amounts

	Note	**31 December 2007**	31 December 2006
		NIS millions	
Assets			
Cash and deposits with banks	**2**	**42,329**	47,609
Securities	**3, 14**	**47,169**	46,375
Securities borrowed or purchased under agreements to resell		**655**	-
Credit to the public	**4**	**198,557**	183,800
Credit to governments	**5**	**642**	1,020
Investments in companies included on equity basis	**6**	**1,873**	1,251
Buildings and equipment	**7**	**3,276**	3,056
Other assets	**8**	**7,650**	6,230
Total assets		**302,151**	289,341
Liabilities and equity capital			
Deposits of the public	**9**	**238,045**	231,823
Deposits from banks	**10**	**6,139**	5,241
Deposits from governments		**1,198**	2,146
Securities loaned or sold under agreements to repurchase		**231**	-
Debentures, bonds and subordinated notes	**11**	**19,248**	15,622
Other liabilities	**12**	**17,636**	16,866
Total liabilities		**282,497**	271,698
Minority interest		**105**	152
Shareholders' equity	**13**	**19,549**	17,491
Total liabilities and equity capital		**302,151**	289,341

The accompanying notes are an integral part of these consolidated financial statements.

For condensed financial statements of the Bank separately – see Note 30.

Eitan Raff	Meir Dayan	Prof. Israel Gilad	Galia Maor	Zeev Nahari
Chairman of the Board	Director	Director	President and Chief Executive Officer	Senior Deputy Chief Executive Officer Head of the Finance and Economics Division

Date of the signing of the financial statements: 30 March, 2008

Consolidated Statements of Profit and Loss for the year ended 31 December 2007

Reported Amounts

	Note	**2007**	2006	2005
		NIS millions		
Net interest income before provision for doubtful debts	**20**	**7,648**	6,922	6,629
Provision for doubtful debts	**4**	**407**	933	1,426
Net interest income after provision for doubtful debts		**7,241**	5,989	5,203
Operating and other income				
Operating commissions	**21**	**3,350**	(a) 3,013	(a) 2,819
Profits from investments in shares, net	**22**	**461**	128	43
Other income	**23**	**411**	740	865
Total operating and other income		**4,222**	3,881	3,727
Operating and other expenses				
Salaries and related expenses	**24**	**4,218**	4,552	3,627
Building and equipment maintenance and depreciation		**1,274**	1,220	1,168
Other expenses	**25**	**1,445**	(a) 1,495	(a) 1,285
Total operating and other expenses		**6,937**	7,267	6,080
Operating profit before taxes		**4,526**	2,603	2,850
Provision for taxes on operating profit	**26**	**1,722**	1,320	1,193
Operating profit after taxes		**2,804**	1,283	1,657
Group's equity in after-tax operating profits of companies included on equity basis, net of related tax effect	**6**	**184**	171	378
Minority interest in after-tax operating (profits) losses of subsidiaries		**(4)**	-	24
Net operating profit		**2,984**	1,454	2,059
After-tax profit from extraordinary items	**27**	**373**	2,080	77
Net profit		**3,357**	3,534	2,136

	2007	2006	2005
	NIS		
Earnings per share			
Basic earnings per share			
Net operating profit	**2.11**	1.03	1.46
After-tax profit from extraordinary items	**0.26**	1.47	0.05
Net profit	**2.37**	2.50	1.51
Diluted earnings per share			
Net operating profit	**2.08**	1.03	1.46
After-tax profit from extraordinary items	**0.26**	1.47	0.05
Net profit	**2.34**	2.50	1.51
	Thousands		
Number of shares for calculation of basic earnings	**1,414,233**	1,414,233	1,414,233
Number of shares calculation of diluted earnings	**1,433,803**	1,414,233	1,414,233

(a) Restated.

The accompanying notes are an integral part of these consolidated financial statements.

For condensed financial statements of the Bank separately – see Note 30.

Statements of Changes in Shareholders' Equity for the year ended 31 December 2007

Reported amounts

	Share capital	Capital reserves in respect of share-based payment transactions and others (a)	Total share capital and capital reserves	Accumulated other comprehensive income Adjustments in respect of presentation of securities available for sale at fair value	Translation adjustments(b)	Retained earnings	Dividend declared after balance sheet date	Loans to employees for purchase of the Bank's shares	Total shareholders'e quity
	NIS millions								
Balance as at 1 January 2005	7,000	10	7,010	94	(367)	8,276	-	(27)	14,986
Net profit for the year	-	-	-	-	-	2,136	-	-	2,136
Proposed dividend (c)	-	-	-	-	-	(1,103)	-	-	(1,103)
Adjustments in respect of presentation of securities available for sale at fair value	-	-	-	1	-	-	-	-	1
Profits in respect of securities available for sale that were realized and classified to profit and loss	-	-	-	(84)	-	-	-	-	(84)
Related tax effect	-	-	-	35	-	-	-	-	35
Adjustments from translation in respect of companies included on equity basis	-	-	-	-	25	-	-	-	25
Loans to employees for purchase of the Bank's shares	-	-	-	-	-	-	-	4	4
Balance as at 31 December 2005	7,000	10	7,010	46	(342)	(d) 9,309	-	(23)	16,000
Net profit for the year	-	-	-	-	-	3,534	-	-	3,534
Proposed dividend (c)	-	-	-	-	-	(2,500)	-	-	(2,500)
Benefit in respect of share-based payment transactions	-	395	395	-		-	-	-	395
Adjustments in respect of presentation of securities available for sale at fair value	-	-	-	906	-	-	-	-	906
Profits in respect of securities available for sale that were realized and classified to profit and loss	-	-	-	(30)	-	-	-	-	(30)
Related tax effect	-	-	-	(299)	-		-	-	(299)
Adjustments from translation in respect of companies included on equity basis	-	-	-	-	(61)	-	-	-	(61)
Loans to employees for purchase of the Bank's shares	-	-	-	-	-	-	-	(454)	(454)
Balance as at 31 December 2006	7,000	405	7,405	623	(403)	(d) 10,343	-	(477)	17,491

See footnotes on next page

Statements of Changes in Shareholders' Equity for the year ended 31 December 2007 (cont'd)

Reported amounts

				Accumulated other comprehensive income					
	Share capital	Capital reserves in respect of share-based payment transactions and others (a)	Total share capital and capital reserves	Adjustments in respect of presentation of securities available for sale at fair value	Translation adjustments(b)	Retained earnings	Dividend declared after balance sheet date	Loans to employees for purchase of the Bank's shares	Total shareholders'equity
	NIS millions								
Balance as at 1 January 2007	**7,000**	**405**	**7,405**	**623**	**(403)**	**(d) 10,343**	**-**	**(477)**	**17,491**
Net profit for the year	-	-	-	-	-	3,357	-	-	3,357
Proposed dividend (c)	-	-	-	-	-	(1,414)	-	-	(1,414)
Dividend declared after balance sheet date (c)	-	-	-	-	-	(270)	270	-	-
Benefit in respect of share-based payment transactions	-	205	205	-	-		-	-	205
Adjustments in respect of presentation of securities available for sale at fair value	-	-	-	116	-	-	-	-	116
Profits in respect of securities available for sale that were realized and classified to profit and loss	-	-	-	(326)	-	-	-	-	(326)
Related tax effect	-	-	-	89	-		-	-	89
Adjustments from translation in respect of companies included on equity basis	-	-	-	-	(42)	-	-	-	(42)
Loans to employees for purchase of the Bank's shares	-	-	-	-	-	-	-	73	73
Balance as at 31 December 2007	**7,000**	**610**	**7,610**	**502**	**(445)**	**(d) 12,016**	**270**	**(404)**	**19,549**

(a) Including NIS 10 million of other capital reserves.
(b) Adjustments arising from translation of the financial statements of autonomous foreign subsidiaries (See Note 1D(3) and 1E(5)).
(c) See Note 13B.
(d) Including NIS 987 million which may not be distributed as a dividend (31 December 2006 - NIS 1,044 million, 31 December 2005 - NIS 633 million). The balance of the amount for distribution is subject to directives of Bank of Israel and to restrictions provided in Proper Conduct of Banking Business Directive.

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows for the year ended 31 December 2007

Reported amounts

	2007	2006	2005
	NIS millions		
Cash flows generated by operating activities:			
Net profit for the year	**3,357**	3,534	2,136
Adjustments to reconcile net profit to net cash flows generated by operating activities:			
Equity in undistributed profits of companies included on equity basis (a)	**(120)**	(114)	(146)
Minority interest in profits (losses) of subsidiaries	**8**	-	(24)
Benefit in respect of share-based payment transactions	**201**	356	-
Depreciation of buildings and equipment	**460**	455	434
Amortization	**15**	13	3
Provision for doubtful debts	**407**	933	1,426
Provision for decrease in value of assets transferred to the Group's ownership	**5**	-	-
Net gain on sale of securities available for sale	**(326)**	(30)	(84)
Realized and unrealized loss (gain) from adjustment of held for trading securities to fair value	**24**	(61)	(10)
After-tax gain on realization of investments in subsidiaries and companies included on equity basis	**-**	(718)	(79)
Net gain from sale of companies on the capital market	**(357)**	(1,361)	-
Net (gains) losses, after tax, on sale of buildings and equipment	**(18)**	(8)	6
Cancellation of Special provisions in connection with fixed assets	**(5)**	-	(4)
Deferred taxes in respect of operating profit, net	**23**	(238)	130
Increase (decrease) in excess of provisions for severance pay and pensions over amounts funded	**(30)**	307	(75)
Other, net	**16**	3	4
Net cash inflow generated by operating activities	**3,660**	3,071	3,717

(a) Net of dividend received.

The accompanying notes are an integral part of these financial statements.

For condensed financial statements of the Bank separately, see Note 30.

Consolidated Statements of Cash Flows for the year ended 31 December 2007 (cont'd)

Reported amounts

	2007	2006	2005
	NIS millions		
Cash flows generated by activities in assets:			
Net increase in deposits with banks for an initial period exceeding three months	**(1,338)**	(2,466)	(558)
Acquisition of debentures held to maturity	**(26)**	(7)	(526)
Proceeds from redemption of debentures held to maturity	**973**	1,114	1,280
Acquisition of securities available for sale	**(37,531)**	(25,014)	(17,406)
Proceeds from sale of securities available for sale	**7,701**	2,885	4,121
Proceeds from redemption of securities available for sale	**29,028**	23,236	8,838
Net decrease (increase) in securities held for trading	**(1,091)**	167	(671)
Net increase in credit to the public	**(15,429)**	(1,312)	(9,159)
Net (increase) decrease in credit to governments	**378**	(172)	115
Additional investments in shares of subsidiaries	**(18)**	(82)	(52)
Acquisition of a subsidiary consolidated for the first time (Appendix A)	**-**	84	(114)
Proceeds from sale of investment in companies included on equity basis	**-**	1,230	139
Acquisition of shares in companies included on equity basis	**(35)**	(43)	(25)
Acquisition of buildings and equipment	**(697)**	(624)	(632)
Net increase in securities borrowed or purchased under agreements to resell	**(655)**	-	-
Proceeds from sale of buildings, after related tax	**58**	22	23
Net proceeds from sale of companies on the capital market	**357**	1,693	-
Net decrease in other assets	**(1,361)**	(210)	861
Net cash outflow generated by activities in assets	**(19,686)**	501	(13,766)
Cash flows generated by activities in liabilities and capital			
Net increase (decrease) in:			
Deposits of the public	**6,222**	8,051	11,972
Deposits from banks	**898**	895	(1,605)
Deposits from governments	**(948)**	(79)	(800)
Issue of debentures, bonds and subordinated notes	**4,233**	640	6,874
Redemption of debentures, bonds and subordinated notes	**(607)**	(2,103)	(877)
Net increase in other liabilities	**1,851**	343	284
Net increase in securities loaned or sold under agreements to repurchase	**231**	-	-
Dividend paid to shareholders	**(2,500)**	(1,103)	(1,004)
Dividend paid to minority shareholders by subsidiaries	**(45)**	(1)	(9)
Repayment of loans to employees for purchase of the Bank's shares	**73**	10	4
Loans to employees to acquire bank shares	**-**	(464)	-
Net cash inflow generated by activities in liabilities and capital	**9,408**	6,189	14,839
Increase (decrease) in cash	**(6,618)**	9,761	4,790
Balance of cash at beginning of year	**41,442**	31,681	26,891
Balance of cash at end of year	**34,824**	41,442	31,681

The accompanying notes are an integral part of these financial statements.
For condensed financial statements of the Bank separately - see Note 30.

Consolidated Statements of Cash Flows for the year ended 31 December 2007 (cont'd)

Reported amounts

Appendix A - Acquisition of subsidiaries consolidated for the first time:

	2007	2006	2005
	NIS millions		
Assets and liabilities of consolidated subsidiaries at date of acquisition:			
Working capital (except cash and cash equivalents)	-	286	(106)
Non-monetary assets	-	(88)	-
Minority interest	-	1	-
Goodwill	-	(115)	(8)
Cash outflow to acquire subsidiaries consolidated for the first time	-	84	(114)

Appendix B - Transactions not involving cash flows:

In 2007:

(1) Proposed dividend in the amount of NIS 1,414 million.
(2) During the year, securities were transferred from credit to the public to the available for sale portfolio, in the amount of NIS 253 million, due to lending of securities that came to an end.
(3) During the year, securities were transferred from credit to the public to other assets, in the amount of NIS 8 million, in respect of loans that were repaid.
(4) During the year, shares were transferred from the available for sale portfolio to investments in affiliated companies, in the amount of NIS 501 million.
(5) During the year, fixed assets were acquired against liabilities to suppliers, in the amount of NIS 18 million.

In 2006:

(1) Proposed dividend in the amount of NIS 2,500 million.
(2) During the year, debentures were transferred from the available for sale portfolio to credit to the public, in the amount of NIS 249 million, due to loaning of securities.
(3) During the year, securities were transferred from credit to the public to other assets, in the amount of NIS 11 million, in respect of loans that were repaid.
(4) During the year, shares were transferred from credit to the public to the available for sale portfolio, in the amount of NIS 571 million.
(5) During the year, an investment, in the amount of NIS 275 million, was transferred from investment in affiliated companies to shares available for sale.
(6) During the year, fixed assets were acquired against liabilities to suppliers, in the amount of NIS 7 million.
(7) Accrued expenses, including taxes in connection with sale of capital market companies, amounted to NIS 222 million.

In 2005:

(1) Proposed dividend in the amount of NIS 1,103 million.
(2) Transfer during the year of debentures in the amount of NIS 156 million from securities available for sale to securities held for trading.
(3) Transfer during the year of securities in the amount of, NIS 17 million from credit to the public to securities available for sale, due to lending of securities that came to an end.
(4) Transfer during the year of real estate from credit to the public to other assets n the amount of NIS 10 million, in respect of loans that were repaid.

Index to Notes

Note 1 - Significant Accounting Policies

A. General

The financial statements have been prepared in accordance with generally accepted accounting principles and the directives and guidelines of the Supervisor of Banks relating to the preparation of annual financial statements of banks.

Pursuant to the recommendations of the Supervisor of Banks, publication of the financial statements is on the basis of the consolidated statements only. Condensed data of the Bank are given in Note 30.

B. Financial statements in reported amounts

(1) General

In October 2001 the Israel Accounting Standards Board published Accounting Standard No. 12 - "Discontinuance of Adjustment of Financial Statements". Pursuant to this standard and in accordance with Accounting Standard No. 17 that was published in December 2002, the adjustment of financial statements was discontinued as at 1 January 2004. Until 31 December 2003, the Bank continued to prepare adjusted financial statements in accordance with the directives of the Supervisor of Banks on the basis of the rules determined in Opinion No. 36 of the Institute of Certified Public Accountants in Israel. As at 1 January 2004 the Bank applies the provisions of Accounting Standard No. 12 and the transitory directives of the Supervisor of Banks.

The adjusted amounts included in the Financial Statements as at 31 December 2003 were used as a starting point for the financial reporting in reported amounts.

(2) Definitions

In these Financial Statements -

Adjusted amount - an historical nominal amount that was adjusted to the December 2003 CPI according to changes in the general purchasing power of the Israeli currency in accordance with the provisions of opinions of the Institute of Certified Public Accountants in Israel;

Reported amount - an amount adjusted to the transition date (31 December 2003) with the addition of amounts in nominal values that were added after the transition date and less amounts that were eliminated after the transition date;

Adjusted financial report - financial report in values adjusted according to the changes in the general purchasing power of the Israeli currency in accordance with the provisions of the opinions of the Institute of Certified Public Accountants in Israel.

Note 1 - Significant Accounting Policies (cont'd)

B. Financial statements in reported amounts (cont'd)

(3) Balance sheet

- Non-monetary assets (mainly buildings and equipment; investments in shares; expenses relating to issuance of debentures, bonds and subordinated notes) and share capital are presented in reported amounts.

  The amounts of the non-monetary assets do not necessarily represent the realisable value or current economic value, but only the reported amounts of such assets.

- Monetary assets and liabilities are presented in the balance sheet at their historical nominal values as at the balance sheet date.

- In the Financial Statements "cost" means cost in a reported amount.

- The equity value of investments in companies included on the equity basis is determined based on the financial statement of these companies.

(4) Profit and loss statement

- Income and expenses that arise from non-monetary items or from provisions included in the balance sheet are derived from the movement between the reported amount of the opening balance and the reported amount of the closing balance.

- The other components of the profit and loss statement are presented at their nominal values.

- The bank share in the results of companies included on the equity basis and the minority interest in the results of subsidiaries is determined based on the financial statements of these companies.

(5) Statement of changes in shareholders' equity

Dividend declared in the year of the report is stated in nominal values.

C. Foreign currency and linkage

(1) Assets (other than investments in subsidiaries and companies included on the equity basis, buildings and equipment) and liabilities are stated in the balance sheet as follows:

- Those in foreign currency or linked thereto are stated according to the representative rates of exchange published by Bank of Israel as at balance sheet date, or other appropriate date, depending on their contractual terms.

Note 1 - Significant Accounting Policies (cont'd)

C. Foreign currency and linkage (cont'd)

Exchange rate differences deriving from the adjustment of assets and liabilities denominated in foreign currency are included in the statement of profit and loss.

- Those fully linked to the CPI are stated on the basis of either the latest index published prior to balance sheet date or some other appropriate index, depending on their contractual terms.

(2) Income and expenses in foreign currency are included in the statement of profit and loss according to current representative exchange rates as at the transaction dates and with the addition of exchange rate differences on the assets and liabilities in respect of which the above income and expenses arose.

(3) Data on representative exchange rates and CPI and the percentage of change therein:

	31 December			Rate of change in		
	2007	2006	2005	**2007**	2006	2004
	NIS			**%**		
Exchange rate of the:						
U.S. dollar	**3.846**	4.225	4.603	**(9.0)**	(8.2)	6.8
Euro	**5.659**	5.564	5.446	**1.7**	2.2	(7.3)
British pound	**7.710**	8.288	7.941	**(7.0)**	4.4	(4.4)
Swiss franc	**3.420**	3.465	3.498	**(1.3)**	(0.9)	(8.1)
Currency basket	**4.543**	4.825	5.089	**(5.8)**	(5.2)	1.7
Consumer Price Index for the month of -	Points					
November	**105.8**	102.9	103.2	**2.8**	(0.3)	2.7
December	**106.4**	102.9	103.0	**3.4**	(0.1)	2.4
Appreciation (devaluation) in real terms of NIS in relation to -						
Exchange rate of the dollar				**12.0**	8.1	(4.3)
Exchange rate of the currency basket				**8.9**	5.1	0.7

D. Translation of financial statements of foreign subsidiaries and branches

(1) Pursuant to directives of the Supervisor of Banks, all foreign subsidiaries of the Bank are considered integrated entities of the Bank.

(2) The financial statements of foreign subsidiaries and branch offices are translated as follows:
Non-monetary items are translated at historical exchange rates and are adjusted to the changes in the general purchasing power of the shekel from their date of purchase until 31 December 2003. Monetary items are translated at the exchange rates in effect as at balance sheet date. Translation differences are included in the statement of profit and loss.
Items in the statement of profit and loss are translated at the exchange rates in effect at the end of each quarter.

Note 1 - Significant Accounting Policies (cont'd)

D. Translation of financial statements of foreign subsidiaries and branches (cont'd)

(3) Until 31 December 1994 certain foreign subsidiaries were considered as autonomous entities. The differences between the value of the investment in the above companies, adjusted according to the changes in the general purchasing power of the Israeli currency, and the Bank's share in their equity according to their financial statements adjusted for changes in the purchasing power of the currency in which they were presented and after being translated according to the exchange rates as at balance sheet date, were transferred to "translation adjustments" within shareholders' equity. These adjustments were calculated in the years 1984 up to and including 1994 (in the years 1990 through 1994 they were calculated after deduction of the exchange rate differences relating to the foreign currency sources of financing the investments in those companies, less the related tax). The translation adjustments will be transferred to the statement of profit and loss upon realization of the investments in those companies.

E. Principles of consolidation and implementation of equity method

(1) Definitions

In these financial statements:

Subsidiaries - companies which are directly or indirectly fully consolidated in the financial statements of the Bank.

Companies included on equity basis - Companies, other than subsidiaries, the investment in which is included in the Bank's financial statements on the equity basis.

Investee companies - subsidiaries and companies included on equity basis.

See Note 6D for details of principal subsidiaries and companies included on equity basis.

(2) Principles of consolidation

The consolidated financial statements include the audited financial statements of the Bank and its subsidiaries and after the adjustments required from the application of uniform accounting principles in the consolidated financial statements.

The financial statements of two wholly-owned real estate and service subsidiaries are included in the financial statements of the Bank.

Material intercompany balances and transactions are eliminated in the consolidated financial statements.

Note 1 - Significant Accounting Policies (cont'd)

E. Principles of consolidation and implementation of equity method (cont'd)

(3) Investee companies

Investments in shares of investee companies are stated according to the equity method based on their audited financial statements. The Bank's equity in the results of operations of those companies is stated net of the amortization of goodwill.

(4) As of 1 January 2006, the Bank has applied Accounting Standard No. 20 (Amended) – "Accounting Treatment of Goodwill and Intangible Assets on Acquisition of Investee Companies: (hereinafter – "Standard 20") of the Israel Accounting Standards Board.

Standard 20 prescribes the accounting treatment of goodwill and intangible assets on the acquisition of a subsidiary or an investee company that is not a subsidiary, including a company under joint control.

According to Standard 20, the excess of the cost of acquisition of an investment in an investee company over the holding company's share in the fair value of its identifiable assets (including intangible assets) less the fair value of its identifiable liabilities (after relevant tax attribution) constitutes goodwill. The excess of the cost of acquisition of an intangible asset acquired will be attributed only in the event that it complies with the definition of intangible asset in accordance with the criteria fixed in Standard 20. According to Standard 20, in the event that negative goodwill (excess of fair value over acquisition cost) arises as of acquisition, such negative goodwill will be immediately recognized as of acquisition date as a profit in the profit and loss statement and will no longer be amortized methodically. Positive goodwill and intangible assts with undefined lives will not be amortized.

Pursuant to the Supervisor of Banks' directives, goodwill is amortized positively or negatively over a period of 10 years unless the Supervisor of Banks shall otherwise permit.

(5) The Bank's share in "translation adjustments" of autonomous units, held by companies included on the equity basis, is included in the statement of changes in shareholders' equity.

(6) The Bank examines in each reporting period the necessity of recording provision for impairment, see U. thereunder.

(7) The Bank has granted loans at preferential terms to a number of wholly-owned subsidiaries (mainly auxiliary companies). Amounts recorded in connection therewith in capital reserves in the financial statements of these companies are included in the balance sheet of the Bank as part of the investment in the companies.

Note 1 - Significant Accounting Policies (cont'd)

F. Securities

(1) Securities are classified in three categories: debentures held to maturity, securities available for sale and securities held for trading.

(a) Debentures held to maturity

Debentures held to maturity are stated at cost with the addition of accrued interest, linkage and foreign currency differences, taking into consideration the proportion of the premium or discount and less provision for impairment in their value which is not of a temporary nature.

(b) Securities available for sale

Securities available for sale are stated in the balance sheet at their fair value except for shares and options in respect of which the fair value is not readily determinable, in which case they are stated at cost. The fair value of quoted securities is determined on the basis of Stock Exchange prices or on valuation data received from external sources. Regarding unquoted debentures, most of the portfolio is revalued on a monthly basis by a recognized international institution engaged in valuation and independent of issuing and marketing entities. The remainder of the portfolio is revalued by other external entities. No use is made of internal models for purposes of valuation of securities. The differences between the fair value and the adjusted cost are shown in a separate item within shareholders' equity net of the related tax effect. Impairment in value which is not of a temporary nature are charged to the profit and loss statement.
Unrealized gains or losses from adjustments to fair value of securities available for sale designated as being hedged by fair value hedges, are charged to the statement of profit and loss over the period of hedge.

(c) Securities held for trading

Securities held for trading are stated at fair value. The fair value is determined on the basis of their market value. Unrealized gains and losses are included in the statement of profit and loss.

(2) The Bank examines on a periodic basis the need for making a provision for impairment of securities which is not of a temporary nature. The examination is carried out if there are indications that the value of securities might be impaired. The test for determining if impairment is not of a temporary nature is based on the following criteria:
- a change in the rating of the securities by international rating agencies:
- the length of time during which the security was at lower than cost;
- the extent of the value of the collaterals backing the security;
- the percentage of impairment from the the cost of the security.
- intention and ability to hold the security until the forecasted recovery in full of the cost.

Losses from securities which are not of a temporary nature are charged to the statement of profit and loss.

Note 1 - Significant Accounting Policies (cont'd)

F. Securities (cont'd)

(3) Lending of securities

Transactions for lending securities carried out as "ordinary" credit transactions wherby the Bank lends securites against the collateral portfolio and the borrower does not transfer a margin relating specifically to the securities lending transaction to the banking corporation, are included as "credit to the public" at market value and are added to the borrower's debt. Changes in the market value of the securities loaned are included on the accrual basis in the statement of profit and loss in "income from credit to the public". Adjustments to fair value are charged to Adjustments in respect of presentation of securities available for sale at fair value. Regarding accounting treatment of transfers and servicing of financial assets commencing 1 January 2007, see paragraph G. below.

G. Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

As of 1 January 2007 the Bank applies the Supervisor of Banks' circular amending the Directives on Reporting to the Public regarding "Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". Directives in this circular adopt principles of measurement and disclosure set out in the American Standard FAS 140 - "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", for the purpose of distinguishing between transfers of financial assets reported as a sale, and others. In view of this, the principle has been adopted whereby a financial asset that was transferred will be shown in the balance sheet of the party controlling it, whether it is the transferor or the receiver of the asset. For this matter, the directives include detailed tests of control relating to repurchase agreements, lending of securities, and securitization of loans, sale and participation in loans.

The amendments to the Directives on Reporting to the Public apply to transactions of lending securities, repurchase of securities, securitization of financial assets, servicing financial assets and the extinguishment of liabilities carried out after 31 December 2006, except for lending of securities described in paragraph F. (3) above.

Implementation of the circular will not have material consequences on the results of the activity or financial situation of the Bank.

Note 1 - Significant Accounting Policies (cont'd)

H. Buildings and equipment

(1) As of 1 January 2007, the Bank applies Accounting Standard No. 27 - "Fixed Property" (henceforth – "Standard 27"). Standard 27 sets rules for recognizing, measuring and subtracting fixed asset items and the disclosure required in respect thereof. Standard 27 provides, inter alia, that at the time of initially recognizing a fixed asset item,the entity must estimate and include as part of the costs of the item, the costs which will be attributed to it due to a commitment to dismantle and transfer the item and restore the site in which it was located. Standard 27 also provides that a group of similar fixed asset items will be measured according to cost less accrued depreciation and less losses incurred from declines in value, or, alternatively, at a revalued amount less accrued depreciation, while an increase in the value of the asset above the initial cost as a result of the revaluation will be credited directlyto shareholders' equity in the revaluation fund item. Each part of fixed assets, whose cost is significant in relation tothe total cost of the item, will be depreciated separately, including the costs of significant periodic inspections. Further, Standard 27 provides that a fixed asset item that was acquired in consideration for another non-monetary item within the framework of a transaction of a commercial nature will be measured according to fair value.

In accordance with instructions of the Supervisor of Banks, banking corporations are required to apply Standard 27 except in those matters for which the Supervisor of Banks has given specific directives concerning the application of Standard 27.

In particular, according to the directives, banks will be permitted to measure items of fixed property according to cost less accumulated depreciation, after deducting losses from impairment. In addition, in those cases where Standard 27 refers to other Standards and/or uses definitions that have not yet been adopted in the Directives for Reporting to the Public, the principles and definitions set out in the Directives for Reporting to the Public will continue to apply. Furthermore, in those places where the language of Standard 27 differs from International Standard 16 – "Fixed Property", the clauses will apply as stated in the International Standard.

Except for the treatment of recognition of the initial assessment of the costs for dismantling and removal of the item of fixed property and restoring the site where it is located, the adoption of Standard 27 will be retroactive.

Implementation of Standard 27 will not have material consequences on the results of the activity or financial situation of the Bank.

(2) Buildings and equipment are stated at cost less accumulated depreciation and a provision for impairment in value. Buildings earmarked for sale are stated at the lower of cost or realizable value.

Note 1 - Significant Accounting Policies (cont'd)

H. Buildings and equipment (cont'd)

Cost is depreciated by the straight-line method over the estimated useful lives of the assets.
Direct expenses in connection with the development of computer software intended for internal use are capitalized to investments in equipment after the initial planning of the project has been concluded, subject to the existence of the conditions detailed in Accounting Standard 30 - "Intangible Assets". The costs are amortized from the beginning of use according to the anticipated useful life of the software.

(3) Commencing 1 January 2007, the Bank applies Accounting Standard No. 16 - "Investment Property" (henceforth – "Standard 16").

Standard 16 stipulates, among other things, that investment property is to be measured initially at cost plus costs of the transaction. In addition, the Standard stipulates that, in subsequent periods, the entity is to choose between measuring all its investment property at cost less accumulated depreciation, after deducting losses for impairment, and measurement at fair c value, whereby the updating of fair value will be charged to profit and loss.

Standard 16 applies to financial reports for periods from 1 January 2007 and thereafter.

An entity choosing initially on 1 January 2007 to use the fair value model for measuring investment property, shall include in the opening balance of reserves the difference between the fair value of the investment property at that date and its book cost.
In accordance with the instructions of the Supervisor of Banks, banking corporations are required to apply Standard 16 except in those matters for which the Supervisor of Banks has given specific directives concerning the application of Standard 16.

In particular, according to the directives, banks will be permitted to measure items of investment property according to cost less accumulated depreciation, after deducting losses from impairment, and to show them under Fixed Assets. In addition, in those cases where Standard 16 refers to other Standards and/or uses definitions that have not yet been adopted in the Directives for Reporting to the Public, the principles and definitions set out in the Directives for Reporting to the Public will continue to apply. Furthermore, in those places where the language of Standard 16 differs from International Standard 40 – "Investment Property", the clauses will apply as stated in the International Standard.

Implementation of Standard 16 will not have material consequences on the results of the activity or financial situation of the Bank.

Note 1 - Significant Accounting Policies (cont'd)

I. Issue expenses

Expenses of issue of debentures, bonds and subordinated notes are amortized in proportion to the balances outstanding each year.

J. Basis of recognition of income and expenses

(1) Income and expenses are recognized on the accrual basis.

(2) Income and expenses from securities held for trading and derivative financial instruments are recorded according to the changes in fair value.

(3) Interest income in respect of problematic debts that were classified as non-accrual loans and overdue interest in respect of housing loans of Leumi Mortgage Bank are recognized upon collection.

(4) Interest received from the Ministry of Finance of Israel, in respect of the difference in interest on loans to housing purchasers in Leumi Mortgage Bank, is charged to the statement of profit and loss over the period of the loan according to the uniform yield method.

K. Derivative instruments and hedging activities

(1) Derivative instruments are included in the balance sheet according to fair value as of balance sheet date. The fair value is fixed according to the market price on the stock exchange for traded instruments; instruments with an active market are estimated according to market value; in the event that an instrument is traded on several markets, the estimate is based on the most active market. Instruments that are not traded on an active market are estimated according to models utilized in the Bank's current activity, taking into account the risks inherent in the instrument (market risk, credit risk, etc). Changes in fair value of derivatives that are not intended for qualifying hedging are recorded on a current basis in the statement of profit and loss.

(2) The Bank is exposed to changes in fair value that may be attributed to changes in the foreign currency interest rate – the Libor rate. As part of the Bank's comprehensive strategy for management of exposure to interest risks, the Bank utilizes foreign currency derivatives to exchange fixed interest for variable interest. The Bank utilizes designated qualifying derivatives to hedge fair value.

The Bank implements the following activities in respect of derivatives: futures and option transactions on underlying assets of interest, currency, shares, commodities and other assets.

Note 1 - Significant Accounting Policies (cont'd)

K. Derivative instruments and hedging activities (cont'd)

(2) (cont'd)

The activity in derivatives is implemented as follows:

(a) Designated derivatives for hedging relationships.
(b) As part of the Bank's system of management of assets and liabilities not designated for hedging relationships – ALM management.
(c) Brokerage transactions with responsibility between banks/brokers and customers.

(3) The Bank may enter into a contract that is not in itself a derivative instrument but includes an embedded derivative. Regarding each derivative, the Bank evaluates whether the economic characteristics of the embedded derivative are clearly and closely related to those of the host contract, and determines whether a separate instrument with the same conditions as the embedded instrument would fulfill the definition of a derivative instrument.
When it is ascertained that the embedded derivative has economic characteristics that are not related clearly and closely with the economic characteristics of the host contract, and that a separate instrument with the same conditions would qualify as a derivative instrument, the embedded derivative is separated from the host contract and treated as a separate derivative. An embedded derivative that was separated is included in the balance sheet together with the host contract according to fair value and changes in fair value are reported on a current basis in the statement of profit and loss.

(4) The Bank documents in writing all the hedging relationships between hedging instruments and hedged items and the purpose and the strategy of the risk management by utilization of various hedging transactions.

The documentation includes specific identification of the asset, liability or firm commitment, designated as a hedged item including the method according to which the hedging instrument is expected to hedge the risks relating to the hedged item. The Bank estimates the effectiveness of the hedging ratios at the beginning of the hedging activity and on a continuing basis in accordance with the Bank's risk management policy.

(5) The Bank ceases utilization of hedge accounting when:

(a) The derivative is no longer effective in setting off changes in fair value.
(b) The derivative expires, is sold, cancelled or realized.
(c) The derivative is no longer designated as a hedging instrument since the contractual commitment will probably not be consummated.
(d) The hedged firm commitment no longer fulfills the definition of a firm commitment.
(e) Management cancels the designation of the derivative as a hedging instrument.

When hedge accounting is ceased because it is ascertained that the derivative no longer qualifies as an effective fair value hedge, the derivative will continue to be recorded in the balance sheet

Note 1 - Significant Accounting Policies (cont'd)

K. Derivative instruments and hedging activities (cont'd)

(5) (cont'd)

according to fair value, but the hedged asset or liability will no longer be adjusted in respect of changes in fair value.

When hedge accounting is ceased because the hedged item no longer fulfills the definition of a firm commitment, the derivative will continue to be recorded according to fair value, and any asset or liability recorded in accordance with recognition of the firm commitment will be removed from the balance sheet and will be recognized as current profit or loss in the statement of profit and loss.

(6) The Bank designates certain derivatives as hedges of fair value. Changes in fair value of derivatives that hedge exposure to changes in fair value of an asset, liability or firm commitment, are recognized on a current basis in the statement of profit and loss as are changes in fair value of the hedged item that may be attributed to the hedged risk.

L. Provision for doubtful debts

Specific provisions are made in respect of those debts the collection of which is in doubt. The amounts of the provisions are determined based on conservative evaluations, by the managements of the Bank and of the subsidiaries, of losses anticipated on credit granted, including indebtedness in off-balance sheet items. Such evaluation takes into account the information which the Bank and the subsidiaries have as to the financial position of the borrower, his business activities, his loan repayment history and the value of the collateral held by the Bank and its subsidiaries.

The specific provisions for housing loans granted by Leumi Mortgage Bank Ltd. are made principally as percentages of the debts according to the period during which the payments are in arrears. These percentages have been determined by the Supervisor of Banks.

Specific and general provisions by foreign subsidiaries are made taking into consideration the practices in the countries in which they operate and the instructions of the local regulatory authorities.

In addition, a "general provision" and a "supplementary provision" are made by banks in Israel.
The general provision is at the amount that was required as at 31 December 1991, after adjustment for inflation to 31 December 2004.
The supplementary provision is based on the quality of the credit portfolio, measured by specified risk characteristics, and calculated as stipulated in the Directives of the Supervisor of Banks.

The accumulated amount of the general provision and the supplementary provision in the consolidated balance sheet is 0.29% of the amount of the risk of credit to the public (31 December 2006 – 0.37%, and 31 December 2005 - 0.39%).

The write-off of bad debts is done only after all legal and other collection procedures have been exhausted and it has become clear beyond any doubt that the balance is not collectible.

See Note 4.C. for additional details regarding provisions for doubtful debts.

Note 1 - Significant Accounting Policies (cont'd)

M. Intangible Assets

In March 2007 the Israel Accounting Standards Board published Accounting Standard No. 30, concerning "Intangible Assets" (henceforth – "Standard 30"). Standard 30 regularizes the accounting treatment of intangible assets, and defines how to measure the book value of these assets, and the disclosures required. Standard 30 will initially be applied retroactively, except as explained below. With regards to business combinations, Standard 30 will be applied for business compinations that occurred on 1 January 2007 or thereafter, while with regards to in-process research and development acquired in a business combination that occurred before 1 January 2007, that meets the definition of an intangible asset at the time of acquisition and is recognized as an expense at the time of acquisition, the entity will recognize the asset on 1 January 2007 as an in-process research and development asset, , after allocation of taxes.

A research and development asset will be recognized according to the amount it was valued at the time of acquisition, less the deduction that would have been accumulated if it had been depreciated from the date of acquisition until 31 December 2006, in accordance with the length of useful life of the asset and after deducting accumulated losses from impairment.

In August 2007, a directive was published by the Supervisor of Banks according to which banking corporations are required to apply Standard 30 in preparing financial reports for periods commencing 1 January 2007, except in those matters for which the Supervisor of Banks has given specific directives concerning the application of Standard 30.
In particular, according to the directives, banks will be permitted to measure intangible assets according to cost less accumulated depreciation, after deducting losses from impairment. Banking corporations will not apply the principles stipulated in Standard 30 with regards to recognition of intangible acquaired in business combinations, this until adoption by banking corporations in Israel of International Financial Reporting Standard IFRS 3 – "Business Combinations", or until the voluntary adoption and approval by the Supervisor of Banks of American Accounting Standard FAS 141 – "Business Combinations", in its entirety. In addition, in spite of that stated in Standard 30, software costs recognized as an intangible asset will be shown in the bank's balance sheet under "Buildings and Equipment".
Furthermore, in those cases where Standard 30 refers to other Standards and/or uses definitions that have not yet been adopted in the Directives for Reporting to the Public, the principles and definitions set out in the Directives for Reporting to the Public will continue to apply; furthermore, in those places where the language of Standard 30 differs from International Standard 38 – "Intangible Assets", the clauses will apply as stated in the International Standard.
Implementation of Standard 30 will not have material consequences on the results of the activity or financial situation of the Bank.

N. Assets transferred to the Group following the settlement of problematic debts

Assets that were transferred to the Group following the settlement of problematic debts and are included in other assets are stated according to the lower of the asset’s market value on the date they were transferred or as at balance sheet date. Decrease in value is charged to “operating and other expenses”.

Note 1 - Significant Accounting Policies (cont'd)

O. Financial instruments

(1) The Bank applies Accounting Standard No. 22, “Financial Instruments: Disclosure and Presentation” (hereinafter – “Standard 22”). Standard 22 provides the presentation rules for financial instruments in the financial statements and detail the proper disclosure required in respect thereof. In addition, Standard 22 provides the manner of classifying financial instruments as financial liabilities and shareholders’ equity, classification of interest, dividends, losses and gains related thereto and the circumstances in which financial assets and financial liabilities are to be offset, and supersedes Opinion No. 53, “The Accounting Treatment of Convertible Liabilities” and Opinion No. 48, “The Accounting Treatment of Options”.

Regarding certain matters relating to the treatment of that stated above, there are directives of the Supervisor of Banks.

(2) Assets and liabilities are set-off when there exists a legally enforceable right to set-off as well as the intent to settle on a net basis. In addition, deposits repayable upon collection of the credit granted from these deposits, in respect of which the Bank has no credit risk, are set-off against the credit granted from these deposits. The interest margin from these transactions is included under "operating commissions".

P. Contingent liabilities

Adequate provisions are made for claims which, in the opinion of the Bank’s management and the managements of its subsidiaries, based on the opinions of legal counsel, will not be dismissed or canceled, notwithstanding the fact that such claims are refuted by the Bank.
Also, legal proceedings exist whose chances cannot be estimated at this stage and therefore no provision was recorded in respect thereof.

In accordance with directives of the Supervisor of Banks, contingent legal claims were treated according to United States Accounting Standard FAS 5 and the regulations relating thereto. According to the directives, the claims are classified according to the probability of realization of the risk exposure as follows:

1. Probable – probability exceeding 70%.
2. Reasonably possible – probability more than 20% and less than or equal to 70%.
3. Remote – probability less than or equal to 20%.

Appropriate provisions were recorded in the financial statements for claims whose realization is probable.

See Note 18 regarding details of the amount of the additional exposure in respect of contingent claims whose amount exceeds NIS 2 million and whose realization is not remote.

Note 1 - Significant Accounting Policies (cont'd)

Q. Employees' rights

Adequate provisions have been included in respect of all liabilities regarding employer/employee relations, in accordance with the law, agreements, accepted practice and Management's expectations. Future liabilities for pensions and jubilee grants are computed by a qualified actuary, according to the accrued benefit valuation method taking into account probabilities based on past experience. The capitalization rate of the provisions is fixed by the Supervisor of Banks and the rate of increase in salary in the future is estimated by on the basis of past experience and changes according to the age of the employee.

Regarding application of updated directives provided by the Supervisor of the Capital Market, Insurance and Savings, with respect to mortality rates – see Note 15(B), below.

The fundings in respect of severance pay are deposited with provident funds.

Pursuant to the Supervisor of Bank's guidance, the financial statements do not reflect the value of the benefit granted to employees who acquired shares pursuant to the sales offer of shares of the Bank in November 2002, September 1998 and in May 1997, because such benefit was granted by the State - the shareholders.

The Bank applies Accounting Standard No. 24 - "Share-Based Payment' (hereinafter - "Standard 24") of the Israel Accounting Standards Board.

Standard 24 requires the recognition of share-based payment transactions in the financial statements. Such transactions include transactions with employees or other parties that are to be settled in the Company's equity instruments or in cash, as well as transactions that provide the company or the supplier of the service or goods with a choice of settling in cash or in equity instruments. Concurrently with the recognition of the goods or services received, it is necessary to recognize an increase in shareholders' equity in the financial statements when the share-based payment transaction will be settled in equity instruments and the incurrence of a liability when such transaction is settled in cash.

Standard 24 prescribes the principles for the recognition, measurement and disclosure of the fair value of the goods or services provided in exchange for the equity instrument granted. In particular, measurement principles are prescribed with the respect to transactions with employees and others providing similar services, transactions with parties who are not employees and transactions that are measured by reference to the fair value of the equity instruments granted. In addition, requirements are prescribed for situations in which modifications are made to the conditions on which the equity instrument was granted.

See Note 15 for further details.

Note 1 - Significant Accounting Policies (cont'd)

R. Taxes on income

The Bank implements Accounting Standard No. 19, "Taxes on Income" (hereinafter – Standard 19). Standard 19 provides rules for recognition, measurement, presentation and disclosure with regard to taxes on income and deferred taxes in the financial statements. Standard 19 provides, *inter alia*, that a deferred tax liability must be recognised in respect of all taxable temporary differences and that a deferred tax asset must be recognised in respect of all temporary differences that can be deducted, losses for tax purposes and tax benefits that have not yet been utilised, if it is anticipated that there will be taxable income against which it will be possible to utilise them, except for a limited number of exceptions.

In certain matters relating to the accounting treatment of taxes on income, including with regard to recognising a deferred tax asset in respect of losses to be carried forward and temporary differences, there are additional limitations in the directives of the Supervisor of Banks.

The main factors, in respect of which deferred taxes were not created, are as follows:

- Amounts of adjustment to changes in the purchasing power of the shekel, referring mainly to buildings, according to the principles provided by the Israel Accounting Standard Board in the Standard 19, see Note 26(F).

- In accordance with directives of the Supervisor of Banks, no deferred taxes were recorded in respect of the general provision, the supplementary provision and the special provision for doubtful debts.

- Investments in subsidiaries and companies included on the equity basis, of which the intention of the Bank to hold such investments and not to sell them.

- No deferred tax assets are created in respect of temporary differences where the probability of realization of the deferred tax asset is doubtful.

Deferred tax balances are calculated according to the tax rates expected to be in force when the deferred tax liability is utilized, or when the deferred tax asset is realized, on the basis of tax laws, the legislation of which has been completed or essentially completed as at balance sheet date.

Note 1 - Significant Accounting Policies (cont'd)

S. Earnings per share

The Bank applies Accounting Standard No. 21, “Earnings per Share” (hereinafter - “Standard 21”) of the Israel Accounting Standards Board. Standard 21 prescribes the principles for the computation and presentation of earnings per share in financial statements.

According to Standard 21, earnings per share are to be computed based on the number of ordinary shares. Basic earnings per share are to include only the weighted average of the number of shares which are outstanding during the period whereas convertible securities (such as convertible debentures and options) are to be included only in the computation of diluted earnings per share. Options will be included in diluted earnings per share when their exercise results in the issuance of shares for a consideration which is less than the market price of the shares.

T. Statement of cash flows

The cash flows from activities in assets and in liabilities, other than changes in non-monetary assets, in securities not held for trading and in debentures, bonds and subordinated notes.
The item "cash" includes cash and deposits with central and commercial banks for an original period not exceeding three months.

U. Impairment of assets

The Bank applies Accounting Standard 15 – "Impairment of Assets" (henceforth – "Standard 15"). The Standard applies to all assets other than financial assets and tax assets. The Bank examines the necessity of recording a provision for the impairment of non-monetary assets in order to ensure that its assets in the balance sheet are not presented at an amount which is in excess of their recoverable value, which is the higher of the net selling price and the use value (the present value of the estimated future cash flows expected to be derived from use and disposal of the asset).

Note 1 - Significant Accounting Policies (cont'd)

U. Impairment in value of assets (cont'd)

When the value of an asset in the balance sheet is higher than its recoverable value, the Bank recognizes a loss from the impairment in value in the amount of the difference between the book value of the asset and its recoverable value. The loss thus recognized will be cancelled only in the event of changes occurring in the estimates that were used to determine the recoverable value of the asset since the date on which the most recent loss from the decline in value was recognized.

V. Comparative figures and restatement

Reclassified comparative figures have been indicated in the financial statements.

W. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from such estimates.

Note 1 - Significant Accounting Policies (cont'd)

X. Disclosure of Effect of New Accounting Standards and Directives of the Supervisor of Banks in the Period Prior to their Implementation:

a. Accounting Standard No. 29 – "Adoption of International Financing Reporting Standards IFRS"

In July 2006 the Israel Accounting Standards Board published Accounting Standard No. 29, "Adoption of International Financial Reporting Standards "IFRS" (hereinafter – Standard 29). Standard 29 provides that entities subject to the Securities Law – 1968 that are required to report according to the regulations of this law, are to prepare their financial statements for periods beginning as from 1 January 2008 according to IFRS. The aforementioned does not apply to banking corporations the financial statements of which are prepared in accordance with the directives and guidelines of the Supervisor of Banks.
With respect to the manner Standard 29 is to be adopted by banking corporations, the Supervisor of Banks notified the banks as follows:

1. He intends to provide on a regular basis directives regarding the adoption of Israeli standards published by the Israel Accounting Standards Board that are based on IFRS and are not related to the core of the banking business.

2. In the second half of 2009 he will publish his decision regarding the date of adopting IFRS related to the core of the banking business. He will do this taking into account the results of adopting these standards in Israel on the one hand, and the progress made in the convergence between IFRS and American standards on the other hand.

3. Therefore, with respect to the core of the banking business, the financial statements of a banking corporation that are prepared in accordance with the directives and guidelines of the Supervisor of Banks will continue to be prepared according to the American standards provided in the reporting to the public directives.

b. Bank of Israel Circular – Measurement and Disclosure of Impaired Loans, Credit Risk and Provision for Credit Losses

On 31 December 2007, the Supervisor of Banks sent amendments to the banking corporations of the Directives for Reporting to the Public on the subject of "Measurement and Disclosure of Impaired Loans, Credit Risk and Provision for Credit Losses". The Directive is based on accepted accounting principles in the U.S.A. (Accounting Standards FASB 114 and 118), directives of the regulatory authorities in the U.S.A., directives of the SEC in the U.S.A. relating to banks, and is also adapted to reports submitted by banks in the U.S.A. The Directives included in the Circular represent a material change in existing directives on the subject of the classification of problematic loans and the measurement of the provision for credit losses on these debts.

Note 1 - Significant Accounting Policies (cont'd)

X. Disclosure of Effect of New Accounting Standards and Directives of the Supervisor of Banks in the Period Prior to their Implementation: (cont'd)

The main changes included in the Directive are:

1. New types have been defined for problematic debts, which have been determined as impaired debts, including:
   - Credit for which the banking corporation is unable to collect all amounts, in accordance with the contractual conditions of the loan agreement;
   - Problematic debt whose terms were changed in the framework of a restructuring;
   - A debt whose principal or interest is in arrears of 90 days or more, excluding a well-secured debt in collection proceedings;
   - A debt in a current loan account or a current account, where the customer's account is charged with additional over-limit interest and with commissions for special treatment in respect of the over-limit current loan account or current account (as mentioned in paragraph 4 (c) in the Conduct of Banking Business Regulations No. 325)
   - In addition, a credit insufficiently covered by the actual present value and repayment ability of the debtor or of the pledged collateral, and characterized by the fact that there is a definite posiibility that the banking corporation will suffer some loss if the deficiencies are not corrected: which is defined as an inferior credit risk.

2. A banking corporation is required to maintain a provision for credit losses at the level appropriate to cover expected credit losses with refernce to its credit portfolio including in respect of off-balance sheet credit risk.

   Provisions for credit losses will include:

   - The specific provision for credit losses will apply to any debt whose contractual balance is NIS 1 million or more and any other debt identified for purposes of specific examination by the banking corporation.
     The provision will be in accordance with the amount of impairment of the debt, based on expected cashflows, discounted at the effective interest rate iof the debt.
   - Group provision for credit losses - for large groups of relatively small homogeneous debts, whose impairment is assessment on a group basis, and for debts examined individually and found to be unimpaired.
     The measurement of credit losses will be carried out based on past credit loss rates for each homogeneous group. Estimates for credit losses are to be documented.

Note 1 - Significant Accounting Policies (cont'd)

X. Disclosure of Effect of New Accounting Standards and Directives of the Supervisor of Banks in the Period Prior to their Implementation: (cont'd)

3. Interest income is not to be reported for impaired debts (excluding index-linkage differences and foreign cuurnecy exchange rate differences on the prinicipal).

4. Change in connection with write-off requirements:
   - An accounting write-off must be made immediately for every part of a debt whose collection is conditional on collateral in excess of the fair value of the collateral, which is identified as non-collectable.
   - Specific provisions should generally be written off after two years.
   - Group provisions for credit losses – debts in arrears of more than 150 days should be written off.

5. Qualitative and quantitative disclosure requirements in financial reports have been expanded in connection with problematic debts.

6. Detailed requirements have been set out for: the preparation of procedures to maintain a systematic process of determining provisions for credit losses, to be applied consistently; documentation requirements to support the credit process; and internal control over methods and processes that have been decided upon.

7. The Directive will be applied to financial reports commencing 1 January 2010. The Directive will not be applied retroactively in financial reports for previous periods. Transitory adjustments arising from the adoption of this Directive as at 1 January 2010 will be recorded directly in reserves under equity. At the first implementation date, the following will be required, among other things:
   - to make an accounting write-off of any debt at that date which meets the conditions for an accounting write-off,
   - to classify as under special supervision, inferior, or defective, any debt meeting the conditions for such classification,
   - to cancel all accrued and unpaid interest income for any debt which at that time meets the conditions for such,
   - and also to examine the need to adjust the balance of current and deferred taxation receivable and payable, because of adjustments to the balance of the provision for credit losses for credit to the public and for off-balance sheet credit instruments as at 1 January 2010.

   In the framework of the Bank's preparations for applying the above Directive, a steering committee has been appointed made up of representatives of the Business Divisions, Accounting and Computing.
   Sub-committees have been appointed to decide on working methods and on the requirements of the Directive.

Note 1 - Significant Accounting Policies (cont'd)

X. Disclosure of Effect of New Accounting Standards and Directives of the Supervisor of Banks in the Period Prior to their Implementation: (cont'd)

Preparations have commenced for changing the computer systems, where substantial changes are needed in information systems in order to carry out the required working procedures.

The Supervisor of Banks has not yet decided if on implementation of the Directive a further provision will be required for unidentified risks in the credit portfolio based on the risk characteristics of the credit portfolio, in accordance with Proper Conduct of Banking Business Directive 315. In addition, he has not yet decided how to relate to the banks' existing general provision. The total amount of general and supplementary provision as at 31 December 2007 is NIS 875 million, of which NIS 593 million is for the Bank.

It is not possible at this stage to estimate the consequences of the Directive on the future financial results of the Bank, when it will have been received.

c. Accounting Standard No. 23 – "The Accounting Treatment of Transactions between an Entity and its Controlling Shareholder"

In December 2006 the Israel Accounting Standards Board published Accounting Standard No. 23, "The Accounting Treatment of Transactions between an Entity and its Controlling Shareholder" (hereinafter – Standard 23). Standard 23 actually replaces the main provisions of the Securities Regulations (Financial Statement Presentation of Transactions between a Company and its Controlling Shareholder) that were amended in February 2007. Standard 23 provides that assets (other than an intangible asset with no active market) and liabilities included in a transaction between the entity and its controlling shareholder shall be measured on the date of the transaction at fair value and that the difference between the fair value and the consideration from the transaction shall be included in shareholders' equity. A debit difference is actually a dividend and accordingly reduces the retained earnings. A credit difference is actually an investment of the shareholder and shall therefore be presented under a separate item of shareholders' equity called "capital reserve from transaction between an entity and its controlling shareholder".

Standard 23 discusses three issues relating to transactions between an entity and its controlling shareholder, as follows: the transfer of an asset to the entity by the controlling shareholder, or conversely, transfer of an asset from the entity to the controlling shareholder; the controlling shareholder assuming upon itself a liability of the entity to a third party, all or part, indemnification of the entity by the controlling shareholder in respect of an expense, and the controlling shareholder waiving the entity's debt to it, all or part; and loans that were granted to the controlling shareholder or loans that were received from the controlling shareholder. Standard 23 also provides the disclosure that is to be made in the financial statements regarding transactions between the entity and its controlling shareholder during the period.

Note 1 - Significant Accounting Policies (cont'd)

X. Disclosure of Effect of New Accounting Standards and Directives of the Supervisor of Banks in the Period Prior to their Implementation: (cont’d)

Standard 23 shall apply to transactions between an entity and its controlling shareholder that are executed after 1 January 2007 and to a loan that was granted to a controlling shareholder or that was received from it before the date this standard came into effect as from the date of it coming into effect.

The Supervisor of Banks is considering applying Standard 23 on banking corporations commencing 1 January 2008, adapted as required. As at the reporting date specific directives have not yet been determined regarding how the standard is to be implemented.

Note 2 - Cash and Deposits with Banks

Reported Amounts

	31 December 2007	31 December 2006
	NIS millions	
Cash and deposits with central banks	**8,181**	5,860
Deposits with commercial banks	**33,662**	41,426
Deposits with specialized banking entities	**486**	323
Total	**42,329**	47,609
Including: cash and deposits with central and commercial banks for original periods not exceeding three months	**34,824**	41,442

Note 3 - Securities
Reported Amounts

	31 December 2007					31 December 2006				
	Amount in balance Sheet	**Amortized cost**	**Unrealized profits from adjustments to fair value**	**Unrealized losses from adjustments to fair value**	**Fair Value (a)**	Amount in balance sheet	Amortized cost	Unrealized profits from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair value (a)
	NIS millions					NIS millions				
1. Debentures held to maturity:										
Government of Israel	**904**	**904**	**22**	**(1)**	**925**	1,805	1,805	48	(1)	1,852
Foreign Governments	**551**	**551**	**-**	**-**	**551**	598	598	-	(9)	589
Other companies	**126**	**126**	**-**	**(3)**	**123**	125	125	-	-	125
Total debentures held to maturity	**1,581**	**1,581**	**22**	**(4)**	**1,599**	2,528	2,528	48	(10)	2,566

	31 December 2007					31 December 2006				
	Amount in balance Sheet	**Amortized cost (in Shares - cost)**	**Accumulated other comprehensive income**		**Fair value (a)**	Amount in balance sheet	Amortized cost (in shares - cost)	Accumulated other comprehensive income		Fair value (a)
			Profits	**Losses**				Profits	Losses	
	NIS millions					NIS millions				
2. Securities available for sale:										
Debentures and bonds -										
Government of Israel	**8,875**	**8,855**	**91**	**(71)**	**8,875**	10,454	10,259	231	(36)	10,454
Foreign Governments	**1,228**	**1,227**	**7**	**(6)**	**1,228**	2,763	2,805	1	(43)	2,763
Other companies	**22,989**	**23,376**	**43**	**(430)**	**22,989**	19,434	19,564	50	(180)	19,434
	33,092	**33,458**	**141**	**(507)**	**33,092**	32,651	32,628	282	(259)	32,651
Shares of other companies and mutual funds (b) (c)	**4,436**	**3,275**	**1,195**	**(34)**	**4,436**	4,199	3,220	981	(2)	4,199
Total securities available for sale	**37,528**	**36,733**	**(d) 1,336**	**(d) (541)**	**37,528**	36,850	35,848	(d) 1,263	(d) (261)	36,850

See footnotes on next page.

Note 3 - Securities (cont'd)
Reported Amounts

	31 December 2007					31 December 2006				
	Amount in balance Sheet	Amortized cost (in shares - cost)	Unrealized profits from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair value (a)	Amount in balance sheet	Amortized cost (in shares - cost)	Unrealized profits from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair value (a)
	NIS millions					NIS millions				
3. Securities held for trading:										
Debentures and bonds -										
Government of Israel	**5,014**	**4,992**	**35**	**(13)**	**5,014**	4,521	4,465	62	(6)	4,521
Foreign Governments	**194**	**194**	**-**	**-**	**194**	359	354	5	-	359
Other companies	**1,933**	**1,924**	**34**	**(25)**	**1,933**	2,084	2,056	31	(3)	2,084
	7,141	**7,110**	**69**	**(38)**	**7,141**	6,964	6,875	98	(9)	6,964
Shares of other companies and mutual funds	**919**	**918**	**28**	**(27)**	**919**	33	34	-	(1)	33
Total securities held for trading	**8,060**	**8,028**	**(e) 97**	**(e) (65)**	**8,060**	6,997	6,909	(e) 98	(e) (10)	6,997
Total securities	**47,169**	**46,342**	**1,455**	**(610)**	**47,187**	46,375	45,285	1,409	(281)	46,413

(a) Fair value data are generally based on stock exchange quotations. The value of debentures traded abroad which are not listed on a recognized stock exchange has been determined on the basis of prices quoted by dealers in these debentures. Such quotations do not necessarily reflect the price which will be obtained upon sale of securities in large volumes.

(b) In January 2001, through the subsidiary Leumi Real Holdings Ltd. ("Leumi Holdings"), the Bank purchased 19% of the effective share capital of Paz Oil Company Ltd. (henceforth – "Paz") for the price of NIS 379 million. Towards the end of 2006, concurrently with the issuance of shares of Paz on the Tel Aviv Stock Exchange, the Bank invested additional amounts totaling NIS 122 million. After issuance of Paz the Bank holds 15.63% of the effective share capital of Paz. In addition the Bank holds 11,961 par value of options issued by Paz. At the beginning of 2007 two representatives of the Bank were appointed to serve as Directors of Paz.
Commencing 1 January 2007 the investment in Paz is stated in the financial statements under the item of investments in companies included on equity basis, see Note 6 below. Until 31 December 2006 – the securities were shown as available for sale (being shares having a readily available fair value).

(c) Including NIS 972 million with respect to shares which have no readily available fair value, which are presented at cost (31 December 2006 - NIS 742 million). In accordance with Directives of the Supervisor of Banks from July 2003, credit to a certain customer in the communications sector was classified in the balance sheet as an investment in shares in the available for sale portfolio instead of in loans to the public, and shown with a fair value not exceeding the value of the loan.

(d) Regarding securities available for sale, total other income is included in shareholders' equity in the item "adjustments in respect of presentation of securities available for sale according to fair value", except securities intended for hedging for purposes of determining fair value.

(e) Reported in the profit and loss statement

(f) Restated.

Note: For details of liens – see Note 14, results of investing activities in debentures – see Note 20(e), results of investing activities in shares and in mutual funds – see Note 22.

Note 3 - Securities (cont'd)
Reported Amounts

	31 December 2007				
	Amount in balance sheet	Amortized Cost (in shares - cost)	Unrealized profits from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair value (a)
	NIS millions				
4. Additional details of Asset-backed securities available for sale					
Mortgage-backed securities (MBS):					
Pass-through securities:					
Securities guaranteed by GNMA	**119**	**119**	**-**	**-**	**119**
Securities issued by FNMA and FHLMC	**1,563**	**1,587**	**1**	**(25)**	**1,563**
Securities issued by others	**114**	**116**	**-**	**(2)**	**114**
Total	**1,796**	**1,822**	**1**	**(27)**	**1,796**
Other Mortgage-backed securities (including CMO and STRIPPED MBS)					
Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	**2,324**	**2,343**	**2**	**(21)**	**2,324**
Other Mortgage-backed securities	**32**	**34**	**-**	**(2)**	**32**
Total	**2,356**	**2,377**	**2**	**(23)**	**2,356**
Total Mortgage-backed securities	**4,152**	**4,199**	**3**	**(50)**	**4,152**
Asset-backed securities (ABS):					
Credit card debtors	**148**	**149**	**-**	**(1)**	**148**
Lines of credit for any purpose secured by dwelling	**11**	**11**	**-**	**-**	**11**
Credit for purchase of vehicle	**175**	**176**	**-**	**(1)**	**175**
Other credit to private persons	**82**	**82**	**-**	**-**	**82**
Credit not to private persons	**1**	**1**	**-**	**-**	**1**
Others	**1,701**	**1,822**	**6**	**(127)**	**1,701**
Of which: CLO	**1,226**	**1,287**	**-**	**(61)**	**1,226**
Of which: SCDO	**430**	**491**	**5**	**(66)**	**430**
Total	**2,118**	**2,241**	**6**	**(129)**	**2,118**
Total Asset-backed securities available for sale	**6,270**	**6,440**	**9**	**(179)**	**6,270**

Note 3 - Securities (cont'd)
Reported Amounts

	31 December 2007					
	Less than 12 months		More than 12 months		Total	
	Fair Value	Unrealized profits from adjustments to fair value	Fair Value	Unrealized profits from adjustments to fair value	Fair Value	Unrealized losses from adjustments to fair value
	NIS millions					
5. Additional details of asset-backed securities available for sale which include unrealized losses from adjustments to fair value						
Pass-through (MBS)	248	(2)	1,178	(24)	1,426	(26)
Other Mortgage-Backed Securities (including REMIC, CMO and STRIPPED MBS)	1,239	(13)	775	(10)	2,014	(23)
Asset-backed securities (ABS)	1,395	(111)	497	(19)	1,892	(130)
Total	2,882	(126)	2,450	(53)	5,332	(179)

(6) The fair value of the asset-backed bonds included in the trading portfolio as a 31 December 2007 amounted to about NIS 390 million, of which about NIS 344 million was invested in mortgage-backed securities and NIS 46 million was invested in other asset-backed securities.

(7) At 31 December 2007 the trading portfolio included future swap transactions on mortgage-backed debentures (MBS) with a nominal value of about 58 million dollars (about NIS 223 million). The above transactions were closed and the profits realized in January 2008.

(8) An additional decrease in the value of the asset-backed debentures occurred between the end of the year and the end of February 2008, in the amount of about NIS 99 million. This decrease is not included in the results at the end of 2007.

<u>Definitions</u>

Mortgage Backed Security – MBS
Debentures backed by mortgages for which the payments of interest and principal are based on cash flows resulting from the repayment of loans secured by mortgages.

Sub-Prime – a particular type of MBS
Debentures for which the interest and principal payments are based on a cash flow from a portfolio of mortgages given to borrowers with low credit ratings who are not able to provide appropriate collateral.

Collateralized Debt Obligation - CDO
A debenture backed by a portfolio of debentures and/or loans with varying levels of seniority and ratings.

Synthetic Collateralized Debt Obligation – SCDO
An agreement backed by a portfolio of CDS (which are derivatives) with varying levels of seniority.

Collateralized Loan Oblgation – CLO
A debenture backed by a portfolio of loans.

Federal National Mortgage Association - FNMA ("Fannie Mae")
A public company backed by the United States government which purchases mortgages, securitizes them and sells them on the open market (this company's securities do not have U.S. government guarantees).

Federal Home Loan Mortgage Corporation - FHLMC ("Freddie Mac")
A United States government sponsored enterprise which purchases mortgages, securitizes them and sells them on the open market (this company's securities do not have U.S. government guarantees).

Note 3 - Securities (cont'd)

Definitions (cont'd)

Government National Mortgage Association - GNMA ("Ginnie Mae")
A federal mortgage company which guarantees the securities it issues.

Credit Default Swap – CDS
A financial instrument transferring the issuer's credit exposure between parties to the transaction.

Note 4 - Credit to the Public

Less provision for doubtful debts (see Note 4.C)

Reported Amounts

A. Composition:

	31 December 2007	31 December 2006
	NIS millions	
Credit	**198,368**	184,108
Customers' liabilities for acceptances	**947**	588
Total credit (b)	**199,315**	184,696
Supplementary, general and special provisions for doubtful debts (c)	**(758)**	(896)
Total	**198,557**	183,800

(a) The specific provision for doubtful debts has been deducted from the related credit items.
(b) Provisions in respect of off-balance sheet items are included in "other liabilities".

Credit to the public includes follow-up loans to employees for the purchase of shares of the Bank in the amount of NIS 10 million (31 December 2006 – NIS 20 million) against liens recorded on the shares that were issued in accordance with a prospectus of 23 August 1993, a prospectus of 21 May 1997 and a prospectus of 17 September 1998, and which were repayable in 1997, 2001 and 2002, respectively. The loans are linked to the CPI.

Loans for the purchase of shares based on a tender offer of shares of Bank Leumi by the State to eligible employees pursuant to a plan from May 2006 and in accordance with a prospectus dated 15 November 2002, the balance of which as at 31 December 2007 was NIS 404 million (31 December 2006 – NIS 477 million), are shown after deduction from shareholders’ equity in accordance with a Directive of the Supervisor of Banks.

Note 4 - Credit to the Public (cont'd)

Reported Amounts

B. Credit to the public includes:

(1) Credit to problematic borrowers not included in the agricultural and municipal sectors:

	31 December 2007	31 December 2006
	NIS millions	
a) Non-accrual loans to problematic borrowers		
In unlinked Israeli currency	**1,006**	1,679
In CPI linked Israeli currency	**158**	219
In foreign currency (a)	**425**	592
b) Restructured credit:		
(1) Loans restructured during current year with waiver of income		
In foreign currency (a)	**-**	624
(2) Loans restructured in prior years with waiver of income		
In CPI linked Israeli currency	**80**	125
In foreign currency (a)	**493**	3
(3) Loans restructured during current year without waiver of income		
In unlinked Israeli currency	**137**	120
In CPI linked Israeli currency	**165**	213
In foreign currency (a)	**54**	94
c) Credit approved for restructuring by Bank Management not yet executed		
Balance as at balance sheet date	**85**	134
d) Credit in temporary arrears		
Balance as at balance sheet date	**764**	657
Related interest income included in the statement of profit and loss	**3**	2
e) Credit under special supervision		
Balance as at balance sheet date	**9,491**	13,315
f) Credit repaid during the current year by foreclosure on assets	**8**	582

(a) Including linked to foreign currency.

Note 4 - Credit to the Public (cont'd)
Reported Amounts

B. Credit to the public includes (cont'd):

(2) Credit to local authorities

	31 December 2007	31 December 2006
	NIS millions	
Composition of credit to local authorities (a)		
Balance as at balance sheet date	**3,309**	3,273
Credit to local authorities includes:		
(a) Non-accrual loans to problematic borrowers		
In unlinked Israeli currency	**6**	9
In CPI linked Israeli currency	**9**	20
(b) Credit in temporary arrears		
Balance as at balance sheet date	**-**	1
(c) Credit under special supervision		
Balance as at balance sheet date	**127**	233
(d) Credit to local authorities not included in the above problematic borrowers		
Balance as at balance sheet date	**3,167**	3,010
Related income included in the statement of profit and loss	**265**	196

(a) Including intercity associations and entities controlled by local authorities.

Note 4 - Credit to the Public (cont'd)

Reported amounts

C. Provision for doubtful debts

	2007				2006				2005			
	Specific provision (a)	**Specific provision according to depth of arrears (a)**	**Supplementary provision (b)**	**Total**	Specific provision (a)	Specific Provision according to depth of arrears (a)	Supplementary provision (b)	Total	Specific provision (a)	Specific provision according to depth of arrears (a)	Supplementary provision (b)	Total
	NIS millions				NIS millions				NIS millions			
Balance at beginning of year	**7,580**	**675**	**1,024**	**9,279**	7.803	409	1,040	9,252	6,931	344	1,041	8,316
Classification of opening balance in subsidiary and acquisition of subsidiary	**-**	**-**	**-**	**-**	(113)	116	5	8	-	-	-	-
Provisions during the year	**1,218**	**218**	**-**	**1,436**	1,375	349	32	1,756	2,008	168	35	2,211
Decrease in provisions	**(679)**	**(168)**	**(149)**	**(996)**	(557)	(158)	(53)	(768)	(644)	(70)	(36)	(750)
Collection of past years' write-offs	**(33)**	**-**	**-**	**(33)**	(55)	-	-	(55)	(35)	-	-	(35)
Net addition (disposal) charged to statement of profit and loss	**506**	**50**	**(149)**	**407**	763	191	(21)	933	1,329	98	(1)	1,426
Write-offs	**(836)**	**(c) (37)**	**-**	**(873)**	(d) (873)	(c) (41)	-	(914)	(457)	(33)	-	(490)
Balance at end of year	**7,250**	**688**	**875**	**8,813**	7,580	675	1,024	9,279	7,803	409	1,040	9,252
Including balance of provision not deducted from credit to the public	**247**	**-**	**117**	**364**	236	-	128	364	32	-	122	154

(a) Not including provision for interest in respect of the period after the debts were determined to be doubtful. With respect to loans in arrears for which a provision was established to the extent of the arrears, no accrual for interest was recorded thereon.

(b) Including a general provision for doubtful debts in the amount of NIS 694 million (31 December 2006 - NIS 710 million; 31 December 2005 – NIS 761 million). Including a special provision of NIS 2 million.

(c) See Section (D), below, overdue payments on housing loans in 2006 include classification of a provision from interest to principal in a subsidiary.

(d) Restated.

Note 4 - Credit to the Public (cont'd)

Reported amounts

D. Overdue payments on housing loans and provisions for doubtful debts according to period of arrears

	From three months to six months	From six months to fifteen months	From fifteen months to Thirty three	More than thirty three months	Balances of rescheduled loans	Total
	NIS millions					
December 31, 2007						
Overdue amount	**14**	**28**	**39**	**419**	**88**	**588**
Of which: interest on Overdue amount	**-**	**1**	**3**	**216**	**6**	**226**
Balance of provision for doubtful debts according to period of arrears (a)	**-**	**90**	**117**	**371**	**110**	**688**
Balance of loan less Provision	**403**	**272**	**86**	**36**	**129**	**926**
December 31, 2006						
Overdue amount	19	34	44	427	31	555
Of which: interest on Overdue amount	1	2	4	224	-	231
Balance of provision for doubtful debts according to period of arrears (a)	-	54	107	418	96	675
Balance of loan less Provision	501	362	129	17	322	1,331

(a) Not including provision in respect of interest on overdue amount.

As from 1 January 2006 Leumi Mortgage Bank applies the Supervisor of Banks of Israel circular dealing with all matters relating to the manner of calculating the provision for doubtful debts with regard to housing credit. The circular determines, inter alia, that a bank that elected to calculate the provisions in respect of loans in accordance with the depth of arrears method, even if not required to do so under the directives, is not entitled to reduce the provisions by deciding to make specific provisions. In addition, clarifications were given as to the manner of calculating the depth of arrears, directives as to the manner of calculating the provision in respect of arrangements and rescheduling of loans and also with respect to the manner of calculating the provision in respect of loans in which the principal is repaid in one payment. Furthermore, the circular relates to the settlement of a debt in arrears after the balance sheet date and does not allow a reduction of the provision even if cash is received in respect of the arrears after balance sheet date.

The effect of the circular on the provision for doubtful debts is a non-recurring addition of NIS 64 million, in respect of adjustment of the opening balance for 2006. In addition, the directives state that the definition of a housing loan for purposes of the financial report will also include loans “all-purpose” loans made secured by a lien on a residential unit. The impact of this directive on Bank Leumi is with respect to classification of the doubtful debt provisions.

Note 4 - Credit to the Public (cont'd)

Reported amounts

E. Details on housing loans and the method of calculating the specific provision

	31 December 2007						31 December 2006					
	Problematic debts						Problematic debts					
				Specific provision						Specific provision		
	Credit	Balance sheet debt balance	Including amount in arrears (b)	According to depth of Arrears	Other	Total	Credit	Balance sheet debt balance	Including amount in arrears (b))	According to depth of arrears	Other	Total
	NIS millions						NIS millions					
Housing loans that require calculating the provision according to depth of arrears	**26,712**	**686**	**342**	**483**	**-**	**483**	26,241	1,027	314	472	-	472
"Large loans" (a)	**4,795**	**142**	**218**	**158**	**-**	**158**	2,372	164	207	155	-	155
Other loans (c)	**5,672**	**132**	**28**	**47**	**5**	**52**	4,135	140	34	48	-	48
Total	**37,179**	**1,020**	**588**	**688**	**5**	**693**	32,748	1,331	555	675	-	675

(a) Housing loans the balance of each is higher than NIS 804 thousand (31 December 2006 – NIS 782 thousand), including loans for purchase and loans for any purpose that are secured by a mortgage.
(b) Including interest on the amount in arrears.
(c) Loans for any purpose secured by a mortgage, the balance of each is lower than NIS 804 thousand.
(d) Including balance of specific provision in excess of amount required according to depth of arrears in the amount of NIS 135 million (31 December 2006 – NIS 132 million).

Note 4 - Credit to the Public (cont'd)

Reported amounts

F. Classification of credit to the public (a) **and of off-balance sheet credit risk** (b) **according to size of debt per borrower**

Credit per borrower NIS thousands		31 December 2007		
From	To	**Number of borrowers (c)**	**Credit(a)**	**Off balance - sheet credit risk (b)**
			NIS millions	
0	10	**1,031,512**	**1,588**	**5,085**
10	20	**184,019**	**1,305**	**1,258**
20	40	**224,166**	**3,175**	**3,142**
40	80	**205,818**	**5,960**	**5,580**
80	150	**117,256**	**7,655**	**4,941**
150	300	**79,472**	**13,716**	**3,168**
300	600	**48,799**	**18,112**	**2,315**
600	1,200	**16,739**	**11,643**	**2,424**
1,200	2,000	**4,876**	**6,156**	**1,288**
2,000	4,000	**3,732**	**8,319**	**2,184**
4,000	8,000	**2,424**	**10,632**	**3,101**
8,000	20,000	**1,977**	**18,629**	**6,226**
20,000	40,000	**853**	**16,749**	**6,712**
40,000	200,000	**730**	**38,863**	**19,265**
200,000	400,000	**89**	**14,868**	**10,541**
400,000	800,000	**32**	**13,461**	**4,449**
800,000	1,200,000	**5**	**3,499**	**1,234**
1,200,000	1,600,000	**5**	**2,814**	**3,934**
1,600,000	2,000,000	**2**	**2,206**	**1,419**
2,000,000	2,400,000	**1**	**14**	**2,060**
2,400,000	2,794,000	**1**	**2,021**	**773**
		1,922,508	**201,385**	**91,099**

Commencing with the NIS 8,000 thousand credit level, the classification is set forth in accordance with the specific consolidation method; with respect to the other levels of borrowers, credit has been classified according to the category consolidation loans method.

(a) Net of specific provisions for doubtful debts and with the addition of the fair value of derivative instruments in the amount of NIS 2,070 million. Open credit card transactions were allocated to the credit level using the category consolidation method.
(b) Credit risk in respect of off-balance sheet financial instruments as calculated for purposes of per borrower debt limitations.
(c) Number of borrowers according to total credit and credit risk.

Note 4 - Credit to the Public (cont'd)

Reported amounts

F. Classification of credit to the public (a) **and of off-balance sheet credit risk** (b) **according to size of debt per borrower (cont'd)**

Credit per borrower NIS thousands		31 December 2006		
		Number of borrowers (c)	Credit(a)	Off balance - Sheet credit risk (b)
From	To		NIS millions	
0	10	751,750	1,228	3,013
10	20	179,193	991	1,515
20	40	213,735	4,085	1,932
40	80	195,887	5,663	5,290
80	150	114,474	7,166	4,844
150	300	81,680	13,933	3,252
300	600	45,024	16,258	2,277
600	1,200	12,795	8,705	1,873
1,200	2,000	3,844	4,723	1,109
2,000	4,000	3,254	7,155	1,758
4,000	8,000	2,246	9,490	2,978
8,000	20,000	1,861	17,046	5,858
20,000	40,000	867	16,303	7,337
40,000	200,000	699	35,506	20,216
200,000	400,000	86	15,542	7,432
400,000	800,000	34	14,061	4,793
800,000	1,200,000	7	6,139	451
1,200,000	1,600,000	3	955	3,114
1,600,000	2,000,000	1	1,352	362
2,000,000	2,298,000	1	12	2,286
		1,607,441	186,313	81,690

Commencing with the NIS 8,000 thousand credit level, the classification is set forth in accordance with the specific consolidation method; with respect to the other levels of borrowers, credit has been classified according to the category consolidation.

(a) Net of specific provisions for doubtful debts and with the addition of the fair value of derivative instruments.
(b) Credit risk in respect of off-balance sheet financial instruments as calculated for purposes of per borrower debt limitations.
(c) Number of borrowers according to total credit and credit risk.

Note 5 - Credit to Governments

Reported amounts

	31 December 2007	31 December 2006
	NIS millions	
Credit to the Government	**250**	449
Credit to foreign Governments	**392**	571
Total credit to Governments	**642**	1,020

Note 6 - Investments in Companies Included on Equity Basis

Reported amounts

A. Composition:

	31 December 2007	31 December 2006
	Companies included on equity basis	Companies included on equity basis
	NIS millions	
Total investments in shares stated on equity basis (including other assets)	**1,858**	1,242
Including shareholders' loans	**15**	9
Total investments	**1,873**	1,251
Including - post-acquisition profits	**661**	518
Post-acquisition changes in shareholders' equity:		
Translation differences	**(64)**	(22)
Details regarding goodwill and other assets:		
Amortization period	**10-20 years**	10-20 years
Original amount, net	**310**	105
Unamortized balance	**248**	67

	31 December 2007		31 December 2006	
	Book value	**Market value**	Book value	Market value
	NIS millions			
Details on book value and market value of quoted securities:				
The Israel Corporation Ltd.	**1,138**	**5,613**	1,101	2,915
Paz Oil Company Ltd.(a)	**560**	**920**	-	-
Total	**1,698**	**6,533**	1,101	2,915

(a) On 31 December 2006 the investment in Paz Oil Company Ltd. was included under securities – see Note 3 above.

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

Reported amounts

B. Group's equity in profit of companies included on equity basis

	2007	2006	2005
	NIS millions		
Group's equity in operating profit of companies included on equity basis	**205**	187	563
Provision for deferred taxes	**(21)**	(16)	(185)
Group's equity in after-tax operating profits of companies included on equity basis	**184**	171	378

C. Details regarding sale of investee companies

1. **Sale of real holding companies (companies included on equity basis)**

a. On 3 July 2007, the Bank of Israel advised the Bank that it has to sell its holdings in one of the conglomerates (Paz or the Israel Corporation) before 30 June 2009. After discussion in August 2007 on the matter of the Bank's holdings in real holding companies, and in view of the position of the Bank of Israel (and subject to continued discussions with the Bank of Israel which are still in progress in this matter and in which the Bank disagrees with the position of the Bank of Israel), the Bank intends to try and sell its holdings in Paz (15.63% of the equity and voting rights – 15.24% fully diluted) subject to conditions, circumstances and additional examinations and considering the timetables set out by the Bank of Israel (i.e. until 30 June 2009) and subject to that until then there will be no change in the time limits or position of the Bank of Israel.

b. The Bank of Israel advised the Bank that it is required to sell its holdings in two conglomerates (Africa Israel and/or Migdal Insurance Holdings and/or the Israel Corporation) as soon as possible and no later than 30 September 2006. Should one of the two corporations being sold be Migdal Insurance Holdings, the Bank will be entitled to sell its holdings in Migdal Insurance Holdings in stages by 31 March 2008 as follows: by 31 March 2007 the holdings of the Bank in Migdal Insurance Holdings will not exceed 10%, and by 31 March 2008, the Bank will be required to sell the balance of its holdings in Migdal Insurance Holdings (if until such time the Banking Law is not amended so that insurance companies are explicitly exempted from the provisions of Section 24 of the Banking Law). The Bank has received an extension from the Bank of Israel for the sale of its holdings in Migdal Insurance Holdings until 30 June 2008.

On 18 January 2006, the Bank notified the Bank of Israel of its intention to sell its holdings in Africa Israel and in Migdal Insurance Holdings.

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

C. Details regarding sale of investee companies (cont'd):

1. (cont'd)

On 1 February 2006 the Bank's Board of Directors approved entering into a transaction for the sale of the Bank's entire holdings in Africa Israel to Mr. Lev Leviev (the controlling shareholder of Africa Israel) or to a company controlled by him, at a price of NIS 150 per share, reflecting a
company value of NIS 7,075 million. The sale agreement was signed on 13 February 2006. The transaction was completed on 27 March 2006. The total consideration to the Bank for the transactions was some NIS 1,131 million. The net gain from the transaction was some NIS 480 million.

On 5 March 2006 an agreement was signed between the Bank and Leumi Real Holdings Ltd., a wholly owned subsidiary of the Bank ("Leumi Holdings") and between Participatie Maatschappij Graafschap Holland N.V. ("the Purchaser"), a wholly owned subsidiary of Assicurazioni Generali S.p.A., for the sale of shares in Migdal Insurance Holdings owned by the Bank and Leumi Holdings, constituting 10% of the issued and fully paid share capital of the company, for a total consideration of some US$ 142 million.

After receipt of the approval of the Supervisor of Insurance, the transaction was completed on 15 March 2006. The net capital gain from the transaction amounted to some NIS 237 million.

Following the completion of the transaction, 9.98% of the issued and fully paid share capital of Migdal Insurance Holdings remains in the hands of the Bank and the investment is shown under securities.

2. Following legislative reform in the capital market the Bank implemented the following measures:

On 10 September 2006, the Bank, Psagot-Ofek Investments House Ltd. and its subsidiaries sold their activities, including their assets and liabilities, this being further to the agreement dated 23 June 2006. The consideration received amounted to NIS 1,284 million and the net gain amounted to NIS 681 million.

On 16 November 2006, the Bank and Leumi Pia Mutual Fund Management Company Ltd. sold their holdings activities, including their assets and liabilities, this being further to the agreement dated 15 September 2006. The consideration received amounted to NIS 565 million and the net gain amounted to NIS 335 million.

On 27 December 2006, the Bank and Leumi Gemel sold the goodwill, activity, assets and liabilities in connection with the Otzma, Tauz, Rimon and Central Severance Pay Fund provident funds, which are managed by Leumi Gemel Ltd. The consideration received amounted to NIS 575 million and the net gain amounted to NIS 345 million.

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

C. Details regarding sale of investee companies (cont'd):

2. (cont'd)

On 31 January 2007, the Bank and Leumi Gemel sold the goodwill, activity, assets and liabilities in connection with the Ya'ad, Rakiya, Siyon, Zur, Sagi, Keshet, Sagnon (Maslulit), Central Severance Pay Fund, Illness Fund and Nidbachim provident funds, which are managed by Leumi Gemel Ltd. The consideration received amounted to NIS 418 million and the net gain amounted to NIS 257 million, which will be recorded in the statement of income in the first quarter of 2007.

On 15 July 2007 the sale was completed of the activities of Kahal Staff Training Fund Ltd. ("Kahal") and Kahal Maslulim Training Fund (managed by Kahal – Training Funds Management (1996) Ltd. - "Kahal Management"), in accordance with the agreement signed on 26 May 2006 between the Bank, Israel Discount Bank Ltd., Kahal and Kahal Management, and Migdal Capital Markets (1965) Ltd. for a company under its control and Migdal Insurance Holdings for a company under its control ("the purchaser"), for the sale of goodwill, management rights, additional rights and means of control of the banks in Kahal, and the sale of goodwill, activities, assets and liabilities in connection with training funds managed by Kahal Management; this for the consideration of the amount of NIS 264 million. The Bank's share in the amount of the consideration is NIS 150 million. The net profit of the Bank, after adjustments and provisions for taxation, is about NIS 93 million.

In addition, the Bank entered into an agreement with Kahal and with the purchaser for provision of operational services by the Bank to the funds being sold, as well as a distribution agreement, pursuant to which the Bank will distribute the funds. The Bank intends to provide consultancy services to its customers regarding investments in training funds by means of investment advisors.

3. Details regarding purchase of investee companies

On 4 August 2006 the transaction was completed between the Bank and Kolal B.V. ("Kolal"), which was the controlling shareholder of Eurom Bank S.A., pursuant to which the Bank acquired over 99% of the issued and paid up share capital of Eurom Bank from Kolal, for a consideration of some US$ 46 million. The name of the Bank was changed to Bank Leumi Romania.

In September 2006 the Bank increased the shareholders' equity of Bank Leumi Romania by some US$ 19 million.

In 2007 the Bank increased the shareholders' equity of Bank Leumi Romania by some US$ 36 million. At the beginning of 2008, the the shareholders' equity of Leumi Romania was additionally increased by some US$ 14 million.

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

C. Details regarding sale of investee companies (cont'd):

As of the third quarter of 2006 the financial statements of Bank Leumi Romania are consolidated with the financial statements of the Leumi Group.

Principal data regarding Bank Leumi Romania as at the acquisition date:

Total assets – US$ 184.8 million
The excess of the acquisition cost over the Bank’s portion of the shareholders’ equity – NIS 115 million.
Total credit to the public – US$ 73.3 million
Total deposits of the public – US$ 142.8 million
Shareholders’ equity – US$ 35.4 million
The loss of Bank Leumi Romania for 2006 – US$ 6.7 million
The loss of Bank Leumi Romania for 2005 – US$ 6.5 million

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

Reported amounts

D. Details concerning principal subsidiaries and companies included on equity basis

(1) Subsidiaries (a)

Name of company	Principal area of activity	Percentage granting a right to profits		Percentage of voting rights		Investment in shares – net asset value	
	At 31 December 2007	31 December		31 December		31 December	
		2007	2006	**2007**	2006	**2007**	2006
		%	%	**%**	%	NIS millions	
In Israel							
Arab-Israel Bank Ltd.	General banking services	**99.7**	99.7	**99.7**	99.7	**324**	323
Leumi Mortgage Bank Ltd.	Provision of housing loans	**100.0**	100.0	**100.0**	100.0	**2,015**	1,790
Leumi Agricultural Development Ltd.		**100.0**	100.0	**100.0**	100.0	**59**	61
Leumi Industrial Development Ltd.		**99.6**	99.6	**99.8**	99.8	**105**	103
Leumi and Co. Investment House Ltd. (c)	Business and financial services	**100.0**	100.0	**100.0**	100.0	**431**	212
Leumi Leasing and Investments Ltd. (d)	Equipment leasing and granting Loans	**99.5**	99.5	**99.7**	99.7	**811**	765
Leumi Finance Company Ltd.	Raising capital by bond issues	**100.0**	100.0	**100.0**	100.0	**154**	157
Leumi Card Ltd.	Provision of credit card services	**100.0**	100.0	**100.0**	100.0	**190**	86
Leumi Securities and Investments Ltd. (e)		**100.0**	100.0	**100.0**	100.0	**42**	822
Leumi Capital Market Services Ltd. (f)	Operating services to provident funds	**100.0**	100.0	**100.0**	100.0	**26**	385
Leumi Financial Holdings Ltd.	Financial holdings	**100.0**	100.0	**100.0**	100.0	**181**	497

See footnotes on page 307.

Note 6 - Investments in Companies Included On Equity Basis (cont'd)

Reported amounts

D. Details concerning principal subsidiaries and companies included on equity basis (cont'd)

(1) Subsidiaries (a) (cont'd)

Name of company	Other equity investments		Contribution to net operating profit		Contribution to net profit from extraordinary transactions		Dividend received		Other items in shareholders' equity (b)		Guarantees on behalf of the Guarantees on behalf of the subsidiary in favor of parties outside the Group	
	31 December		For year ended 31 December						31 December		31 December	
	2007	2006	**2007**	2006	**2007**	2006	**2007**	2006	**2007**	2006	**2007**	2006
	NIS millions		NIS millions		NIS millions		NIS millions		NIS millions		NIS millions	
In Israel												
Arab-Israel Bank Ltd.	**-**	-	**88**	61	**-**	-	**90**	60	**3**	1	**-**	-
Leumi Mortgage Bank Ltd.	**68**	81	**219**	50	**-**	-	**-**	-	**6**	(2)	**5**	5
Leumi Agricultural Development Ltd.	**-**	-	**2**	1	**(1)**	3	**4**	3	**-**	-	**-**	-
Leumi Industrial Development Ltd.	**-**	-	**4**	2	**-**	-	**2**	3	**-**	-	**-**	-
Leumi and Co. Investment House Ltd. (c)	**722**	511	**128**	5	**-**	-	**-**	-	**92**	29	**21**	20
Leumi Leasing and Investments Ltd. (d)	**-**	-	**43**	24	**-**	-	**-**	-	**3**	44	**-**	-
Leumi Finance Company Ltd.	**-**	-	**10**	7	**-**	-	**8**	9	**(5)**	(2)	**-**	-
Leumi Card Ltd.	**230**	269	**104**	82	**-**	-	**-**	-	**-**	-	**4**	4
Leumi Securities and Investments Ltd. (e)	**-**	31	**12**	41	**-**	681	**792**	-	**-**	-	**-**	-
Leumi Capital Market Services Ltd. (f)	**-**	-	**20**	38	**259**	345	**638**	-	**-**	-	**-**	-
Leumi Financial Holdings Ltd.	**-**	-	**6**	31	**-**	335	**361**	-	**-**	-	**-**	-

See footnotes on page 307.

Note 6 - Investments in Companies Included On Equity Basis (cont'd)

Reported amounts

D. Details concerning principal subsidiaries and companies included on equity basis (cont'd)

(1) Subsidiaries (a) (cont'd)

Name of company	Principal area of activity	Percentage granting a right to profits		Percentage of voting rights		Investment in shares – net asset value	
	At 31 December 2007	31 December		31 December		31 December	
		2007	2006	**2007**	2006	**2007**	2006
		%	%	**%**	%	NIS millions	
Abroad							
Bank Leumi le-Israel Corporation	Holding company - registered in the U.S.	**100.0**	100.0	**100.0**	100.0	**558**	595
Bank Leumi USA (g)	General banking services - registered in the U.S.	**99.9**	99.9	**99.9**	99.9	**1,766**	1,716
Bank Leumi (UK) plc	General banking services - registered in Great Britain	**99.7**	99.7	**99.7**	99.7	**741**	756
Bank Leumi le-Israel (Switzerland) (h)	General banking services - registered in Switzerland	**84.1**	81.9	**93.9**	93.1	**523**	669
Leumi Re Ltd.	Insurance	**100.0**	100.0	**100.0**	100.0	**106**	97
Bank Leumi (Luxembourg) SA	General banking services - registered in Luxembourg	**100.0**	100.0	**100.0**	100.0	**112**	121
Bank Leumi Romania (i)	General banking services - registered in Rumania	**99.9**	99.7	**99.8**	99.7	**441**	265
Leumi Finance Corporation (j)		**99.9**	99.9	**99.9**	99.9	**5,084**	5,147
Leumi USA Investment Corporation (i)		**99.9**	99.9	**99.9**	99.9	**3,354**	3,654

See footnotes on page 307.

Note 6 - Investments in Companies Included On Equity Basis (cont'd)

Reported amounts

D. Details concerning principal subsidiaries and companies included on equity basis (cont'd)

(1) Subsidiaries (a) (cont'd)

Name of company	Other equity investments		Contribution to net operating profit		Contribution to net profit from extraordinary transactins		Dividend received		Other items in shareholders' equity (b)		Guarantees on behalf of the subsidiary in favor of parties outside the Group	
	31 December		For year ended 31 December						31 December		31 December	
	2007	2006	**2007**	2006	**2007**	2006	**2007**	2006	**2007**	2006	**2007**	2006
	NIS millions		NIS millions		NIS millions		NIS millions		NIS millions		NIS millions	
Abroad												
Bank Leumi le-Israel Corporation	**-**	-	**(36)**	(33)	**-**	-	**-**	-	**(1)**	-	**-**	-
Bank Leumi USA (g)	**-**	-	**(6)**	(58)	**-**	-	**-**	-	**56**	68	**126**	63
Bank Leumi (UK) plc	**331**	294	**45**	138	**-**	-	**45**	280	**(9)**	1	**-**	-
Bank Leumi le-Israel (Switzerland) (h)	**-**	-	**9**	(1)	**-**	-	**171**	-	**(1)**	(7)	**-**	4
Leumi Re Ltd.	**-**	-	**31**	21	**-**	-	**22**	22	**-**	-	**-**	-
Bank Leumi (Luxembourg) SA	**26**	29	**18**	13	**-**	-	**11**	-	**(17)**	-	**-**	-
Bank Leumi Romania (i)	**-**	-	**(32)**	(20)	**3**	-	**-**	-	**-**	-	**-**	-
Leumi Finance Corporation (j)	**-**	-	**(250)**	(255)	**-**	-	**-**	-	**-**	-	**-**	-
Leumi USA Investment Corporation (j)	**-**	-	**(186)**	(158)	**-**	-	**-**	-	**-**	-	**-**	-

See footnotes on next page.

Note 6 - Investments in Companies Included On Equity Basis (cont'd)

D. Details concerning principal subsidiaries and companies included on equity basis (cont'd)

(1) Subsidiaries (a) (cont'd)

<u>Footnotes:</u>

(a) Data regarding subsidiaries reflecting the Bank's investment therein less investments of each company in other companies in the Bank Group, and the Bank's equity in their results less each company's share in other companies in the Bank Group of the above said investments.

(b) Including adjustments from presentation of securities available for sale of subsidiaries according to fair value.

(c) The Bank's share in the capital reserve in respect of the benefit inherent in controlling shareholders' loans is NIS 42 million.

(d) The Bank's share in the capital reserve in respect of the benefit inherent in controlling shareholders' loans is NIS 82 million.

(e) Formerly Psagot Ofek Investments House Ltd. – regarding sale of the activities of this company in 2006 – see Section C(2), above.

(f) On 25 February 2008 the name of Leumi Fund Ltd. was changed to Leumi Capital Market Services Ltd.

(g) Investment in the company by Bank Leumi le-Israel Corporation.

(h) In 2007, the Bank acquired approximately 2.2% of the share capital of Bank Leumi le-Israel (Switzerland) (2006 – 7.0%). The investment includes a balance of goodwill, in the amount of NIS 40 million in 2007 (2006 – NIS 39.8 million).

(i) In 2007 the Bank purchased 0.16% of the equity of Bank Leumi Romania (in 2006 – 99.7%). In 2007 Bank Leumi Romania issues shares to its shareholders. The investment includes a balance of goodwill, in the amount of NIS 97.5 million (31 December 2006 – NIS 109 million).

(j) Property companies established by Bank Leumi U.S.A. and that are consolidated in the their financial statements. The companies have shareholders' equity against credit transferred from Bank Leumi U.S.A. As a result of adjustment of the financial statement and translation thereof into shekels, income (losses) on the capital were created, which are offset from Bank Leumi U.S.A.

Note 6 - Investments in Companies Included On Equity Basis (cont'd)

Reported amounts

D. Details concerning principal subsidiaries and companies included on equity basis (cont'd)

(2) Companies included on equity basis (a)

Name of company	Principal area of activity	Percentage granting a right to profits		Percentage of voting rights		Investment in shares – net asset value	
		31 December		31 December		31 December	
		2007	2006	**2007**	2006	**2007**	2006
		%	%	**%**	%	NIS millions	
The Israel Corporation Ltd. (b)	Holding company	**18.3**	18.3	**18.3**	18.3	**1,138**	1,101
Paz Oil Company Ltd. (c)	Delivery of energy products and management of refueling and commerce areas	**15.6**	-	**15.6**	-	**560**	-

See footnotes on next page.

Note 6 - Investments in Companies Included On Equity Basis (cont'd)

Reported amounts

D. Details concerning principal subsidiaries and companies included on equity basis (cont'd)

(2) Companies included on equity basis (a) (cont'd)

Name of company	Investment in shares – market value		Contribution to net operating profit		Dividend received		Other items in shareholders' equity		Guarantees on behalf of the investee in favor of parties outside the Group	
	31 December		For the year ended 31 December				31 December		31 December	
	2007	2006	**2007**	2006	**2007**	2006	**2007**	2006	**2007**	2006
	NIS millions									
The Israel Corporation Ltd. (b)	**5,613**	2,915	**110**	129	**45**	54	**(40)**	(50)	**8**	-
Paz Oil Company Ltd. (c)	**920**	-	**65**	-	**14**	-	**-**	-	**402**	-

(a) The data regarding companies included on equity basis are on a consolidated basis.
(b) Includes balance of other assets in the amount of NIS 61 million (31 December 2006 - NIS 66 million).
(c) The investment includes balance of goodwill and other assets in the amount of NIS 186 million.

Note 7 - Buildings and Equipment

Reported Amounts

A. Composition:

	Buildings and real estate (a)	Equipment, furniture and motor vehicles	Total
	NIS millions		
Cost			
As at 31 December 2006	**3,068**	**5,900**	**8,968**
Additions	**124**	**591**	**715**
Disposals	**(55)**	**(760)**	**(815)**
As at 31 December 2007	**3,137**	**5,731**	**8,868**
Accumulated Depreciation			
As at 31 December 2006	**1,520**	**4,392**	**5,912**
Current year provision	**67**	**393**	**460**
Recognized losses from impairment	**3**	**-**	**3**
Cancelled losses from impairment	**(8)**	**-**	**(8)**
Disposals	**(22)**	**(753)**	**(775)**
As at 31 December 2007	**1,560**	**4,032**	**5,592**
Balance after depreciation as at 31 December 2007	**1,577**	**1,699**	**3,276**
Balance after depreciation as at 31 December 2006	**1,548**	**1,508**	**3,056**

(a) Including leasehold installations and improvements.

Note 7 - Buildings and Equipment (cont'd)
Reported Amounts

B. Average depreciation rates:

	31 December 2007	31 December 2006
Buildings and real estate	**2.88%**	2.99%
Equipment, furniture and motor vehicles	**15.42%**	17.56%

C. The Group has rental or lease rights on real estate and equipment for a period of from 1 to 94 years from the balance sheet date in an amount (net of depreciation) of NIS 135 million (31 December 2006 - NIS 132 million).

D. Investment property - buildings and real estate not used by the Group, mainly rental buildings, amount to NIS 31 million in the balance sheet (31 December 2006 - NIS 18 million).

E. The item "buildings" includes improvements and leasehold rights, including payments on account. Some of the buildings are on leased land. Assets in the amount of NIS 217 million (31 December 2006 - NIS 220 million) in the balance sheet have not yet been registered at the Land Registry Office in the name of the Bank. The principal reasons for the non-registration are the absence of a land registry arrangement in the area (parcellation), and non-registration of the project as a condominium building by the contractor/developer.

F. Buildings earmarked for sale, in the amount of NIS 54 million (31 December 2006 - NIS 22 million) are shown net of a provision for anticipated losses. The fair value of the assets earmarked for sale at 31 December 2007 was NIS 63 million.

G. The balance of equipment includes capitalized costs relating to the development of computer software in the amount of NIS 90 million (31 December 2006 - NIS 86 million).

Note 8 - Other Assets
Reported Amounts

	31 December 2007	31 December 2006
	NIS millions	
Deferred tax asset, net - see Note 26I	**1,265**	1,194
Excess of deposits for severance pay over provision – see Note 15F	**262**	267
Assets transferred to ownership of the Group as a result of settlement of problematic credit	**38**	35
Investment in insurance policies in foreign branch	**369**	390
Goodwill	**142**	154
Excess of advance tax payments over current provisions	**127**	20
Issue expenses of debentures, bonds and subordinated notes	**44**	42
Debit balances in respect of derivative instruments (except embedded derivatives)	**4,947**	3,496
Accrued income	**142**	134
Prepaid expenses	**121**	129
Ma'of Clearing House	**-**	131
Other receivables and prepayments	**193**	238
Total other assets	**7,650**	6,230

Note 9 - Deposits of the Public
Reported Amounts

	31 December 2007	31 December 2006
	NIS millions	
Demand deposits	**33,447**	29,611
Time and other deposits	**197,480**	192,475
Deposits in savings plans (before the reform)	**7,118**	9,737
Total deposits of the public	**238,045**	231,823

Note 10 - Deposits from Banks

Reported Amounts

	31 December 2007	31 December 2006
	NIS millions	
Commercial banks:		
Demand deposits	**3,129**	799
Time deposits	**1,874**	3,486
Acceptances	**947**	588
Central banks:		
Demand deposits	**10**	74
Specialized banking entities:		
Demand deposits	**179**	294
Total deposits from banks	**6,139**	5,241

Note 11 - Debentures, Bonds and Subordinated Notes

Reported Amounts

	Average maturity (a)	Internal Rate of return (a)	31 December **2007**	31 December 2006
	Years	%	NIS millions	
Debentures and Bonds (b)				
In Israeli currency linked to the CPI (d)	**2.98**	**4.73**	**2,201**	2,158
In unlinked Israeli currency	**0.78**	**5.61**	**723**	680
Subordinated notes (b)				
Unlinked Israeli currency	**3.13**	**6.92**	**119**	119
In Israeli currency:				
- linked to the CPI	**4.71**	**4.88**	**13,620**	9,703
- linked to the U.S. dollar	**(c) 1.66**	**6.22**	**505**	551
In U.S. dollars	**(c) 3.69**	**6.06**	**2,080**	2,411
Total debentures, bonds and subordinated notes			**19,248**	15,622

Debentures issued by Israeli subsidiaries are secured by liens registered on their assets - see Note 14.

(a) The average maturity is the average of the payment periods, weighted according to the payment flow discounted at the internal yield rate. The internal yield rate is the rate of interest discounting the value of the anticipated future flow of payments to the amount included in the balance sheet.

(b) The unamortized balance of the discount less the premium on debentures and on subordinated notes has been deducted from the amount of the debentures.

(c) The average life as of the change in interest in subordinated notes linked to the U.S. dollar is 0.58 years and subordinated notes in U.S. dollars is 0.78 years.

(d) Of which, subordinated notes (non-marketable) in the amount of NIS 442 million (31 December 2006 - NIS 430 million) that, in certain circumstances, may be converted to shares. See Note 13.a.

Note 12 - Other Liabilities
Reported Amounts

	31 December 2007	31 December 2006
	NIS millions	
Deferred tax liability, net – see Note 26I	**117**	104
Excess of current provisions for taxes over advance payments	**108**	1,269
Excess of provisions for severance pay and pensions over amounts funded - see Note 15F	**2,673**	2,708
Provisions for unutilized vacations and long service bonus	**712**	671
Deferred income	**407**	428
Credit balances in respect of derivative instruments (except embedded derivatives)	**4,647**	2,792
Provision for doubtful debts in respect of off-balance sheet items	**397**	364
Accrued expenses in respect of salaries and related expenses	**839**	596
Proposed dividend	**1,414**	2,500
Payables in respect of credit cards	**4,684**	4,119
Accrued expenses	**401**	378
Market value of securities sold short	**520**	-
Other payables and credit balances	**717**	937
Total other liabilities	**17,636**	16,866

Note 13 - Shareholders' Equity and Capital Adequacy

A. Share capital

	31 December 2007		31 December 2006	
	Authorized	**Issued and paid**	Authorized	Issued and paid
	NIS	**NIS**	NIS	NIS
Ordinary shares of NIS 1.0 each	**1,715,000,000**	**1,414,232,680(a)**	1,715,000,000	1,414,232,680

(a) Until 10 March 2008 NIS 1,460,826,331 after exercise of options. For details see below in Note 15.D.

All issued shares are registered in the names of the shareholders.
The issued shares have been converted into ordinary stock which is transferable in units of NIS 1.0.
The ordinary stock is listed on the Tel-Aviv Stock Exchange.

In 2002, NIS 400 million par value deferred deposits/capital notes (non-marketable), repayable on 30 June 2101, were issued. The deferred deposits/capital notes were recognized by the Bank of Israel as upper tier II capital of the Bank. In certain circumstances, as defined by the Supervisor of Banks, the capital notes may be converted to 138,064,557 ordinary shares of the Bank.

On 2 February 2006, the General Meeting of the Bank approved an option plan for employees of the Bank, Leumi Mortgage Bank Ltd., Arab-Israel Bank Ltd. and the Bank Leumi le-Israel Restaurant Association R.S., as provided in the plan published on 24 January 2006.

In accordance with the option plan, 84,853,960 options were issued on 14 February 2006 to the above mentioned employees. The options are exercisable into 84,853,960 ordinary shares of NIS 1.0 of the Bank (about 6% of the issued share capital of the Bank as of the date of the allotment).

The options were exercisable in two equal portions: the first of them - at the end of two years from the date of the allotment of the options, in February 2008, which were exercised in full, and the second - from the end of the second year from the date of the allotment and up to the end of the third year from the date of the allotment of the options.

Regarding the exercising of share options by the employees – see Note 15D below.

On 14 June 2006, Bank employees purchased 2.8478% of the capital of the Bank (40,274,560 ordinary shares, of which, 75,532 were purchased by the Chief Executive Officer), in accordance with an outline published on 9 May 2006 (and amended on 10 and 25 May 2006). On 3 July 2006, the General Meeting approved the purchase of 59,131 ordinary shares by the Chairman of the Board of Directors of the Bank, and the purchase was carried out on 5 July 2006.

The purchase of the shares was carried out in accordance with an agreement from March 2006 with the Accountant-General regarding an offer of the Bank's ordinary shares to the employees of the Bank by the State, in accordance with the agreements in respect of the privatization of the Bank and decisions of the Finance Committee of the Knesset. According to the above agreement, the shares would be offered to the employees in two stages, the first of which, an offer of 2.873% of the share capital, has been carried out, as mentioned above. The second stage, in which a further 1% of the Bank's share capital will be offered to the employees, will be carried out after completion of the privatization process.

For additional information see Note 15E below.

Note 13 - Shareholders' Equity and Capital Adequacy (Cont.)

B. Dividend policy for the years 2006-2008

On 29 March, 2006 the Board of Directors of the Bank determined the following dividend policy:

The Board of Directors intends to recommend to the General Meeting distribution of an annual dividend for the years 2006 and 2007 in an amount constituting at least 50% of the Bank's annual net income available for distribution, in the event that no negative change is evident in the Bank's earnings and/or in its business situation and/or in the situation in the economy in general and/or in the legal or fiscal environment.

All dividend distributions will be implemented in accordance with the provisions of the Companies Law - 1999, stating, *inter alia*, that the Bank is entitled to make a distribution from its profits as long as it is not reasonably expected that such distribution will prevent the Bank from being able to fulfill its existing and expected liabilities, as of the date of their maturity. Also, the Bank is required to fulfill limitations and restrictions fixed by the Supervisor of Banks, e.g. capital adequacy ratio of not less than 9%, fulfillment of the provisions of Section 23A of the Banking Law (Licensing), 1981, restricting the rate of capital that a banking institution may invest in real entities, and fulfillment of limitations and restrictions fixed by the Supervisor of Banks regarding granting of credit as a percentage of capital and regarding distribution of dividends, e.g. a dividend will not be distributed in the event that the non-monetary assets exceed the capital or in the event that such distribution will result in this situation; a dividend will not be distributed from capital reserves or from payable differences derived from translation of financial statements of autonomous units abroad; or when a loss was recorded in respect of one or more of the last three calendar years.

The above declaration of dividend policy does not purport to constitute any commitment toward any third party (including regarding dates of dividend payment or rate of dividend distribution in the future).

In January 2008 the Board of Directors of the Bank decided to extend the above dividend policy also for 2008.

Dividend for 2007

The Extraordinary General Meeting that convened on 17 January 2008 approved the recommendation of the Board of Directors from 11 December 2007 regarding distribution of a cash dividend at the rate of 49.8% of the net income for the first nine months of 2007 (approximately NIS 1.414 million), and at a rate of 100.0% of the paid-up share capital.
The dividend was paid on 5 February 2008 to the shareholders that held shares of the Bank on 20 January 2008 (the determining date). The shares were traded "ex dividend" on 21 January 2008. The dividend was at a rate of NIS 1.0 for each ordinary share of NIS 1.0 par value.
The Board of Directors decided in its meeting on 30 March 2008 to recommend to the next Annual General Meeting the distribution of an additional cash dividend for 2007 at the rate of 52.2% of the net income for the fourth quarter of 2007 (approximately NIS 270 million) approximately 18 agorot per share. The dividend will be paid on 30 June 2008, subject to the approval of the next General Meeting, to the shareholders holding shares of the Bank on 17 June 2008 (the determining date). The shares will be traded "ex dividend" on 18 June 2008.

Note 13 - Shareholders' Equity and Capital Adequacy (Cont.)

Based on the issued share capital at 10 March 2008, the dividend is at a rate of about 18.5% of the paid-up share capital. If additional options will br exercised before the determining date, the rate of the dividend on the paid-up share capital and the dividend per share will be reduced respectively. The dividends for the year 2007 will total NIS 1,684 million which is 50.2% of the ner profit for 2007, and is at a rate of NIS 1.185 for each ordinary share of NIS 1.0 nominal value (subject to change due to the above exercise of options.

Dividend for 2006

The Extraordinary General Meeting that convened on 14 February 2007 approved the recommendation of the Board of Directors from 24 December 2006 regarding distribution of a cash dividend at the rate of 101.6% of the net income for the first nine months of 2006 (approximately NIS 2,500 million), at a rate of 176.8% of the paid-up share capital.
The dividend was paid on 28 February 2007 to the shareholders that held shares of the Bank on 15 February 2007 (the determining date). The shares were traded "ex dividend" on 18 February 2007. The dividend was at a rate of NIS 1.768 for each ordinary share of NIS 1.0 par value.

Dividend policy for the years 2003- 2005

The dividend policy for the years 2003-2005, inclusive, was to recommend to the General Meeting distribution of a dividend in an amount constituting at least 35% of the Bank's annual net income available for distribution, similar to the policy for 2006 and 2007 detailed above.

Dividend for 2005

The Extraordinary General Meeting that convened on 2 February 2006 approved the recommendation of the Board of Directors from 4 December 2005 regarding distribution of a cash dividend at the rate of 65.9% of the net income for the first nine months of 2005 (approximately NIS 1,103 million), at a rate of 78.0% of the paid-up share capital. The dividend was paid on 28 February 2006 to the shareholders that held shares of the Bank on 15 February 2006 (the determining date). The shares were traded "ex dividend" on 16 February 2006. The dividend was at a rate of NIS 0.78 for each ordinary share of NIS 1.0 par value.

Note 13 - Shareholders' Equity and Capital Adequacy (Cont.)

Reported Amounts

C. Capital adequacy

Calculated pursuant to Directives Nos. 311 and 341 issued by the Supervisor of Banks, regarding minimum "capital ratio" and "allocation of capital in respect of exposure to market risks" And certain disclosure requirements in accordance with Pillar 3 of Basel II.

	31 December 2007	31 December 2006
	NIS millions	
(1) Bank's capital for purposes of calculating the capital ratio		
Tier I capital:		
Share capital	**7,000**	7,000
Capital reserves from share-based payment trasactions and others	**610**	405
Unrealised losses, from adjustments to fair value of shares available for sale	**(22)**	(2)
Adjustments from translation	**(445)**	(403)
Accumulated reserves	**12,286**	10,343
Loans to employees for purchasing shares of the Bank	**(404)**	(477)
Less goodwill	**(288)**	(154)
Minority interests in equity of consolidated companies	**105**	152
Total Tier 1 capital	**18,842**	16,864
Tier II capital:		
Upper tier II capital (a)	**855**	843
Other tier II capital	**9,127**	8,219
Tier III capital (b)	**-**	41
Less investments in shares and subordinated notes of financial companies (d)	**(87)**	(83)
Total capital	**28,737**	25,884

See footnotes on page 320.

Note 13 - Shareholders' Equity and Capital Adequacy (Cont.)

C. Capital adequacy (cont'd)

31 December 2007

	Balances (c) NIS millions	**0%**	**Weighting percentages** **20%**	**50%**	**100%**	**Deductn. from equity**	**Risk balances**	**Capital require-ment**
(2) Weighted risk balances and capital requirement								
Assets								
Cash and deposits with banks	**42,329**	**8,253**	**34,073**	**-**	**3**	**-**	**6,818**	**614**
Securities (d)	**47,169**	**15.456**	**18,135**	**-**	**13,578**	**-**	**17,205**	**1,548**
Securities borrowed or purchased under agreements to resell	**655**	**655**	**-**	**-**	**-**	**-**	**-**	**-**
Credit to the public (a)	**198,890**	**14,842**	**1,689**	**14,676**	**167,683**	**-**	**173,359**	**15,782**
Credit to governments	**642**	**563**	**-**	**-**	**79**	**-**	**79**	**7**
Investments in companies included on equity basis (d)	**1,873**	**-**	**-**	**-**	**1,808**	**65**	**1,808**	**163**
Buildings and equipment	**3,276**	**-**	**-**	**-**	**3,276**	**-**	**3,276**	**295**
Other assets	**7,650**	**404**	**2,809**	**-**	**4,149**	**288**	**4,711**	**424**
Total assets	**302,484**	**40,173**	**56,706**	**14,676**	**190,576**	**353**	**209,256**	**18,833**

	Balances (c)	Balance sheet equivalent	0%	Weighting percentages 20%	50%	100%	Risk balances	Capital require-ment
Off-balance sheet instruments								
Transactions in which the balance reflects a credit risk	**93,141**	**26,658**	**2,418**	**1,202**	**-**	**23,038**	**23,278**	**2,095**
Derivative financial instruments	**226,230**	**23,113**	**678**	**15,076**	**-**	**7,359**	**10,374**	**934**
Other	**1,123**	**112**	**-**	**-**	**-**	**112**	**112**	**10**
Total off-balance sheet instruments	**320,494**	**49,883**	**3,096**	**16,278**	**-**	**30,509**	**33,764**	**3,039**
Total credit risk assets							**243,020**	**21,782**
Market risk							**6,531**	**588**
Total risk assets							**249,551**	**22,460**

See footnotes on page 320.

Note 13 - Shareholders' Equity and Capital Adequacy (Cont.)

C. Capital adequacy (cont'd)

31 December 2006

(2) Weighted risk balances and capital requirement

	Balances (c) NIS millions	0%	20%	50%	100%	Deductn. from equity	Risk balances	Capital require-ment
		Weighting percentages						
Assets								
Cash and deposits with banks	47,609	5,642	41,574	-	393	-	8,708	784
Securities (d)	46,375	18,135	18,810	-	9,430	-	13,192	1,187
Credit to the public (a)	184,132	14,200	1,674	13,562	154,696	-	161,812	14,563
Credit to governments	1,020	868	-	-	152	-	152	14
Investments in companies included on equity basis (d)	1,251	-	-	-	1,188	63	1,188	107
Buildings and equipment	3,056	-	-	-	3,056	-	3,056	275
Other assets	6,230	173	1,877	-	4,026	154	4,401	396
Total assets	289,673	39,018	63,935	13,562	172,941	217	192,509	17,326

	Balances (c)	Balance sheet equivalent	0%	20%	50%	100%	Risk balances	Capital require-ment
			Weighting percentages					
Off-balance sheet instruments								
Transactions in which the balance reflects a credit risk	84,825	22,988	3,191	802	-	18,995	19,155	1,724
Derivative financial instruments	129,321	13,740	548	7,877	-	5,315	6,890	620
Other	999	100	-	-	-	100	100	9
Total off-balance sheet instruments	215,145	36,828	3,739	8,679	-	24,410	26,145	2,353
Total credit risk assets							218,654	19,679
Market risk							5,184	467
Total risk assets							223,838	20,146

(a) General provision for doubtful debts of NIS 428 million constituting part of the upper tier II capital (31 December 2006 - NIS 428 million). General provision for doubtful debts in the amount of NIS 333 million is not deducted from loans to the public (31 December 2006 – NIS 332 million).

(b) Held against market risks only.

(c) Assets – balance sheet balances, off-balance sheet instruments – stated value weighted on the basis of credit conversion factors.

(d) Balances of investments in shares and in deferred liability notes of financial companies are deducted from equity and therefore also from the balance of securities and from investments in affiliated companies.

Note 13 - Shareholders' Equity and Capital Adequacy (Cont.)

C. Capital adequacy (cont'd)

	31 December 2007	31 December 2006
	%	%
(3) Ratio of capital to risk assets on a consolidated basis		
The ratio of tier I capital to risk assets	**7.55**	7.53
The ratio of total capital to risk assets	**11.52**	11.56
Ratio of total minimum capital to risk assets required by the Supervisor of Banks	**9.00**	9.00
(4) Capital adequacy in principal subsidiaries		
Bank Leumi Mortgage Bank Ltd.		
The ratio of tier I capital to risk assets	**6.63**	6.42
The ratio of total capital to risk assets	**9.96**	9.69
Ratio of total minimum capital to risk assets required by the Supervisor of Banks	**9.00**	9.00
Arab-Israel Bank Ltd.		
The ratio of tier I capital to risk assets	**16.00**	19.01
The ratio of total capital to risk assets	**16.38**	19.49
Ratio of total minimum capital to risk assets required by the Supervisor of Banks	**9.00**	9.00
Bank Leumi USA		
The ratio of tier I capital to risk assets	**8.23**	8.13
The ratio of total capital to risk assets	**11.03**	11.45
Ratio of total minimum capital to risk assets required by the local Authorities	**10.00**	10.00
Bank Leumi (UK) plc		
The ratio of total capital to risk assets	**14.13**	15.85
Ratio of total minimum capital to risk assets required by the local Authorities	**12.50**	12.50

Note 14 - Liens and Restrictive Conditions on Assets

Debentures and bonds issued by Israeli subsidiaries amounting to NIS 43 million (31 December 2006 - NIS 66 million) are secured by floating charges on their assets. Foreign branches and subsidiaries have pledged securities and other assets as security for deposits received from the Federal Home Loan Bank and certain obligations pursuant to requirements of the authorities of the countries in which they operate. Pledged assets amount to NIS 1,931 million (31 December 2006 - NIS 2,571 million). The total liabilities in respect of which the assets were pledged amount to NIS 1,358 million (31 December 2006 - NIS 1,871 million).

The Bank recorded a pledge on a securities deposit, at the request of the Euroclear clearing house, in favor of Morgan Guaranty Trust Company Of New York, in the amount of the liability created from time to time in respect of actual utilization of credit by the Bank which was not repaid, for purposes of securities transactions through the said clearing house. The credit limit against which the securities were pledged as at 31 December 2007 amounted to approximately US$ 193 million (31 December 2006 - $ 73 million).

The Bank transferred to CIBC a number of bonds from its available portfolio for the purpose of regularizing short transactions of the Bank's customers in American stocks. Interest on these bonds is paid to Leumi. The total of the bonds transferred as at 31 December 2007 is about $ 22 million and as at 31 December 2006 – about $ 41 million.

The Bank is a member of the TASE Clearing House Ltd. and the Maof Clearing House Ltd. The Bank (like every other clearinghouse member) pledges securities to these clearing houses as security for transactions of its customers, nostro transactions and the mutual guarantee of the clearinghouse members.

Each of the members in the risk fund charges collateral in favor of the Stock Exchange Clearing House in the amount of its proportionate part in the fund, which will secure the member's liabilities to the Clearing House and the member's share in the risk fund. Furthermore, such collateral will also secure the liabilities of the other members of the risk fund, if the collateral that the other member provided will not be sufficient to cover the other member's liabilities, and in accordance with the proportionate part of each of the members in the fund up to the amount of the collateral given or up to the amount of the liabilities to the Stock Exchange Clearing House, whichever is the lower.

Securities pledged for the activity described above are government type bonds and Makam, and their total as at 31 December 2007 was about NIS 2.5 billion and as at 31 December 2006, about NIS 1.8 billion.

In preparation for the operation of the Zahav (RTGS) System for intra-day real-time settlement of payments, the Bank signed a debenture on 23 July 2007, in favor of the Bank of Israel to secure amounts received or to be received by the Bank from the Bank of Israel. As security for this, the Bank pledged in favor of the Bank of Israel by way of an unlimited floating charge government type bonds and Makam deposited in a specific account held in the Tel Aviv Stock Exchange Clearing House in the name of the Bank of Israel. The balance of the account as at 31 December 2007 was about NIS 3.2 billion. On 31 December 2006, for purposes of managing the Bank's liquidity, prior to the operation of the Zahav (RTGS) System, the Bank pledged in favor of the Bank of Israel a floating charge on its stock of Makam, Gilon, Shahar and Galil debentures up to an amount of NIS 12.0 billion. This debenture was cancelled on 31 December 31 2007 with the agreement of the Bank of Israel.

Note 14 - Liens and Restrictive Conditions on Assets (cont'd)

As at 31 December 2007, the Bank had no borrowings from the Bank of Israel (31 December 2006 – NIS 58 million only). The highest balance of borrowings from the Bank of Israel in 2007 based on month-end balances amounted to NIS 10,128 million and the average balance for 2007 amounted to NIS 3,699 million. On the other hand, the balance of deposits with the Bank of Israel amounted to NIS 5,773 million (31 December 2006 – NIS 3,711 million). The highest balance based on month-end balances amounted to NIS 8,271 million and the average balance for 2007 amounted to NIS 5,278 million.

	31 December 2007 NIS millions
Sources of securities received which the Bank may sell or pledge, by fair value, excluding set-offs:	
Securities received in securities borrowing transactions against cash	**655**
Uses of securities received as collateral and securities of the Bank, by fair value, excluding set-offs:	
Securities loaned in securities lending transactions against cash	**231**

Apart from these securities, as at the date of the balance sheet, additional securities were given as collateral, shown under "Securities" below, which the lenders are not permitted to sell or pledge.

Note 15 - Employees Rights

A. Group labor agreement regarding privatization

On 30 November, 2005 a special group labor agreement was signed between management of the Bank and the employees' representatives in respect of the privatization process in the Bank. The group labor agreement reinforces the implementation of the employees' option plan, the employees' right to acquire 3.873% of the Bank shares to which the employees are entitled at a discount of 25%, the payment of an advance at the rate of one month's salary for provisions on account of the annual bonus for 2005, and the existing group labor agreements and arrangements in the Bank, as relevant, for a period of five years as from 1 January, 2006.

The employees, on their part, committed in the agreement to refrain from disputes in connection the privatization process in the Bank.

The agreement was approved by the General Meeting on 2 February 2006.

Regarding the implications of the option plan and acquisition of shares by the employees, see paragraphs D and E below.

B. Severance pay and pensions

(1) General

For employees that commenced their employment with the Bank starting 1 January 1999 and had not yet received permanent employment status as at the signing date of the special collective bargaining agreement in 2000 covering a special pension arrangement. Current deposits are made in a pension fund The pension plan is a comprehensive cumulative pension plan with additional insurance for loss of working ability and death. The Bank will not have any pension liability in respect of these employees other than to supplement severance pay according to the agreement.

Employees, who began working with the Bank before 1 January 1999 and have received permanent employment status before the date of signing the aforementioned agreement, that retire from the Bank at retirement age, except those mentioned at the end of this paragraph and in (4) below, may choose between the right to receive severance pay plus their accumulated provident fund, or the right to receive a pension in which case they relinquish their right to the severance pay and provident fund. The right to a pension is calculated at a pension rate of 2.67% per annum for the first 15 years of employment and of 1.5% for each additional year, up to a maximum rate of 70%.

Provisions for severance pay are calculated on the basis of the latest salary, at one month's salary per each year of employment. The fundings in respect of the liabilities for severance pay are deposited with provident funds.

Note 15 - Employees Rights (Cont.)

B. Severance pay and pensions (cont'd)

The provisions for pensions are based on an actuarial calculation that takes into account the change in the retirement age according to the Retirement Age Law, 5764-2004. The actuarial calculation was made according to the accrued benefits valuation method, taking into account various parameters including the probability, based on past experience with respect to the rate of utilization of the pension benefits and the withdrawal rate of severance and remuneration benefits (the distribution is about 65% choosing a pension and 35% choosing severance pay) and past experience regarding disability, etc.

The actuarial examination is based on the updated provisions of the Chief Actuary in the Ministry of Finance with respect to mortality rates from February 2007, which were determined by the Commissioner of the Capital Market, Insurance and Savings for insurance companies, as a result of the change in the rate of improvement in life expectancy and that were adopted for the population of the Bank’s employees (see paragraph (2) below). Following modification to the directives, as stated, an actuarial revision was made in 2006 to the mortality tables at a cost of NIS 214 million (and in 2005, an actuarial revision was made at a cost of NIS 36 million, further actuarial examinations carried out in the Bank that found that life expectancy in the Bank is lower than in the Israsel Mortality Table for 1999).

Calculation of the Bank's actuarial liability for pension payments is made using the capitalization rate determined by the Supervisor of Banks (4%) and on the assumption of a real salary increase based on past experience and varying based on the age of the employee. The rates of increase range from 1.5% to 4.6%. Up to and including 2005, the real salary increase was estimated by Management at an average rate of 2.5% for all the employees.

The calculation is made for a comprehensive pension plan, which includes old age, disability and survivor pensions and also takes into account employees who have not yet completed the period required for receipt of pension benefits (15 years of service).

The balance sheet provisions are based on the higher of the liabilities for severance pay plus the provident benefits and the pension liability. The Bank's pension liability for employees who have left and have opted for pension benefits, as well as that stated in (4) below, is covered by the pension provision, which is calculated based on the present value of the actuarially computed liability, as noted above.

(2) In November 2005 the Supervisor of Banks announced that he was adopting the letter of the Chief Actuary of the Capital Market, Insurance and Savings Department of the Ministry of Finance to the insurance companies, pursuant whereto as from the first quarter of 2006 an insurer must assess the reserves for life insurance policies on the basis of the mortality tables as presented in the position paper sent by the Commissioner of Insurance for the observations of the insurance and pension fund companies in April 2005.

In February 2007 the Chief Actuary of the Capital Market, Insurance and Savings Department of the Ministry of Finance issued additional circulars to the pension funds and insurance companies that apply to financial statements from 31 December 2006, by which the provisions for pension and life insurance are to be assessed on the basis of the new mortality tables.

Note 15 - Employees Rights (Cont.)

B. Severance pay and pensions (cont'd)

(2) (cont'd)

The Bank has adopted the aforementioned mortality tables, as stated in Section (1), above.

(3) Benefits to “Leumi Alumni”

“Leumi Alumni” are entitled to receive, in addition to their individual choice of a pension and/or severance payments, additional benefits which consist mainly of a holiday gift and participation in the cost of additional welfare and social activities.

“Leumi Alumni” – persons who, regardless of their age, have concluded working with the Bank after 25 years of employment, or have concluded working with the Bank at the age of 65 or more after at least 15 years of employment.

In 2006 anticipated costs were recorded for the first time in respect of the aforementioned benefits in the post-employment period on the basis of an actuarial calculation. The accumulated amount at 31 December 2007 amounts to approximately NIS 91 million.

(4) Early retirement for employees under personal employment contracts

(a) According to the employment contract with the Bank's President and Chief Executive Officer ("CEO") that was signed at the beginning of 1996 ("the contract"), the CEO is entitled to a pension immediately upon her retirement (whether due to resignation or dismissal) or to severance pay at the rate of 200% of the latest monthly salary for each year of work in the Bank plus the amounts that have accrued in the pension fund, at her choice.

In the contract with the CEO the Bank undertook to continue to employ the CEO until 12 February 2010 ("the period of the commitment"). In the event of dismissal of the CEO (including in the event of resignation which is deemed to be dismissal and including also resignation in the event of change in control in the Bank), the Bank will pay to the CEO compensation in the amount of all salaries and related benefits until the end of the period of the commitment.

As a result of the above, in the event of dismissal of the CEO in the period of the commitment the Bank will incur an additional expense in respect of the period from the date of the dismissal and until the end of the period of the commitment. If the CEO had been dismissed immediately on 1 January 2008 the maximum additional expense to the Bank would have been NIS 3,273 thousand ("the maximum expense"). The maximum expense was calculated, as stated, for a full two-year period and decreases to zero over the period in which the CEO continues to work in the Bank, so that if the CEO contiues to work until the end of the period of the commitment, i.e. on 12 February 2010, the Bank will not have any additional expense. The maximum expense is before tax and includes VAT on salary.

Note 15 - Employees Rights (cont'd)

B. Severance pay and pensions (cont'd)

(4) Early retirement for employees under personal employment contracts (cont'd)

In addition the personal employment contract of the CEO was amended so that the period in which the CEO is entitled to a pension of 3% per year is extended from 18 years until the conclusion of her work at the Bank.

It should also be noted that the Board of Directors announced that it does not intend to dismiss the CEO and therefore no provision is required in respect of the amendment to the contract.

(b) The Bank signed personal employment contracts with members of Management and senior executives of the Bank (deputy general managers, senior assistants to the general manager and assistants to the general manager) according to which the Bank has undertaken to pay an immediate pension, in the event of dismissal of such an employee, if their age plus the number of years of employment with the Bank reach 75. The years of service of a member of Management (if the employee served at least 7 years as a member of Management) will be counted as additional years of seniority for purposes of the age of 75 as stated. The pension will be calculated at the rate of 2.67% per annum for the first 15 years of employment plus 2% for each additional year of employment in which the individual did not serve as a member of Management, or 2.5% for each year of service as a member of Management, up to a maximum rate of 70%. The pension for senior executives is calculated at the rate of 2.67% per annum for the first 15 years of employment, 1.5% for each additional year until the signing of the contract and 2% in respect of each year thereafter, up to a maximum rate of 70%. Alternatively, the said employees are entitled to choose, in the event of dismissal, severance pay at the rate of 200% (and 250% if his age plus the number of years of employment with the Bank do not reach 75) of his latest monthly salary multiplied by the number of years of employment, plus the amounts accumulated to his credit in the provident fund. In such case, the employee is not entitled to a pension.

An employee who voluntarily resigns will be entitled to severance pay at the rate of 100%, plus the funds accumulated to his credit in the provident fund.

The Bank and the said employees are entitled to terminate the employee-employer relationship at an advance announcement of six months.

The personal employment contract of the senior deputy CEO states that replacement of the Bank's CEO (the replacement includes also replacement following the resignation of the CEO) is tantamount to dismissal, with all attendant implications. In such a case, the Bank will have the right to extend the advance notice period which the said party must give prior to his resignation to 12 months (in place of 6 months).

Note 15 - Employees Rights (cont'd)

B. Severance pay and pensions (cont'd)

(4) Early retirement for employees under personal employment contracts (cont'd)

The personal employment contracts of members of Management of the Bank were amended as from 31 December, 2003 as follows: an employee who retires voluntarily at the age of 62 years or more will be entitled, upon fulfillment of a number of conditions, to severance pay at a rate of 200% plus accrued amounts in his provident fund (a provision that was amended again in September 2006). An employee who, upon termination of the employee-employer relationship did not utilize his special long-service vacation will be entitled to an advance announcement of one additional month.

In the adaptation period, which does not coincide with the period of the advance announcement, the employee will be entitled to a salary and to related benefits. Subject to the said amendment, the provisions of the individual employment contracts will remain in effect and will be binding on the parties for all effects and purposes. The financial statements include appropriate provisions to cover these commitments.

The maximum additional expense that the Bank can incur in the event of the employees mentioned above being dismissed immediately amounts to NIS 355 million (including VAT on salaries, payable on the pension) (2006 – NIS 359 million). Since it is not likely that all the above mentioned employees will be immediately dismissed, the Bank recorded a provision at the rate of 25% of the above amount, in the amount of NIS 91 million (including VAT on salaries) (2006 – NIS 90 million). The above amounts also include members of Management.

After amendment of the personal employment contracts of members of Management, as stated above, part of the said provision, in the amount of NIS 10 million as of 31 December 2007 (31 December 2006 – NIS 13 million), was attributed specifically to members of Management.

(5) In the case of involuntary retirement, the Chairman of the Bank's Board of Directors is entitled to additional severance benefits at the rate of 100% of the amounts provided at that time (hereinafter – "the increased severance benefits"), provided that the increased severance benefits, as stated, do not exceed an amount equal to nine monthly salaries, and is also entitled to an adaptation grant at the rate of six monthly salaries. The financial statements include appropriate provisions.

C. Voluntary retirement

In the framework of implementation of the Bank's efficiency program, in 2006 and 2005 the Bank proposed early voluntary retirement at special conditions to all its employees. In 2006, 191 Group employees (2005 – 137 employees) retired at a cost of NIS 175 million (2005 – NIS 107 million). Also, from time to time employees retire from the Bank at improved conditions. In 2007, 12 employees retired in this framework.

Note 15 - Employees Rights (cont'd)

D. Issue of options to employees

On 2 February 2006 the Bank's General Meeting approved a plan for the issue of options to eligible employees, as determined in the outline published by the Bank on 24 January 2006 (the "Outline"). In accordance with this plan, on 14 February 2006 - 84,853,960 options, exercisable into 84,853,960 ordinary shares of the Bank were allotted (of which 122,644 options were allotted to the Chairman of the Board of Directors and 156,659 were allotted to the Chief Executive Officer). The balance of the options on 31 December, 2007, was 83,595,949. The said options are subject to all the provisions of the Outline, including:

1. The options were exercisable in two equal tranches, the first tranche at the end of two years from the date of allotment of the options and the second tranche as from the end of the second year from the date of the allotment and up to the end of the third year from the date of allotment of the options.

2. The options were issued to the employees free of consideration.

3. The exercise price per share will be NIS 13.465 and will be linked to the CPI (commencing from September 2005). The price will be adjusted for the distribution of dividends (whose amounts will be linked to the CPI), bonus shares and the benefit component of a rights' issuance, should there be any. As at 31 December 2007 and 16 March 2008 the adjusted price of the option was NIS 11.205 and NIS 10.3179 respectively.

The exercise date of the first tranche of the options was in mid-February 2008, and all the options included in this tranche, totalling 41,723,516 options, were exercised, at an exercise price of 10.338. From then until 10 March 2008, 4,870,135 options were exercised.

In respect of the issue of the said options, the Bank records salary expenses in accordance with the fair value at the date of granting the options with the addition of salary tax and national insurance contributions. This expense is recorded as salary expenses in the Bank's financial statements over a period of two years from the date of allotment.

In 2007, the Bank recorded about NIS 247 million as salary expenses in the profit and loss statement (2006 - about NIS 235 million).

The estimate of the fair value of the options as at the date of allotment, which was made by an external consultant in accordance witht the Black and Scholes model, was about NIS 422 million.

The calculation was based on the following main parameters:

- Standard deviation of annual yield: 25%.
- Rate of risk free index linked interest: 3.5%
- Share price: Closing price on 14 February 2006 – NIS 17.30
- Dividend distribution policy: 50% of the net profit.
- Rate of employees leaving during the vesting period of the options: 2%.

Note 15 - Employees Rights (cont'd)

D. Issue of options to employees (cont’d)

In view of the limitation imposed on the Bank in giving loans to its employees to finance the exercising of the options, and following agreement in principle reached between the representative body of Leumi employees and Israel Discount Bank Ltd., Discount Bank gave those employees of Leumi who so requested loans to finance the exercising of the options in February 2008.

The total amount of the above loans given in 2008 was NIS 277 million.

The loans were given at an annual rate of prime less 0.5% for a period of one and a half years, the conclusion of the period the shares are held in trust for the employees by the trustee in accordance with the Options Plan, without the shares being pledged and with full recourse to the borrowers. Bank Leumi is not responsible for nor guarantees the repayment of the loans in any manner.

The Supervisor of Banks approved the Bank providing Bank Discount with operational services in connection with these loans.

Below are the changes in options during the years 2006-2007:

	Number of Options
Allotted in 2006	84,853,960
Appropriated during the year	466,133
Total options in circulation as at 31 December 2006	84,387,827
Cancelled during the year	(791,878)
Total options in circulation as at 31 December 2007	83,595,949
Exercising of first tranche	(41,723,516)
Exercising of second tranche until 10 March 2008	(4,870,135)
Total options in circulation as at 10 March 2008	37,002,298

E. Sale of shares to employees

On 14 June 2006, Bank employees purchased 2.8478% of the capital of the Bank (40,274,560 ordinary shares, of which, 75,532 were purchased by the Chief Executive Officer), in accordance with an outline published on 9 May 2006 (and amended on 10 and 25 May 2006). On 3 July 2006, the General Meeting approved the purchase of 59,131 ordinary shares by the Chairman of the Board of Directors of the Bank, and the purchase was carried out on 5 July 2006.

The purchase of the shares was carried out in accordance with an agreement from March 2006 with the Accountant-General regarding an offer of the Bank’s ordinary shares to the employees of the Bank by the State, in accordance with the agreements in respect of the privatization of the Bank and decisions of the Finance Committee of the Knesset. According to the above agreement, the shares are to be offered to the employees in two stages, the first of which, an

Note 15 - Employees Rights (cont'd)

E. Sale of shares to employees (cont'd)

offer of 2.873% of the share capital, has been carried out, as mentioned above. The base purchase price was set at NIS 16.10 per share (the average price of the share, as agreed by the Ministry of Finance and matching the average price of the sale to Barnea). The shares were offered to the employees at a discount of 25% below the base price, the price being linked to the CPI for September 2005 up to the date of exercise of the offer with the addition of interest of 2% per annum from 24 November 2005 (the "Exercise Price"). The Exercise Price was therefore NIS 11.652 per share (NIS 11.665 for the Chairman of the Board).

The second stage, in which a further 1% of the Bank's share capital will be offered to the employees, will be carried out after completion of the privatization process.

The value of the benefit granted to the employees and the Chairman of the Board of Directors in respect of the said purchase (the first stage only), which was evaluated by an external appraiser, includes a number of components and totals some NIS 220 million (including salary tax and national insurance). This amount was recorded as a salary expense in 2006 and 2007, and of this an amount of NIS 207 million was against the capital account.

Set out below are the parameters according to which the calculation was made:

- The calculation of the fair value was made according to the price of the Bank's share at the time of granting, which is the average price of the Bank's share in the period during which the employees subscribed for the shares. The period was 31 May 2006 to 11 June 2006, and the average price of the share during this period was NIS 16.71.

- The calculation of the fair value takes into account the "flaws" in the offered shares (locked-up for 4 years and regular tax payment in respect of the benefit component) relative to the regular shares.

- The shares are locked-up for 4 years. In respect of this "flaw" of lack of marketability, 15% was reduced from the value of the shares at the time of granting.

- An annual dividend payment of 50% of the net profit was assumed.

- The financing of the purchase of the employees' shares was through CPI-linked, interest free loans granted by the Bank.

- The interest rate for the calculation of the value of the benefit embodied in the loans was 4% per annum linked to the CPI.

- The Bank received an approval from the Tax Authority under which the provisions of Section 102 of the Income Tax Ordinance will apply to the plan.

Note 15 - Employees Rights (cont'd)

E. Sale of shares to employees (cont'd)

In accordance with generally accepted accounting principles, the changes in the value of the profit benefit portion are adjusted on an ongoing basis in the profit and loss statement, according to the market value of the share.

Below are details of the effect of the sale of shares to the employees on the financial statements:

	31 December 2007	31 December 2007
	NIS millions	
Fair value of the shares less the lack of marketability	**103**	103
Cost of financing loans	**55**	55
Salary tax and national insurance	**62**	59
Total salary expense	**220**	217
Tax shelter in profit and loss	**53**	52
Total net cost in profit and loss	**167**	165
Amount recorded in capital account	**207**	203

To finance the purchase of the shares, the employees were granted loans, repayable at the end of the 4 years' lock-up period of the shares. The loans are linked to the CPI, do not bear interest and are not at non-recourse conditions. The granting of the loans was approved by the Supervisor of Banks, who, in his approval, noted that when determining the repayment terms, the Bank was requested to take into account the fact that approval would not be given for the extension of the repayment period of the loans beyond the end of the lock-up period. The total of the loans granted to the employees (including the Chairman of the Board of Directors) was some NIS 466 million, which was deducted from the Bank's capital.

Note 15 - Employees Rights (cont'd)

F. Data relating to provisions and fundings
Reported amounts

The amounts of provisions and related fundings for severance pay and pensions are included in the balance sheet as follows:

	31 December	
	2007	2006
	NIS millions	
Provision for severance pay	**2,183**	2,069
Amounts funded for severance pay (1)	**(2,396)**	(2,290)
Provision for pensions	**2,813**	2,864
Amounts funded for pensions	**(189)**	(202)
Excess of provisions over deposits, net	**2,411**	2,441
Excess of provisions over deposits, net, included in "other liabilities"	**2,673**	2,708
Excess of deposits included in "other assets"	**262**	267
Excess of provisions over deposits, net (2)	**2,411**	2,441

(1) The Bank and subsidiaries may not withdraw amounts funded other than for the purpose of making severance payments.

(2) This surplus represents mainly the actuarial pension liability of the Bank for the pensioners of the Bank, and the cover for this liability is part of the Bank's assets and its current applications.

G. Long service bonuses

Employees of the Bank and some employees of subsidiaries are entitled to a cash bonus in the amount of several monthly salaries ("jubilee grants") and to special vacation periods upon their attaining 20, 30 and 40 years of employment.

As at balance sheet date, there is a provision in the amount of NIS 550 million (31 December 2006 - NIS 523 million).
Calculation of the liability is made on an actuarial basis and takes into account, based on past experience, the probability that on the determining date, the employee will still be employed by the Bank. The said calculation is made using a capitalization rate determined by the Supervisor of Banks and on the assumption of a real salary increase, estimated as stated in B(1), above. In 2006, the liability for long service bonuses increased by NIS 23 million, due to the change in the manner of calculating the real salary increase.
The provision for special service vacations is made on an actuarial basis taking into account past experience with respect to utilization of such vacations and the increase in retirement age according to the Retirement Age Law 5764-2004.

Note 15 - Employees Rights (cont'd)

H. Unutilized vacation pay

There is a provision of NIS 162 million under the "other liabilities" item for unutilized vacation pay (31 December 2006 - NIS 148 million). The provision is calculated on the basis of the latest salary plus related benefits.

I. Provident funds of the employees of the Bank and Leumi Mortgage Bank

The Bank has completed, together with the employees' representative body, most of the preparations required in the provident funds of the employees of the Bank and the employees of Leumi Mortgage Bank ("employees' funds"), for purposes of meeting the conditions of the permit granted to the banks in legislation to engage in the managing of provident funds the members of which are all employees of the Bank or the employees of a corporation under its control, and the employees' funds will be transferred to the management of a management company to be held by the members of the funds.

In January 2008 a further Amendment to the Provident Funds Law came into force, which changes existing provident funds and arrangements for withdrawing funds from them, for monies deposited in them from January 2008, and also limits the possibility of setting aside monies for the Central Severance Pay Funds until the end of 2010. The Bank is examining the effect of the Amendment to the Law.

Note 16 - Assets and Liabilities Classified According to Linkage Basis
Reported Amounts

31 December 2007

	Israeli currency		Foreign currency (a)				
	Unlinked	Linked to the CPI	In U.S. dollars	In Euro	In other currencies	Non-monetary items (c)	Total
	NIS millions						
Assets							
Cash and deposits with banks	**8,039**	**587**	**23,026**	**6,347**	**4,330**	**-**	**42,329**
Securities	**8,081**	**6,455**	**17,322**	**9,003**	**953**	**5,355**	**47,169**
Securities borrowed or purchased under agreements to resell	**655**	**-**	**-**	**-**	**-**	**-**	**655**
Credit to the public (b)	**88,584**	**53,314**	**36,826**	**7,315**	**12,419**	**99**	**198,557**
Credit to governments	**-**	**251**	**391**	**-**	**-**	**-**	**642**
Investments in companies included on equity basis	**15**	**-**	**-**	**-**	**-**	**1,858**	**1,873**
Buildings and equipment	**-**	**-**	**-**	**-**	**-**	**3,276**	**3,276**
Other assets	**2,980**	**113**	**2,210**	**532**	**907**	**908**	**7,650**
Total assets	**108,354**	**60,720**	**79,775**	**23,197**	**18,609**	**11,496**	**302,151**
Liabilities							
Deposits of the public	**96,656**	**26,919**	**79,842**	**22,457**	**11,676**	**495**	**238,045**
Deposits from banks	**2,596**	**669**	**1,555**	**753**	**566**	**-**	**6,139**
Deposits from governments	**58**	**788**	**343**	**9**	**-**	**-**	**1,198**
Securities loaned or sold under agreements to repurchase	**173**	**-**	**58**	**-**	**-**	**-**	**231**
Debentures, bonds and subordinated notes	**842**	**15,821**	**2,585**	**-**	**-**	**-**	**19,248**
Other liabilities	**10,566**	**3,082**	**1,782**	**578**	**1,035**	**593**	**17,636**
Total liabilities	**110,891**	**47,279**	**86,165**	**23,797**	**13,277**	**1,088**	**282,497**
Difference	**(2,537)**	**13,441**	**(6,390)**	**(600)**	**5,332**	**10,408**	**19,654**
Effect of hedged derivative instruments							
Derivative instruments (except options)	**-**	**-**	**6**	**(6)**	**-**	**-**	**-**
Options in the money, net (in terms of underlying asset)	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Options out of the money, net (in terms of underlying asset)	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Effect of derivative instruments that are not hedged:							
Derivative instruments (except options)	**10,775**	**(10,030)**	**4,075**	**99**	**(4,919)**	**-**	**-**
Options in the money, net (in terms of underlying asset)	**88**	**(1)**	**(312)**	**55**	**170**	**-**	**-**
Options out of the money, net (in terms of underlying asset)	**(41)**	**(4)**	**(168)**	**119**	**94**	**-**	**-**
Total	**8,285**	**3,406**	**(2,789)**	**(333)**	**677**	**10,408**	**19,654**
Options in the money, net (discounted par value)	**467**	**-**	**(573)**	**(65)**	**171**	**-**	**-**
Options out of the money, net (discounted par value)	**1,465**	**(17)**	**(2,326)**	**559**	**319**	**-**	**-**

(a) Including linked to foreign currency.
(b) The general, supplementary and special provisions for doubtful debts were deducted proportionately from the different linkage bases in this item.
(c) Including derivative instruments whose underlying asset is a non-monetary item.

Note 16 - Assets and Liabilities Classified According to Linkage Basis (cont'd)

Reported Amounts

31 December 2006

	Israeli currency		Foreign currency (a)				
	Unlinked	Linked to the CPI	In U.S. dollars	In Euro	In other currencies	Non-monetary items (c)	Total
	NIS millions						
Assets							
Cash and deposits with banks	4,838	440	34,059	4,897	3,375	-	47,609
Securities	10,704	5,331	18,490	6,840	778	4,232	46,375
Credit to the public (b)	76,966	50,221	38,625	6,594	11,161	233	183,800
Credit to governments	193	256	571	-	-	-	1,020
Investments in companies included on equity basis	9	-	-	-	-	1,242	1,251
Buildings and equipment	-	-	-	-	-	3,056	3,056
Other assets	1,843	24	2,135	513	788	927	6,230
Total assets	94,553	56,272	93,880	18,844	16,102	9,690	289,341
Liabilities							
Deposits of the public	88,662	31,245	81,686	18,830	10,812	588	231,823
Deposits from banks	1,107	1,303	1,579	481	771	-	5,241
Deposits from governments	664	897	556	28	1	-	2,146
Debentures, bonds and subordinated notes	799	11,861	2,962	-	-	-	15,622
Other liabilities	10,346	2,878	1,655	436	890	661	16,866
Total liabilities	101,578	48,184	88,438	19,775	12,474	1,249	271,698
Difference	(7,025)	8,088	5,442	(931)	3,628	8,441	17,643
Effect of hedged derivative instruments							
Derivative instruments (except options)	-	-	56	(22)	(34)	-	-
Options in the money, net (in terms of underlying asset)	-	-	-	-	-	-	-
Options out of the money, net (in terms of underlying asset)	-	-	-	-	-	-	-
Effect of derivative instruments that are not hedged:							
Derivative instruments (except options)	13,586	(4,911)	(5,327)	226	(3,574)	-	-
Options in the money, net (in terms of underlying asset)	(283)	-	(159)	404	38	-	-
Options out of the money, net (in terms of underlying asset)	(206)	-	40	(11)	177	-	-
Total	6,072	3,177	52	(334)	235	8,441	17,643
Options in the money, net (discounted par value)	(284)	-	(383)	604	63	-	-
Options out of the money, net (discounted par value)	(522)	(9)	(90)	125	496	-	-

(a) Including linked to foreign currency.
(b) The general, supplementary and special provisions for doubtful debts were deducted proportionately from the different linkage bases in this item.
(c) Including derivative instruments whose underlying asset is a non-monetary item.

Note 17 - Assets and Liabilities Classified According to Maturity Date and Linkage Basis (a)

Reported Amounts

31 December 2007

	Estimated future contractual cash flows											Balance sheet balance (d)	
	Upon demand and up to one month(e)	One month to three months(e)	Three months to one year (e)	One year to two years	Two years to three years	Three years to Four years	Four years to five years	Five years to ten years	Ten years to twenty years	Over twenty years	Total Cash flows	Without fixed maturity (b)	Total
	NIS millions												
Israeli currency – unlinked													
Assets	**43,305**	**12,080**	**25,094**	**9,788**	**6,937**	**4,709**	**3,470**	**9,940**	**3,097**	**478**	**118,898**	**1,980**	**108,354**
Liabilities	**51,955**	**15,763**	**32,783**	**6,438**	**4,664**	**439**	**325**	**574**	**232**	**85**	**113,258**	**315**	**110,891**
Difference	**(8,650)**	**(3,683)**	**(7,689)**	**3,350**	**2,273**	**4,270**	**3,145**	**9,366**	**2,865**	**393**	**5,640**	**1,665**	**(2,537)**
Derivative instruments (except options)	**3,625**	**323**	**5,446**	**430**	**246**	**424**	**58**	**533**	**(8)**	**-**	**11,077**	**-**	**10,775**
Options (in terms of underlying asset)	**(136)**	**(253)**	**519**	**1**	**16**	**-**	**(95)**	**-**	**-**	**-**	**52**	**-**	**47**
Israeli currency - linked to the CPI													
Assets	**1,947**	**1,604**	**8,349**	**8,564**	**8,953**	**6,796**	**6,090**	**20,252**	**14,033**	**2,624**	**79,212**	**86**	**60,720**
Liabilities	**1,056**	**1,670**	**7,535**	**6,390**	**5,962**	**3,554**	**7,150**	**16,048**	**7,445**	**1,083**	**57,893**	**63**	**47,279**
Difference	**891**	**(66)**	**814**	**2,174**	**2,991**	**3,242**	**(1,060)**	**4,204**	**6,588**	**1,541**	**21,319**	**23**	**13,441**
Derivative instruments (except options)	**(360)**	**(639)**	**(4,141)**	**(455)**	**(384)**	**(454)**	**(592)**	**(2,775)**	**(242)**	**-**	**(10,042)**	**-**	**(10,030)**
Options (in terms of underlying asset)	**-**	**-**	**(5)**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(5)**	**-**	**(5)**
Foreign currency- Local operations (c)													
Assets	**27,995**	**12,707**	**13,247**	**7,105**	**6,678**	**5,142**	**4,460**	**5,776**	**1,197**	**282**	**84,589**	**351**	**76,694**
Liabilities	**46,729**	**20,716**	**13,233**	**1,787**	**1,709**	**428**	**547**	**1,270**	**168**	**-**	**86,587**	**2**	**84,271**
Difference	**(18,734)**	**(8,009)**	**14**	**5,318**	**4,969**	**4,714**	**3,913**	**4,506**	**1,029**	**282**	**(1,998)**	**349**	**(7,577)**
Derivative instruments(except options)	**(3,265)**	**316**	**(1,305)**	**25**	**138**	**30**	**534**	**2,242**	**250**	**-**	**(1,035)**	**-**	**(745)**
Options (in terms of underlying asset)	**136**	**253**	**(514)**	**(1)**	**(16)**	**-**	**95**	**-**	**-**	**-**	**(47)**	**-**	**(42)**

See footnotes on next page.

Note 17 - Assets and Liabilities Classified According to Maturity Date and Linkage Basis (a) (cont'd)
Reported Amounts
31 December 2007 (cont'd)

	Estimated future contractual cash flows											Balance sheet balance (d)	
	Upon demand and up to one month(e)	One month to three months(e)	Three months to one year (e)	One year to two years	Two years to three years	Three years to Four years	Four years to five years	Five years to ten years	Ten years to twenty years	Over twenty years	Total Cash flows	Without fixed maturity (b)	Total
	NIS millions												
Foreign currency - integrated foreign operations													
Assets	**16,965**	**7,795**	**9,375**	**3,997**	**2,821**	**2,612**	**1,940**	**1,330**	**2,010**	**785**	**49,630**	**101**	**44,887**
Liabilities	**22,382**	**6,132**	**6,183**	**856**	**458**	**1,077**	**494**	**2,348**	**-**	**-**	**39,930**	**178**	**38,968**
Difference	**(5,417)**	**1,663**	**3,192**	**3,141**	**2,363**	**1,535**	**1,446**	**(1,018)**	**2,010**	**785**	**9,700**	**(77)**	**5,919**
Non-monetary items													
Assets	-	-	-	-	-	-	-	-	-	-	-	**11,496**	**11,496**
Liabilities	-	-	-	-	-	-	-	-	-	-	-	**1,088**	**1,088**
Difference	-	-	-	-	-	-	-	-	-	-	-	**10,408**	**10,408**
Total													
Assets	**90,212**	**34,186**	**56,065**	**29,454**	**25,389**	**19,259**	**15,960**	**37,298**	**20,337**	**4,169**	**332,329**	**14,014**	**302,151**
Liabilities	**122,122**	**44,281**	**59,734**	**15,471**	**12,793**	**5,498**	**8,516**	**20,240**	**7,845**	**1,168**	**297,668**	**1,646**	**282,497**
Difference (f)	**(31,910)**	**(10,095)**	**(3,669)**	**13,983**	**12,596**	**13,761**	**7,444**	**17,058**	**12,492**	**3,001**	**34,661**	**12,368**	**19,654**

See footnotes on next page.

Note 17 - Assets and Liabilities Classified According to Maturity Date and Linkage Basis (a) (cont'd)
Reported Amounts

31 December 2006

	Estimated future contractual cash flows											Balance sheet balance (d)	
	Upon demand and up to one month(e)	One month to three months(e)	Three months to one year (e)	One year to two years	Two years to three years	Three years to Four years	Four years to five years	Five years to ten years	Ten years to twenty years	Over twenty years	Total Cash flows	Without fixed maturity (b)	Total
	NIS millions												
Total													
Assets (g)	88,590	29,744	57,586	26,928	21,965	18,861	15,057	33,243	19,479	3,456	314,909	13,591	289,341
Liabilities (g)	112,911	41,677	54,015	18,180	13,220	7,088	5,509	21,426	10,221	1,118	285,365	2,514	271,698
Difference (f)	(24,321)	(11,933)	3,571	8,748	8,745	11,773	9,548	11,817	9,258	2,338	29,544	11,077	17,643

(a) Including estimated future cash flows in respect of assets and liabilities according to linkage basis, in accordance with the remaining contractual period to maturity of each cash flow. The data are presented after deduction of provisions for doubtful debts.
(b) Including overdue amounts of NIS 610 million (31 December 2006 – NIS 1,321 million).
(c) Including linkage foreign currency.
(d) As included in Note 16, "Assets and Liabilities According to Linkage Basis", including off-balance sheet amounts in respect of derivatives.
(e) Credit with debitory account conditions is classified in accordance with the credit framework (credit line of NIS 14.5 billion; 31 December 2006 - NIS 13.9 billion). Special credit in the amount of NIS 0.6 billion (31 December 2006 - NIS 1.5 billion) is classified without repayment date.
(f) The above difference does not necessarily reflect the exposure to interest and/or linkage basis.

Note: Total off-balance sheet restricted liabilities against with short-term credit was granted in the Bank amount to NIS 5.1 billion as at 31 December 2007 (31 December 2006 - NIS 4.6 billion).

Note 18 - Contingent Liabilities and Special Commitments
Reported Amounts

	31 December 2007	31 December 2006
	NIS millions	
A. Off-balance sheet financial instruments		
Balances of contracts or their stated amounts as at the end of the year		
Transactions in which the balance reflects a credit risk		
Documentary credits	**2,582**	2,430
Credit guarantees (a)	**6,993**	5,918
Guarantees to apartment purchasers	**7,440**	6,011
Other guarantees and liabilities	**13,822**	12,767
Commitments regarding uncompleted credit card transactions		
Unutilized credit card facilities	**14,993**	12,015
Other unutilized revolving credit facilities to the public and credit facilities on demand	**17,347**	16,442
Irrevocable commitments to provide credit which has been approved and not yet granted	**21,335**	21,439
Commitments to issue guarantees	**5,883**	5,067
(a) Of which guarantees for debt balances deriving from credit card transactions.	**-**	87
B. Off-balance sheet commitments for transactions based on collection (a)		
Balance of credit from deposits on collection basis (b)		
Israeli currency unlinked	**1,806**	1,994
Israeli currency linked to the CPI	**7,855**	8,135
Foreign currency	**938**	1,483
Total	**10,599**	11,612

See footnotes on next page.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)
Reported Amounts

B. Off-balance sheet commitments for transactions based on collection (a) (cont'd)

Flows in respect of collection commissions and interest margins on activities based on the extent of collection as at December 31

	Up to one year	One year to three years	Three years To five years	Five years to ten years	Ten years to twenty years	After twenty years	Total 2007	Total 2006
	NIS millions							NIS millions
1.CPI linked sector (c)								
Future flows per contracts	**37**	**67**	**63**	**145**	**157**	**54**	**523**	567
Expected future flows net of Management's estimate of early repayments	**40**	**69**	**61**	**143**	**137**	**47**	**497**	529
Discounted expected future flows net of Management's estimate of early repayments (d)	**39**	**64**	**52**	**105**	**81**	**21**	**362**	372
2.Unlinked shekel sector								
Future flows per contracts	**8**	**6**	**6**	**13**	**12**	**1**	**46**	50
Expected future flows net of Management's estimate of early repayments	**8**	**6**	**6**	**13**	**12**	**1**	**46**	50
Discounted expected future flows net of Management's estimate of early repayments (d)	**8**	**6**	**5**	**10**	**7**	**-**	**36**	36

(a) Credit and deposits out of deposits returnable upon repayment of the credit (or the deposits) with interest margin or with collection commission (instead of interest margin).
(b) Standing loans and Government deposits given in respect thereof in the amount of NIS 1,014 (31 December 2005 - NIS 1,202 million) are not included in this table.
(c) Including foreign currency sector.
(d) The present value of future flows is computed at the rate of 4.14% (2006 - 4.62 %).

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

	2007	2006
	NIS millions	
B. Off-balance sheet commitments for transactions based on collection (cont'd)		
Information on loans granted during the year by the Mortgage Bank:		
Loans from deposits on collection basis	**342**	367
Standing loans	**9**	7
C. Other contingent liabilities and special commitments:		
(1) Long-term rental contracts -		
Commitments in respect of rental of buildings, equipment and motor vehicles payable in the following years:		
First year	**246**	197
Second year	**131**	158
Third year	**107**	103
Fourth year	**80**	83
Fifth year	**53**	57
After five years	**106**	135
Total	**723**	733
Commitments to purchase securities	**298**	261
Commitments to invest in buildings, equipment and in other Assets	**219**	177
(2) Future deposits		
Transactions with depositors for purposes of receipt of large deposits at various future dates and at fixed interest rates determined in advance as of the date of the investment		
First year	**17**	17
Second year	**17**	17
Third year	**17**	17
Fourth year	**17**	17
Fifth year	**17**	17
After five years	**49**	66
Total future deposits	**134**	151

(3) The Bank has credit exposures in respect of obligations to supply liquidity to securitization products under the auspices of others which have not been utilized in the amount of NIS 384 million.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

D. Fair value of financial instruments

(1) General

This note includes information regarding the determination of the fair value of financial instruments according to directives of the Supervisor of Banks. Most of the financial instruments of the Bank do not have a market value because they do not have an active trading market. Their fair value is therefore determined on the basis of the present value of future cash flows, discounted at an interest rate that reflects the interest at which the Bank would have effected a similar transaction on the reporting date. The estimated fair value is calculated by means of estimating future cash flows and a subjective determination of the discount rate. Therefore, in respect of most financial instruments, the reported fair value does not necessarily indicate the realizable value of the financial instrument on the reporting date. The estimate of fair value is made on the basis of interest rates in effect on the reporting date and does not take into account interest rate fluctuations. Under different interest rates the fair value calculated may be significantly different. This is true especially in respect of financial instruments with interest at fixed rates or which are non-interest bearing. Furthermore, the determination of fair value does not take into account commissions that will be received or paid over the course of business. Furthermore, the difference between the balance sheet value and the fair value may not be realized because in most cases the Bank may hold the financial instrument until maturity. Therefore, it should be noted that the data included in this note do not purport to reflect the value of the Bank as a going concern. Furthermore, because of the wide range of valuation techniques and estimates that can be applied in the calculation of fair value, caution must be exercised when comparing fair values of different banks.

(2) Principal methods and assumptions used in the estimating fair value of financial instruments

Financial assets:

Credit to the public - the fair value of credit to the public is determined on the basis of the present value of future cash flows discounted at an appropriate discount rate. The balance of credit was classified into a number of categories according to the activity sector and the credit rating of the borrowers. Future cash flows (principal and interest) were calculated in respect of each category according to the various linkage bases. These receipts were discounted at an interest rate that reflects the rate of risk and average margin inherent in that category of credit and the term of the credit.
The interest rate is usually determined according to the interest rate used by the Bank in similar transactions on the reporting date.
The fair value of current debit accounts were determined according to the book value.
The fair value of problematic debts was calculated at interest rates that reflect the inherent high credit risk. In any case these interest rates are not lower than the highest rate of interest used by the Group in its transactions in the same sector on the reporting date.
Additionally, a sensitivity analysis was implemented regarding the estimated fair value of the problematic loans to the discounted interest rate. The examination ascertained that an additional 1% discounted interest will decrease the estimated fair value of the problematic loans as of the end of 2007 by NIS 175 million.
The fair value of current account balances classified as problematic loans was calculated in accordance with an estimate of their average maturity and based on the maximum interest rates in the Bank.
The future cash flows in respect of problematic debts were calculated after deducting the specific provisions for doubtful debts.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

D. Fair value of instruments (cont'd)

(2) Principal methods and assumptions used in the estimating fair value of financial instruments (cont'd)

Deposits with banks, unquoted debentures and credit to governments - by the discounted future cash flows method, at interest rates at which similar transactions were executed on the reporting date.

Quoted securities - at their fair value as defined in Note 1.F.

Financial liabilities:

Deposits of the public - the balance of the deposits is classified according to a number of categories according to activity sectors, adjustment basis and the terms of deposit. Future cash flows (principal and interest) were calculated in respect of each category. These payments were discounted at an interest rate that reflects the average interest rate the Group pays on similar deposits in the same category. The balance sheet amount of current accounts and deposits without a repayment date is considered to be an estimate of their fair value.

Deposits from banks and deposits from governments - the fair value estimated by the discounted future cash flows method, at the rate of interest at which the Group raises similar deposits on the reporting date.

Debentures, bonds and subordinated notes - at their fair value or by the discounted future cash flows method, at the rate of interest at which the Group raises similar deposits or at the rate at which it issues similar bonds on the reporting date.

Derivative instruments - derivative instruments that have an active market were valued at market value and, when there are a number of markets in which the instrument is traded, the value is determined according to the most active market.
Derivative instruments that are not traded on an active market were valued on the basis of models the Bank uses in its current operations as at the reporting date, that take into account the risks inherent in the financial instrument.

Off-balance sheet financial instruments in which the balance reflects a credit risk:
The fair value was determined according to the balance sheet value of the commissions on these transactions, which approximates the fair value.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

D. Fair values of financial instruments (cont'd)

(3) Balances and estimated fair value of financial instruments
Reported Amounts

	31 December 2007				31 December 2006			
	Balance sheet value				Balance sheet value			
	(a)	**(b)**	**Total**	**Fair value**	(a)	(b)	Total	Fair value
	NIS millions				NIS millions			
Financial assets								
Cash and deposits with banks	**11,271**	**31,058**	**42,329**	**42,334**	10,269	37,340	47,609	47,616
Securities	**45,558**	**1,581**	**47,169**	**47,187**	43,847	2,528	46,375	46,413
Securities borrowed or purchased under agreements to resell	**655**	**-**	**655**	**655**	-	-	-	-
Credit to the public	**33,791**	**164,766**	**198,557**	**199,960**	34,912	148,888	183,800	184,370
Credit to governments	**-**	**642**	**642**	**644**	194	826	1,020	1,021
Other financial assets	**5,663**	**8**	**5,671**	**5,670**	4,359	-	4,359	4,359
Total financial assets	**96,968**	**198,055**	**295,023**	**296,450**	93,581	189,582	283,163	283,779
Financial liabilities								
Deposits of the public	**45,824**	**192,221**	**238,045**	**239,100**	36,631	195,192	231,823	232,723
Deposits from banks	**4,484**	**1,655**	**6,139**	**6,168**	2,698	2,543	5,241	5,279
Deposits from governments	**53**	**1,145**	**1,198**	**1,205**	250	1,896	2,146	2,045
Securities loaned or sold under agreements to repurchase	**173**	**58**	**231**	**228**	-	-	-	-
Debentures, bonds And subordinated notes	**93**	**19,155**	**19,248**	**19,860**	(426)	16,048	15,622	16,118
Other financial liabilities	**11,905**	**159**	**12,064**	**12,068**	10,048	-	10,048	10,048
Total financial liabilities	**62,532**	**214,393**	**276,925**	**278,629**	49,201	215,679	264,880	266,213
Off-balance sheet financial instruments								
Transactions in which the balance the balance reflects a credit risk	**289**	**-**	**289**	**289**	250	-	250	250

(a) Financial instruments in respect of which the balance sheet value is an estimate of fair value - instruments that are stated in the balance sheet at their market value.
(b) Other financial instruments regarding which the fair value was calculated.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

E. The Group's activity in derivative instruments

General

The above activity involves taking risks, mainly those discussed below:

- Credit risk measures the maximum loss which will be incurred if the other party will fail to discharge its obligations under the transaction. To cover this risk collateral is required from the client commensurate with the risk on the transactions. The collateral is included in the total amount of collateral required in respect of the client's obligations. For transactions which include the writing of options or the purchase/sale of contracts that are traded on a stock exchange, the clients are required to deposit at least the liquid collateral required by those stock exchanges.
- Market risk includes risks due to changes in interest rates and changes in foreign exchange rates, the CPI and stock exchange prices. The market risks relating to transactions in derivatives are part of the total of the market risk relating to financial instruments. Activity in derivatives is carried out within the limits of exposure to market risks determined by the boards of directors of the Group companies.
- Liquidity risk results from the uncertainty with respect to the price which the Bank will need to pay to cover the transaction. This risk exists mainly with respect to instruments with a low trade volume or a low trade volume of the underlying asset. This risk is taken into account in determining the collateral to be obtained.
- This activity does not refer derivative instruments embedded in other activities.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)
Reported Amounts

F. Activity in Derivatives - Scope, Credit Risks and Repayment Dates
a. Scope of Activity

	31 December 2007				
	Interest contracts		Foreign currency contracts	Contracts in respect of shares	Contracts in respect of goods and Others
	Shekel – index	Other			
	NIS millions				
(1) Amount of derivative instruments					
a) Hedged instruments (1)					
Swaps	**-**	**2,710**	**24**	**-**	**-**
Total	**-**	**2,710**	**24**	**-**	**-**
Of which: Swap contracts in which the banking institution agreed to pay a fixed rate of interest	**-**	**1,739**	**-**	**-**	**-**
b) ALM derivatives (1)(2)					
Futures contracts	**19**	**4,465**	**-**	**148**	**158**
Forward contracts	**8,585**	**27,992**	**85,748**	**-**	**708**
Traded options					
Put options	**-**	**-**	**4,760**	**9,961**	**125**
Call options	**-**	**-**	**5,108**	**10,034**	**125**
Other options					
Put options	**27**	**15,987**	**40,919**	**1,740**	**-**
Call options	**8**	**12,536**	**37,320**	**2,025**	**-**
Swaps	**1,220**	**47,936**	**6,098**	**-**	**-**
Total	**9,859**	**108,916**	**179,953**	**23,908**	**1,116**
Of which: Swap contracts in which the banking institution agreed to pay a fixed rate of interest	**-**	**7,465**	**-**	**-**	**-**
c) Other derivatives (1)					
Swaps	**-**	**-**	**-**	**-**	**-**
Total	**-**	**-**	**-**	**-**	**-**
d) Credit derivatives and Spot contracts					
Credit derivatives in which the banking institution is a guarantor	**-**	**-**	**-**	**-**	**975**
Spot contracts	**-**	**-**	**12,207**	**-**	**-**
Total	**-**	**-**	**12,207**	**-**	**975**
Overall total	**9,859**	**111,626**	**192,184**	**23,908**	**2,091**

(1) Except credit derivatives and Spot contracts.
(2) Derivatives constituting part of the Bank's system of management of assets and liabilities, not intended for hedging.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)
Reported Amounts

F. Activity in Derivatives - Scope, Credit Risks and Repayment Dates (cont'd)

a. Scope of Activity (cont'd)

	31 December 2007				
	Interest contracts		Foreign currency contracts	Contracts in respect of shares	Contracts in respect of goods and Others
	Shekel – index	Other			
	NIS millions				
(2) Gross fair value of derivative instruments					
a) Hedged derivatives (1)					
Gross positive fair value	**-**	**98**	**-**	**-**	**-**
Gross negative fair value	**-**	**17**	**18**	**-**	**-**
b) ALM derivatives (1)(2)					
Gross positive fair value	**18**	**667**	**3,214**	**609**	**24**
Gross negative fair value	**193**	**593**	**3,254**	**627**	**23**
c) Other derivatives (1)					
Gross positive fair value	**-**	**317**	**-**	**-**	**-**
Gross negative fair value	**-**	**306**	**-**	**-**	**-**
d) Credit derivatives					
Credit derivatives in which the banking institution is a guarantor	**-**	**-**	**-**	**-**	**-**
Gross positive fair value	**-**	**-**	**-**	**-**	**20**

(1) Except credit derivatives.
(2) Derivatives constituting part of the Bank's system of management of assets and liabilities, not intended for hedging.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

F. Activity in Derivatives - Scope, Credit Risks and Repayment Dates (cont'd)

a. Scope of Activity (cont'd)

	31 December 2006				
	Interest contracts		Foreign currency contracts	Contracts in respect of shares	Contracts in respect of goods and Others
	Shekel – index	Other			
	NIS millions				
(1) Amount of derivative instruments					
a) Hedged instruments (1)					
Swaps	-	(3) 6,817	81	-	-
Total	-	6,817	81	-	-
Of which: Swap contracts in which the banking institution agreed to pay a fixed rate of interest	-	2,415	-	-	-
b) ALM derivatives (1)(2)					
Futures contracts	-	5,137	-	167	130
Forward contracts	3,705	8,648	57,671	-	2,415
Traded options					
Put options	-	-	4,647	13,419	242
Call options	-	-	4,698	13,419	241
Other options					
Put options	12	11,393	29,551	1,678	-
Call options	-	7,768	26,218	2,067	-
Swaps	1,201	(3) 18,327	365	-	-
Total	4,918	51,273	123,150	30,750	3,028
Of which: Swap contracts in which the banking institution agreed to pay a fixed rate of interest	-	7,620	-	-	-
c) Other derivatives (1)					
Swaps	-	(3) -	-	-	-
Total	-	-	-	-	-
d) Credit derivatives and Spot contracts					
Credit derivatives in which the banking institution is a guarantor	-	-	-	-	232
	-	-	11,378	-	-
Spot contracts	-	-	11,378	-	232
Total	4,918	58,090	134,609	30,750	3,260
Overall total					

(1) Except credit derivatives and Spot contracts.
(2) Derivatives constituting part of the Bank's system of management of assets and liabilities, not intended for hedging.
(3) Reclassified.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)
Reported Amounts

F. Activity in Derivatives - Scope, Credit Risks and Repayment Dates (cont'd)
a. Scope of Activity (cont'd)

	31 December 2006				
	Interest contracts		Foreign currency contracts	Contracts in respect of shares	Contracts in respect of goods and others
	Shekel – index	Other			
	NIS millions				
(2) Gross fair value of derivative instruments					
a) Hedged derivatives (1)					
Gross positive fair value	-	423	-	-	-
Gross negative fair value	-	281	25	-	-
b) ALM derivatives (1)(2)					
Gross positive fair value	81	526	1,784	627	52
Gross negative fair value	2	303	1,799	649	51
c) Other derivatives (1)					
Gross positive fair value	-	2	-	-	-
Gross negative fair value	-	55	-	-	-
d) Credit derivatives					
Credit derivatives in which the banking institution is a guarantor	-	-	-	-	1
Gross positive fair value					

(1) Except credit derivatives.
(2) Derivatives constituting part of the Bank's system of management of assets and liabilities, not intended for hedging.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)
Reported Amounts

F. Activity in Derivatives - Scope, Credit Risks and Repayment Dates (Cont'd)

b. Credit Risk in Respect of Derivative Instruments According to Other Party to the Contract

	31 December 2007					
	Stock Exchanges	**Banks**	**Dealers/ brokers**	**Governments and central banks**	**Others**	**Total**
	NIS millions					
Balance sheet balances of assets derived from derivative instruments (1)	**210**	**2,710**	**26**	**-**	**2,001**	**4,947**
Off-balance sheet credit risk in respect of derivative instruments	**1,221**	**14,821**	**144**	**1**	**6,670**	**22,857**
Total credit risk in respect of derivative instruments	**1,431**	**17,531**	**170**	**1**	**8,671**	**27,804**

	31 December 2006					
	Stock Exchanges	Banks	Dealers/ brokers	Governments and central banks	Others	Total
	NIS millions					
Balance sheet balances of assets derived from derivative instruments (1)	226	1,796	38	1	1,435	3,496
Off-balance sheet credit risk in respect of derivative instruments	1,074	7,877	377	2	4,410	13,740
Total credit risk in respect of derivative instruments	1,300	9,673	415	3	5,845	17,236

(1) Net accounting arrangements do not exist.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)
Reported Amounts

F. Activity in Derivatives - Scope, Credit Risks and Repayment Dates (Cont'd)

c. Repayment Dates - Nominal Amounts: Balances as at End of Year

	31 December 2007				
	Up to three Months	**From three months to one year**	**From one year to five years**	**More than five years**	**Total**
	NIS millions				
Interest (Swap) contracts					
Shekel – index	**1,800**	**6,081**	**286**	**1,692**	**9,859**
Other	**19,081**	**34,742**	**33,935**	**23,868**	**111,626**
Foreign currency contracts	**115,054**	**53,845**	**16,130**	**7,155**	**192,184**
Contracts in respect of shares	**19,963**	**1,989**	**1,931**	**25**	**23,908**
Contracts in respect of commodities and others	**392**	**684**	**1,015**	**-**	**2,091**
Total	**156,290**	**97,341**	**53,297**	**32,740**	**339,668**

	31 December 2006				
	Up to three Months	From three months to one year	From one year to five years	More than five years	Total
	NIS millions				
Interest (Swap) contracts					
Shekel – index	723	2,639	1,556	-	4,918
Other	14,048	12,277	25,159	6,606	58,090
Foreign currency contracts	89,369	37,325	7,398	517	134,609
Contracts in respect of shares	22,731	5,757	2,184	78	30,750
Contracts in respect of commodities and others	2,083	1,035	142	-	3,260
Total	128,954	59,033	36,439	7,201	231,627

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. As a member of the Tel Aviv Stock Exchange, the Bank is a member of the risk fund of the stock exchange clearing house. As from 15 May, 2005, each of the members of the risk fund records a charge on securities in favor of the stock exchange clearing house in the amount of its proportionate part in the fund, to ensure the member's liabilities toward the clearing house and the part of the member in the risk fund. Also, the collateral ensures the liabilities of the other members of the risk fund in the event that the collateral provided by the other member is not sufficient to cover all liabilities of the other member, and in accordance with the proportionate part of each of the members in the fund, up to the amount of the collateral provided or up to the amount of the liabilities toward the stock exchange clearing house, according to the lower of the two. Total debentures subordinated by the Bank to the Stock Exchange Clearing House, as at 31 December, 2007 amount to NIS 174 million.

See Note 14 above for further details on the assets pledged to the stock exchange Clearing House.

H. The Bank is a member of the risk fund of the Maof Clearing House. The Bank is obligated to the Maof Clearing House to pay any monetary charge which results from Maof transactions on behalf of its customers, its nostro and Maof transactions of another member of the Stock Exchange which does not do its own clearing in the Maof Clearing House. The amount of the Bank's obligation is included in "other guarantees and liabilities".

The Bank provides security to the Maof Clearing House in the amount of its relative part in the risk fund and in respect of its aforementioned obligations, which guarantee any charge of the Maof Clearing House and its share in the risk fund. In addition, the security guarantees the monetary charges of the other risk fund members: if the security provided by one member of the fund did not cover all the amounts it was charged, the Maof Clearing House is entitled to also exercise the security that was provided to it by the other members of the risk fund, according to the proportionate share of each one in the fund, up to the amount of the security that was provided or the amount charged by the Maof Clearing House, whichever lower.

As balance sheet date, the Bank's share of the Maof Clearing House risk fund is NIS 194 million.

The Bank, like any other member of the clearing house, is allowed to guarantee its charges to the risk fund of the Maof Clearing House, by pledging treasury bonds. The total of all bonds pledged by the Bank to the Maof Clearing House as at 31 December 2007 is NIS 2,290 million.

See Note 14 above for further details on the assets pledged to the Maof Clearing House.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

I. In the regular course of business, lawsuits were filed against the Bank and certain subsidiaries, including applications for approval of class actions. According to Management of the Bank and the Managements of its consolidated companies, based on legal opinions regarding the chances of the claims, including the applications for approval of class actions, appropriate provisions were recorded insofar as required to cover damages resulting from the said claims.

In the opinion of Management of the Bank and the managements of its subsidiaries, the additional exposure in respect of claims that were filed against the Bank and the subsidiaries on various matters, each of which exceeds NIS 2 million and the probability of occurring is not remote, amounts to about NIS 58 million.

1. Following are details of claims in material amounts:

a. In September 1997 a foreign company in the process of liquidation filed a claim against the Bank, a subsidiary of the Bank (Bartrade International Trade and Finance Company 83 Ltd.) and certain employees in the amount of NIS 153 million as of the date of submission of the claim. The claim relates to transfer of US$ 43.4 million by the foreign company to an account with the Bank in the name of a manager of the foreign company. The liquidator of the foreign company claims, inter alia, that the defendants acted in such a way that enabled the manager of the foreign company to withdraw the said amount from the account.

b. On 15 June 2000 a claim was filed against the Bank with the Tel Aviv District Court together with a request to certify the claim as a class action in the amount of NIS 1 billion.

The plaintiff alleges that the Bank in its various publications promised to depositors of shekel deposits made by self service through direct banking channels a preferred interest rate of 1% over the accepted rate, and that the various publications and the information provided to the depositors at the time of the original deposit misled the depositors to think that the 1% additional interest is granted also in respect of the periods in which the deposit is automatically renewed and not only in respect of the original period of deposit, as is the actual case.

Accordingly, the plaintiff requests that the Bank pay to it and all the relevant depositors being represented, the preferred interest also in respect of the periods in which the deposits were automatically renewed. In December 2003 the Court certified the claim as a class action. The Bank submitted an appeal on the decision to the Supreme Court, which has not yet rendered a ruling on the matter.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

I. 1. (cont'd)

c. On 14 October 2004 a request to certify a claim as a class action in the amount of NIS 2 billion was filed with the Tel Aviv-Jaffa District Court against the Bank on the basis of the Banking Law (Customer Service) – 1981 and Regulation 29 of the Civil Procedure Regulations – 1984.

The subject of the claim is the allegations of the petitioner that he and all the other customers of the Bank were illegally and contrary to the exemptions indicated next to the fees on the Bank's price list were charged with fixed management fees, a credit service charge and a securities deposit management fee. The petitioner contends that the Bank has misled its customers and has breached the disclosure duties required of it by charging them with fees even though according to the Bank's price list they were entitled to be exempted from the payment of such fees. The applicant is also claiming that as such the Bank was unlawfully enriched.

After the reply to the request to certify the claim as a class action of the Bank was submitted to the Court its reply, and the reply of the petitioner to the reply of the Bank to certify the claim as a class action, a request to amend the claim was submitted to the Court, in the framework of which the petitioner requested the deletion of all of that section in the claim relating to securities deposit management fees. The Court agreed to the amendment request and the claim was reduced to the amount of approximately NIS 1.12 billion. Further to the amendment, an amended reply was submitted on behalf of the Bank to the amended request to certify the claim as a class action and the amended reply on behalf of the petitioner.

On 25 December 2007 the Tel-Aviv District Court rejected the request to certify the claim as a class action. On 10 February 2008 the petitioner submitted a request for approval of an appeal to the Supreme Court on the verdict.

d. In June 2005, an application for the approval of a class action was filed in the Tel Aviv District Court against the Bank in the amount of NIS 576 million.

The applicant claims that the Bank did not stand by promises advertised on its internet site during the years 2002 to 2004 (inclusive), regarding interest benefits on certain deposits made through the internet. The applicant is demanding that the Bank pay him and all depositors through the internet who did not receive the promised benefits as advertised, the damages that they suffered as a result of non-receipt of such promised benefits. The Bank has filed a response to the application for the approval of the claim as a class action.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

e. On 7 August 2005, an application was filed against the Bank in the Tel Aviv District Court for the approval of an action as a class action. The claim being made is that up until January 2003, the Bank did not credit its customers with the relative part of the commission amounts paid by them in respect of bank guarantees issued at their request, where the amounts of the guarantees were reduced before the end of the guarantee period.

The applicants maintain that the value of the claim exceeds NIS 2.5 million. On 20 July 2007 the Court rejected the request for the approval of the action as a class action.

f. In February 2006 a request was submitted by a customer of the Bank in the Tel Aviv District Court to approve submission of a class action against the Bank, in an amount estimated by the petitioner at approximately NIS 300 million.

According to the petitioner, in the framework of sale of the said "Structured Products" to Bank customers the Bank does not disclose the full pricing and charges a hidden "commission" that is expressed in the Bank's financial margin on the transaction, which in the applicant's view contradicts the requirement for disclosure imposed upon the Bank in accordance with the law.

The group, to which the requested class action relates, according to the claim, is all Bank customers that invested in various "structured products" marketed by the Bank, from January 1999 until January 2006, where the Bank did not disclose to them what allegedly should have been disclosed.

The Bank has filed a response to the application for the approval of the claim as a class action.

g. On 12 September 2006, an application to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, Bank Hapoalim and the Israel Discount Bank. The amount claimed in the class action for which approval has been requested is NIS 7 billion, while in the body of the claim, it is contended that the damage to the claimed group amounts to NIS 10 billion. No specific sum of the amount of the claim has been clearly attributed to each respondent. According to the applicant, the respondent banks charged their customers with interest for unlinked shekel credit, a commission for credit allotment and fixed management fees with regard to debitory current accounts at identical rates and amounts, as a result of price coordination and a restrictive arrangement, which are prohibited under the Restrictive Trade Practices Law. The remedy requested by the applicant is refund of the alleged over-charging to the respondent customers, who took unlinked shekel credit or a “retroactive reduction” of the aforementioned interest and commission rates that the respondent banks collected during the past decade. The Bank has filed a response to the application for the approval of the claim as a class action. On 21 January 2008 the Tel-Aviv District Court received the response and approved the claim to be made as a class action. The Bank intends to submit a request to appeal the verdict in the Supreme Court.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

h. On 31 January 2007, a petition to approve a class action was filed in the Tel-Aviv-Jaffa District Court against the Bank, as well as against Israel Discount Bank Ltd. and the First International Bank of Israel Ltd. One of the petitioners is, he alleges, a member of provident funds which he claims are managed by the Bank and are under its ownership. The aforesaid petitioner alleges that the commissions being paid by the provident funds to the Bank in respect to transactions in securities are "excessive." He claims that he and the other fund members have suffered damage in the amount of commissions that were paid that were beyond the "reasonable and acceptable commissions that should have been paid." The amount being claimed in the class action from all of the respondents is NIS 200 million. The petitioners are requesting various remedies, including the determination of a ceiling for commissions in accordance with "an appropriate rate," as well as an order that the Bank restore to the funds all of the commissions that it over-charged them, together with appropriate interest. The Bank has filed a response to the application for the approval of the claim as a class action.

i. On 23 November 2006, a claim and a request to approve the claim as a class action were filed in the District Court at Jerusalem against the Bank and against Bank Hapoalim Ltd. and Bank Discount Ltd. The petitioners allege that in respect to credit to the household sector, the banks collected interest at a rate that is much higher than that collected from the commercial sector and from the business sector, this in spite of the fact that the risk in extending credit to the household sector is significantly lower than the risk for those sectors, and that this excessive interest rate derives from the exploitation of the low bargaining power of the household sector and from the monopolistic power of the respondents. The petitioners allege that the reference is to an infringement of the Restrictive Trade Practices Law, 1988, which prohibits the owner of a monopoly from abusing his position in the market, and that there is a real suspicion that the lack of competition among the respondents, regarding everything concerning the household sector, is the result of the restrictive arrangement among the parties.

The petitioners also allege that the interest rate is determined while misleading the consumers regarding the acceptable price for the credit service to the household sector, contrary to the provisions of the Consumer Protection Law, 1981 and the Banking Law, 1981.

The petitioners allege that the damage caused to them and the members of the group is the result of a multiplier of (1) the gap between the interest rate effectively collected and the fair interest rate that would have been determined for loans to the household sector in a competitive market, (2) the amounts of credit that each of the petitioners and members of the group took during the seven years preceding the filing of the claim.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

The damage alleged by them is NIS 5,581 billion according to one method, and NIS 5,206 billion according to the second method, where out of this amount, the estimated damage attributed to the Bank's customers is at lest NIS 1,550 billion.
The Bank has filed a response to the application for the approval of the claim as a class action. The Bank has submitted a request fo a delay in proceedings in this lawsuit until the conclusion of the proceedings in the lawsuit described in paragraph g. above

j. On 31 January 2008, 260 identical claims were to the Tel-Aviv Magistrates Court, against the Bank and the liquidators appointed by the Court. The amount of each claim is between NIS 787,000 and approximately NIS 1,350,000. By decision of the Court, the proceedings for all of the above claims were amalgamated, and they will be judged as one claim. The total amount of the claims is about NIS 270 million. The petitioners are purchasers of vacation apartments in the Nofit Hotel project in Eilat. According to the claim of the petitioners, the Bank and the liquidators were negligent in their supervision of the project and did not finance safe custody charges, and as a result of this much damage was caused to the petitioners including the impairment in value of the apartments. These claims join with 5 additional claims submitted against the Bank for the same reason and are being arbitrated separately. The total amount of all the claims in connection with the project is about NIS 288.6 million.

2. Also, lawsuits were filed against the Bank, including applications for approval of class actions, as detailed below. According to Management of the Bank, based on the opinion of its legal advisor, it is not possible at this stage to estimate the chances of the claims and therefore no provision was recorded in the financial statements.
Following are the details of the legal claims:

a. On 1 April 2007, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, additional banks, and entities that purchased the control of the mutual fund managers from the banks. The amount claimed against the Bank is estimated by the petitioners at some NIS 131 million.

The petitioners claim that they held and hold mutual fund units that were managed by fund managers controlled by the Bank. According to the petitioners, the Bank, beginning in 2004, charged the fund managers it controlled brokerage commissions with respect to the execution of securities and foreign currency transactions, at a rate higher than the rate it charged other entities, and in doing so, it acted unlawfully.

According to them, although during 2006 the Bank sold its holdings in the fund managers to third parties, it continues to provide the same services to the mutual funds in exchange for even higher commissions than those charged prior to the sale of the control, and the continued provision of the said services suggests that the Bank and the purchasers of the control of the fund managers had agreed that in exchange for a reduction in the price paid for a mutual fund manager, the Bank would continue to provide the trading services that it had provided prior to the sale, in exchange for the high commissions that had been charged up until the sale – a matter which removes all substance, they allege, from the sale of the control of the fund managers.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

The petitioners argue that they and the other holders of mutual fund units that were or are under the Bank’s control have suffered damages that reflect the reduction in the value of the mutual fund units due to the alleged over-charging.

In the opinion of the Bank's management, which is based on the opinion of the Bank's legal advisors, at this preliminary stage it is not possible to estimate the chances for the request.

b. On 26 June 2007, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, for a claim in the amount of NIS 200 million. The plaintiff claims that the Bank charged its customers securities deposit management fee commissions which were higher than had been agreed, each time a low volume partial sale of a specific share took place during a single quarter, for which a commission was paid on the execution date at the minimum rate established in the Bank’s price list, and in addition a management fee commission was paid at the end of the quarter for shares that were not sold. Therefore, each time the plaintiff carried out a low volume partial sale of a particular share for which the commission was less than the minimum, the Bank charged the customer with the minimum commission as well as the management fee commission collected at the end of the quarter, with the aggregate amount of the two commissions being higher than the agreed maximum management fees that the Bank was entitled to collect. The plaintiff claims that the Bank was required to deduct the minimum commission collected at the time of the partial sale from the total amount of the management fees. The plaintiff also argues that the Bank’s documents and announcements do not reflect the amounts of the management fee commissions that are actually charged during a single quarter.

In the opinion of the Bank's Management, which is based on the opinion of the Bank's legal advisors, it is not possible at this early stage to estimate the chances of the petition.

c. On 11 October 2007, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, for a claim in the amount of some NIS 435 million. The petition includes a number of claims – the plaintiffs claim that the Bank collects management fees for securities accounts, in the minimum amount of NIS 5.5, for securities that are bought and sold on the same day, even if they are held for only one hour; that the Bank unilaterally cancelled an exemption from the management fee that the Bank is required to give, the plaintiffs claim, regarding the purchase of certain mutual funds through monthly standing orders; the Bank collects a commission for the buying and selling of securities at the minimum rate, without providing a 20% discount which is given, according to the Bank’s representation, in respect of buying and selling commissions regarding transactions carried out through the Internet; when a nominal sale of securities was carried out by customers during the month of December 2005 (in anticipation of the rise in tax rates for capital market transactions at the beginning of 2006), the Bank did not – according to the plaintiffs – treat the management fees that it had collected as a deductible expense for the customer when calculating the applicable tax. The plaintiffs further contend that if a security is sold during a particular quarter and the customer is charged with a minimum securities management fee, such fee should be

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

deducted from the minimum management fee that the bank charges for that quarter, and the Bank does not do so; that the Bank charged an exorbitant penalty for withdrawing funds from deposits other than at the set exit dates of the deposits and that such fines reduced accumulated interest and principal; that with regard to daily deposits of the *Pidyom* type, the Bank rounds up the interest to full *agurot* each day, which the plaintiffs argue is in violation of Bank of Israel directives according to which the rounding up is to be done only once; that the Bank does not consolidate a single customer's shekel deposits which are of the same type and for the same period, and that the customer thus receives a lower interest rate than the customer would have received if the Bank had consolidated the deposits.

In the opinion of the Bank's Management, which is based on the opinion of the Bank's legal advisors, it is not possible at this early stage to estimate the chances of the petition.

d. Regarding the demand by the Company for the Tracing and Return of Property of Holocaust Victims Ltd. in the sum of NIS 148 million, see P. below.

3. Following are details of requests for approval of class actions in material amounts that were submitted against Leumi Mortgage Bank Ltd. ("Leumi Mortgage Bank"). In the opinion of the Management of the Bank, based on the opinion of the Management of Leumi Mortgage Bank, which is based on the opinion of Leumi Mortgage Bank's legal advisors as to the chances of these proceedings, appropriate provisions have been included in the Financial Statements, insofar as required, to cover damages resulting from such claims:

a. A claim was filed with the Tel Aviv District Court and an application for approval as a class action against the bank based on the Banking Law (Customer Service), 1981, Regulation 29 of the Civil Procedures Regulations, 1984, and the Law for Supervision of Insurance Practices, 1981. The amount of the claim, whose approval as a class action was requested, is estimated by the petitioners at NIS 100 million.

The claim relates to the petitioners' arguments regarding the value of buildings for purposes of property insurance in the framework of loans taken out from Leumi Mortgage Bank. According to the petitioners, Leumi Mortgage Bank or its representative prepared an excessive valuation of the said building, resulting in overpayment of premiums by bank customers. In accordance with the decision of the District Court, the hearing on the claim will be deferred until the appeals discussed in paragraph 4.1 below are decided.

b. On 3 July 2001 an application was filed in the Tel Aviv District Court for approval of a class action based on the Banking Law (Customer Service), 1981, the Restricted Practices Law, 1988, and Regulation 29 of the Civil Procedure Regulations, 1984.

The class action is estimated by the petitioner at NIS 180 million as of the date of submission of the claim.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

The subject of the claim is alleged overcharging by Leumi Mortgage Bank in respect of loans at variable interest. According to the petitioner, the interest according to which Leumi Mortgage Bank updates loans at variable interest is excessive and collected illegally based on misleading information to borrowers, a syndicate between the mortgage banks and other arguments.

In addition to the monetary claim, additional measures were requested including declarative measures and determination of various rights for borrowers in accordance with the loan agreement.

On 3 June 2003 the Court deferred the application for approval of the claim as a class action. On 23 September 2003 the petitioner appealed the said decision to the Supreme Court. On 30 June 2004 the Supreme Court decided to defer the continued hearing of the appeal in order to await a decision in the additional hearing regarding Regulation 29 of the Civilian Regulations, 1984 (5161/03) that was handed down on 1 September 2005. In summary, the decision states that although interpretive means may be utilized to convert Regulation 29 to an instrument for submission of class actions, such utilization is not appropriate, taking into consideration contingent outstanding legal procedures in the class action sector. Accordingly, the parties agreed to remove from the appeal the subject of Regulation 29.

On 12 March 2006, the Class Actions Law, 2006 (the “Law”) was published. The object of the Law is to regulate uniform rules relating to the filing and conduct of class actions.

The Law stipulates that a class action shall not be filed, other than a claim detailed in the schedule to the Law or pursuant to an express statutory provision. The matters in respect whereof a class action may be filed on the basis of the Law include “a claim against a banking corporation in connection with a matter between it and a customer, irrespective of whether they entered into a transaction or not”. The Law provides that in principle its provisions shall also apply to applications to approve a class action and to class actions that were pending before a court on the day the Law was published. At the same time, the Law repeals the provisions in the Banking Law (as well as in the Restrictive Trade Practices Law and in additional laws) that enable the filing of class actions. The Law also lays down provisions as to the prescription of causes of action that had not been established in specific arrangements that enabled the filing of a class action prior to its enactment (such as the arrangements pursuant to the Banking Law or the Restrictive Trade Practices Law) and that were included in applications to approve class actions that were submitted prior to the publication of the Law. On 24 April 2006 the Supreme Court ruled that the parties should submit their summations as to the applicability of the Law to the proceeding before it, and if the Law in fact applies - the implications of its application. In the hearing held on 15 October 2007, the Supreme Court rejected the appeal.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

c. On 7 July 2003 an application for approval of a class action was filed against Leumi Mortgage Bank and against the Director of Stamp Duty based on the Banking Law (Customer Service), 1981, and Regulation 29 of the Civil Procedure Regulations, 1984.

The petitioner argues that he received a loan from Leumi Mortgage Bank. According to the Law, Leumi Mortgage Bank was required to stamp the loan documents. Leumi Mortgage Bank charged the petitioner a higher amount than the required stamp duty according to the Law, calculated according to the total amount of the loan repayments, including interest in respect thereof, over the whole period of the loan. The correct amount of stamp duty should be calculated according to the amount of the loan without taking into account interest. Leumi Mortgage Bank presented misleading documents to the petitioner according to which the required stamp duty is the amount according to the Law.

The required procedure involves refunding to the group of petitioners by Leumi Mortgage Bank and the Director of Stamp Duty the difference between the actual stamp duty and the amount claimed by the petitioners.

The amount of the class action whose approval is requested is estimated by the petitioner at NIS 100 million. By agreement with the parties Leumi Mortgage Bank has not yet filed a response to the request for approval. Proceedings in the case were amalgamated with proceedings in similar claims submitted against other banks. On 16 March 2008, the petitioners submitted a request to be removed from the claim. Their request was received on 16 March 2008, and the Court gave instructions to postpone the claim.

d. On 2 December 2006, a request to approve a class action was filed with the District Court at Tel-Aviv-Jaffa against the Leumi Mortgage Bank and against the Migdal Insurance Company Ltd. ("Migdal") regarding the payments of partial life insurance compensation. The estimated amount for the class action, as claimed by the petitioner, is NIS 150 million.

The petitioner and his deceased spouse took out a loan from Leumi Mortgage Bank. According to what is alleged in the request: borrowers who took out a loan from the Leumi Mortgage Bank were able to join a life insurance arrangement for borrowers, in which the insurer is Migdal; numbered among the borrowers who joined the aforesaid life insurance are borrowers who, when an insurance event occurred, received partial insurance compensation at a rate lower than the amount of the insurance and of the balance of the loan; contrary to the amount actually paid, Leumi Mortgage Bank and Migdal promised to pay the insured-borrower parties, as stated "insurance compensation at the rate of the loan balance that is due or at the rate of the amount of insurance (the lower among them)" - so alleges the petitioner.

e. On 27 March 2006, an application was filed against Leumi Mortgage Bank in the Tel Aviv-Jaffa District Court to approve a class action with regard to an alleged overcharging of stamp duty.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

The estimated amount of the class action against Leumi Mortgage Bank is asserted in the application to be NIS 22 million.

The application was filed by a person who took a loan from Leumi Mortgage Bank and who contends that Leumi Mortgage Bank charged customers who had taken loans from it, stamp duty in respect of the amount of the interest that is added to the loans. As is asserted in the application, the claim involves overcharging since Leumi Mortgage Bank should have only charged stamp duty in respect of the amount of the loan principal.

It should be noted that an application is pending against Leumi Mortgage Bank to approve a class action in an asserted amount of some NIS 100 million, that was filed against it and against the Director of Stamp Duty authorities on 7 July 2003, in which overcharging of stamp duty is also asserted, which it is contended was affected by charging stamp duty in respect of the interest component of the loan (see paragraph 3.c. above for further details of the matter). It is contended in the present application that it relates to a charge period that is different from that asserted in the application to approve a class action with regard to stamp duty that is already pending against Leumi Mortgage Bank.

At the request of the petitioner the request was rejected without an order for expenses.

4. Also, lawsuits were filed against Leumi Mortgage Bank, including applications for approval of class actions, as detailed below. According to Management of the Bank, based on the opinion of Management of Leumi Mortgage Bank, which is based on the opinion of Leumi Mortgage Bank's legal advisors, it is not possible at this stage to estimate the chances of the claims and therefore no provision was recorded in the financial statements.

   Following are details of claims:

a. On 17 July 1997 an application for approval of a class action in an amount exceeding NIS 1 billion was filed with the Tel Aviv District Court against Leumi Mortgage Bank and against other mortgage banks in connection with collection of borrowers' life assurance and property insurance commissions.

   Each of the petitioners took out a loan from the respondent mortgage banks. According to the petitioners, in the framework of taking out the loan, the respondent banks included them in life assurance or property insurance policies implemented through the banks and part of the insurance premiums reached the respondent banks in contradiction to the law.

   On 17 November 1997 the Court decided that the claim cannot be heard as a class action according to the Banking Law (Customer Service), 1981, and the Restricted Practices Law, 1988. Accordingly, the Court dismissed the monetary claim.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Nevertheless, the Court decided that the claim can be heard in the framework of Regulation 29 of the Civil Procedure Regulations, 1984, only regarding claims for declaratory measures relating to periods before 10 May 1996. The Court decided that the cases that can be heard in this framework relate to the "restrictive arrangement and various insurance issues".

Appeals to the Supreme Court regarding these matters were submitted by Leumi Mortgage Bank, all other mortgage banks involved in the claim and the petitioners. In accordance with the decision of the Supreme Court, the District Court's decision was deferred. Accordingly, the claim will not be determined until the Supreme Court decides regarding all appeals filed.

On 1 September 2005 the Supreme Court handed down a judgment in which it was determined, in short, that although it was possible to utilize interpretive means to convert Regulation 29 into an instrument for submission of class actions, such utilization is not appropriate at this time, taking into consideration the legislative procedures underway in the field of class actions. On 12 March 2006 the Class Actions Law was published. For details of the Law, see in paragraph 3.b above. Aon the appeal has benn scheduled for 27 March 2008.

According to Management of the Bank, based on the opinion of Management of Leumi Mortgage Bank, based on the opinion of Leumi Mortgage Bank's legal advisors, at this stage it is not possible to estimate the chances of the appeals.

b. On 10 June 2003 an additional application for approval of a class action was filed against Leumi Mortgage Bank regarding alleged over-collection from borrowers who took out loans at variable interest. Although the application and the claim are stated unclearly, it appears that at least partial overlapping exists with the basic arguments raised in paragraph 3.b above, the measures requested and the group of petitioners.

The amount of the class action requested is estimated by the petitioners at NIS 90 million.

In light of the (at least partial) overlapping between the application for approval of the class action reviewed here and the application for approval of the class action reviewed in paragraph 3.b above, it was agreed between the parties to defer the process in the claim until after clarification of the appeal submitted in connection with paragraph 3.b above. The Court was informed regarding this agreement and, accordingly, a response has not yet been submitted to the application for approval of a class action.

According to Management of the Bank, based on the opinion of management of Leumi Mortgage Bank, based on the opinion of Leumi Mortgage Bank's legal advisors, in light of the preliminary stage of the process, the chances of the claim cannot be estimated at this time.

c. On 19 August 2007, a petition to approve a class action was filed in the Jerusalem District Court against Leumi Mortgage Bank, together with the text of a statement of classaction claim regarding the joining of an "additional borrower" to a portion of the

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

loans granted by Leumi Mortgage Bank. The amount of the class action is estimated, according to the petitioners, at over NIS 5 million.

The petitioners are claiming that LeumiMortgage Bank demanded the joining of an "additional borrower" within the framework of a loan taken out. According to the petitioners, the additional borrower is not a borrower at all but a fiction and in fact he is

a guarantor of the loan.The petitioners claim that, if the person joined as an "additional borrower" was actually joinedas a guarantor of the loan, he would not have been required to take out life insurance for the purposes of the loan, as he was required to do in practice.

The petitioners are requesting the approval of a class action on behalf of all such people who wereclassified as "additional borrowers" by LeumiMortgage Bank, who have no rights to the pledged property and who, as part of the loan, wererequired to take out life insurance and pay insurance premiums in respect thereof, either directly or throughthe principal borrowers, for the seven years prior to the filing of the petition.

The petitioners are requesting the reimbursementof insurance premiums that were paid as mentioned, and an order instructing Leumi Mortgage Bank to cancel the requirement to take out life insurance, and the pledging thereof with regard to the additional borrowers who are members of the group.

According to Management of the Bank, in reliance on the opinion of management of Leumi Mortgage Bank, based on the opinion of Leumi Mortgage Bank's legal advisors, it is not possible at this early stage to estimate the chances of the claim.

5. An indictment was in March 2007 against the Bank, Leumi L.P. Ltd. (formerly Leumi-Pia Trust Management Co. Ltd.), Leumi Management Ltd. (formerly Psagot Managers of Mutual Funds - Leumi Ltd.) and Leumi Securities and Investments Ltd. (formerly Psagot Ofek Investment House Ltd.), subsidiaries of the Bank, and against a number of employees of the Bank and of the said companies at the time of the offence attributed to them, in respect of a breach of section 82 of the Joint Investment Trust Law, 1984 in its form at the time of the alleged offence, together with section 29(b) of the Penal Law, 1977.

   In January 2008 the Magistrates Court in Tel-Aviv-Jaffa approved a plea arrangement arrived at between the Bank and the above companies and the Attorney's Office. In the framework of the plea arrangement the Attorney's Office withdrew from all charges made against employees of the Bank and employees of the subsidiary companies. The bank and the subsidiary companies admitted the facts which were the subject of the charges, which were based on section 82 of the of the Joint Investment Trust Law, 1984, in its form at the time of the alleged offence, as amended in the framework of the plea arrangement, and fines were imposed on them according to the following details: the Bank – NIS 5 million, Leumi L.O. Ltd. – NIS 10 million, and

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Leumi Management Ltd. and Leumi Securities and Investments Ltd. – NIS 10 million, divided between them both.

J. The Bank is a guarantor for part of the members of the provident funds that were managed by Leumi Capital Market Services Ltd. (formerly Leumi Fund Ltd.), whose operations were sold to Prizma Provident Funds Ltd. ("Prizma"). The guarantee secures the repayment of the amounts of the original principals that were deposited which, at 31 December 2007, amounted in nominal values to NIS 3,451 million (31 December 2006 - NIS 3,619 million). The value of the assets of the aforesaid Funds as of 31 December 2007, amounted to NIS 10.601 million. Regarding those members who joined the aforesaid provident funds from 31 August 1994, this guarantee applies only three years after their joining. Regarding members of the Zur provident fund, this guarantee applies to accounts opened since October 2003, and only three years after they were opened. In addition, this guarantee does not apply to deposits in accounts that were opened in the above funds from 22 January 2007. The amounts accumulated in the provident funds credited to the aforesaid members and that are lower than the total of their nominal deposits are about NIS 277 thousand as of 31 December 2007. The fair value of the above liabilities as of 31 December 2007 is not material.

Prizma undertook that against the aforesaid liability, that in the event the guarantees, or any part of them are realized, it will pay the Bank participation in an amount that is not to exceed NIS 35 million per calendar year, this amount being linked to the Israeli CPI dated 30 October 2006 - and until the payment date. A participation amount that is not utilized in a certain year will not be carried forward to future years.

K. According to by-laws of the provident fund of the employees of the Bank, and in order that the fund will always have sufficient cash to pay the benefits to its members, the Bank is committed to advance to the fund any amount it may require from time to time for the payment of amounts due to members of the fund in accordance with its by-laws, on the condition that such advances are to be repaid to the Bank from the first amounts received by the fund from any source. For this purpose, the Bank was authorized by the fund to retain and to maintain amounts to be received by the fund from members' payments, from the Bank's payments and from any other source.

L. Subsidiaries of the Bank which serve as trust companies, as well as a number of banking subsidiaries, perform trust operations. Such operations include, mainly, trusteeship over funds, securities and real estate; the handling of donations, gifts and bequests; acting as agent in regard to deposits and loans; handling of share transfers; and management of investment accounts. Some of these companies also act as trustees for debenture holders and for mutual funds.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

M. Letters of indemnity

(1) The Bank has undertaken to indemnify the underwriters and the distributors in Europe of an offer for sale and issue of securities of the Bank according to prospectuses published in 2003 (hereinafter – "the prospectuses") for any amount (with the addition of expenses) that they will be required to pay according to a Court ruling or a compromise to which the Bank will agree, as a result of any misleading item in the prospectus or the omission of any item which is likely to be important to a reasonable investor contemplating the purchase of securities offered according to the prospectus or as a result of a claim under the Securities Law, 5728-1968, the cause of action of which is inherent in or derives from the prospectus, on condition that the claim is related to and/or derives from the Bank's acts of commission or omission (no limit was determined for these indemnities).

The Bank has undertaken in advance to grant indemnification to directors and the other officers of the Bank in respect of monetary liability which may be imposed on them and in respect of reasonable legal expenses in connection with the prospectuses, the privatization of the Bank and in connection with the prospectuses and issues, guaranteed by the Bank, of the wholly owned subsidiary, Leumi International Investments N.V. (hereinafter -"LII") as from 1997. The overall maximum amount of the indemnification is not to exceed the gross proceeds from the sale offers and the issues, including the proceeds from the exercise of options or other convertible securities, the amount of NIS 569 million; in the event of privatization, it is not to exceed the gross proceeds received from the privatization (including proceeds from an issue by the Bank, if included in a prospectus in respect of the privatization, and proceeds from the exercise of options or other convertible securities); in the case of LII, the gross proceeds received (as of 31 December 2007, the amount of $ 1,088 million) and/or which will be received from issues of LII as from 1997.

(2) The Bank has undertaken in advance to provide indemnifications to Leumi Finance Co. Ltd., a fully controlled subsidiary (hereinafter – "the Company"), in order for it to carry out the indemnifications which the Company gave in respect of prospectuses for the issue of subordinated capital notes and debentures to the public, which the Company published in 2001, 2003, 2005, 2007 and 2008 and will publish in 2008 to its directors and officers as well as to the lawyers of the issue, in respect of monetary liability that may be imposed on them for action taken within the scope of their duties as officers of the Company and/or within the scope of the services they provide the Company related to the prospectuses, and in respect of reasonable litigation expenses. The maximum indemnification is NIS 14.3 billion.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

M. Letters of indemnity (cont'd)

The Bank has also given indemnification to Leumi Leasing and Investment Ltd. in respect of amounts the latter may be required to pay according to the letter of indemnification which it issued to an employee of the Bank, who served on its behalf as a director of Airport City Ltd., in excess of amounts which it is able to pay. The maximum amount payable under the indemnification shall be the total amount of the directors and officers liability insurance policy of the Bank which existed on 1 July 1998 (including the amounts which may be reinstated under that policy). The maximum indemnification is NIS 200 million.

(3) The Bank has undertaken in advance to provide indemnification to two employees of the Bank in respect of monetary liability that may be imposed on them and reasonable litigation expenses in connection with their service as directors of Gambit Computer Communications Ltd. in which the Bank holds approximately 16.9% of the means of control. The maximum amount payable under the indemnification shall be the total amount of the directors and officers liability insurance policy of the Bank which existed on 1 July 1998 (including the amounts which may be reinstated under that policy). The maximum indemnification is NIS 200 million.

(4) The Bank has undertaken in advance to indemnify its officers as a result of fulfillment of their duties in the Bank and in subsidiaries and other companies on behalf of the Bank, and in respect of a list of events as accepted practice in the banking system in Israel including, inter alia, the regular course of business of the Bank, offerings to the public in the framework of a prospectus and reports to the public and to the statutory authorities. The actual fulfillment of the indemnity commitment is subject to the two following conditions being met: (1) The maximum amount of the actual indemnification to all officers of the Bank and of the subsidiaries, in respect of monetary liability which may be imposed on any of them and in respect of reasonable legal fees, in connection with the above events, will not exceed in aggregate 10% (ten percent) of the shareholders' equity of the Bank as defined in Directive 313 of the Supervisor of Banks, as stated in the last financial statements of the Bank published immediately prior to the date of the actual indemnification; and (2) The maximum amount of the actual indemnification does not impair the minimum capital requirement in accordance with Directive 311 of the Supervisor of Banks. The obligation for indemnification is also for reasonable litigation expenses paid subsequent to an investigation or proceeding that ended without an indictment being filed, and without a financial liability being imposed as an alternative to criminal proceedings, or that ended without a bill of indictment being filed but with a financial liability being imposed as an alternative to criminal proceedings for an infraction that does not require proof of criminal intent. The obligation for indemnification will be in effect only after exhaustion of the rights of the officer toward a third party (e.g. insurer). Also, the Bank undertook in advance to similarly indemnify the legal advisor to the Board of Directors of the Bank in respect of legal services provided to the Board of Directors, to the Bank and to the Directors as legal advisor to the Board of Directors.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

M. Letters of indemnity (cont'd)

(5) The Bank has undertaken in advance to indemnify the employees ranking assistant CEO and up that are not officers of the Bank and that have personal employment contracts ("the personal contract employees") with respect to the duties they fulfill with the Bank and in the subsidiaries and other companies on behalf of the Bank and in respect of a list of events as is the accepted practice in the banking system in Israel, similarly to the Bank's indemnity undertaking in paragraph (4) above. The actual fulfillment of the indemnity commitment is subject to the two following conditions being met: (1) The maximum amount of the actual indemnification to all the officers of the Bank, the officers of the subsidiaries and the personal contract employees, in respect of monetary liability which may be imposed on any of them and in respect of reasonable legal fees, in connection with the above events, will not exceed in aggregate 10% (ten percent) of the shareholders' equity of the Bank as defined in Directive 313 of the Supervisor of Banks, as stated in the last financial statements of the Bank published immediately prior to the date of the actual indemnification; and (2) The maximum amount of the actual indemnification does not impair the minimum capital requirement in accordance with Directive 311 of the Supervisor of Banks.

(6) The Bank is obligated to indemnify officers of Leumi France (former "Banque Leumi France") in respect of a list of events including, inter alia, the regular course of business of Leumi France, merger or split or liquidation of the business of Leumi France and transactions with interested parties. The conditions of the indemnification, including the maximum amount thereof, are as stated in paragraph (5) above.

(7) The Bank undertook in advance to indemnify the trustees of Bank Leumi le-Israel Employees Provident Fund Ltd. ("the Fund") (including one officer of the Bank), the CEO and the employees of the Fund, in respect of any monetary liability that is imposed on any of them and in respect of reasonable legal expenses relating to any past or future decision or action (including omissions) relating to the plan to dissolve the insurance fund of the Fund. The actual fulfillment of the indemnity commitment is subject to all the three following conditions being met: (1) The maximum amount of the actual indemnification to all the trustees, the CEO and employees of the Fund will not exceed, in aggregate, NIS 20 million, linked to the Consumer Price Index, beginning from 28 November, 2004 until the date of indemnification, (2) The maximum amount of the actual indemnification to all officers of the Bank, officers of the subsidiaries and employees of the Bank will not exceed, in aggregate, 10% (ten percent) of the shareholders' equity of the Bank as defined in Directive 313 of the Supervisor of Banks, as stated in the last financial statements of the Bank published immediately prior to the date of the actual indemnification; and (3) The maximum amount of the actual indemnification does not impair the minimum capital requirement in accordance with Directive 311 of the Supervisor of Banks.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

M. (cont'd)

(8) The Bank granted an exemption to officers of the Bank and to the personal contract employees from responsibility for damage as a result of breach of their duty of care toward the Bank. The Bank granted a similar exemption to the legal advisor to the Board of Directors in connection with the provision of legal services as stated in paragraph (5) above.

(9) The Bank committed to indemnify Yitzhak Suari Ltd. ("the consultants") in respect of any liability to pay to any third party in connection with their services provided to the Bank in excess of the amounts of the limitation of responsibility agreed between the parties (three times the amount of the professional fees) and committed to reimburse the consultants for reasonable expenses incurred by the consultants for legal consulting and representation, etc in connection with any claim, demand or other processes derived or related in any manner to services provided by the consultants to the Bank, all in respect of economic consulting services and accompaniment of the Bank's preparations for implementation of the reform in the capital market (maximum indemnification was not determined).

(10) The Bank committed to indemnify Goldman Sacks International ("Goldman Sacks") in respect of any liability or loss levied or incurred to them and in respect of legal and other expenses derived from a claim, procedure or investigation submitted against them by any third party (including shareholders in the Bank), all in connection with the appointment of Goldman Sacks as the Bank's financial consultant in connection with sale of the Bank's subsidiaries operating in the capital market (maximum indemnification was not determined).

(11) The Bank committed in advance to indemnify the underwriters to the Group's insurance policy (including banking, responsibility, directors and other offices and professional responsibility insurance) in respect of losses incurred as a result of application of the Israeli law on such policies relating to foreign subsidiaries of the Bank (maximum indemnification was not determined).

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

M. (cont’d)

(12) The Bank committed to indemnify Psagot Basket Certificates Ltd. (formerly Ofek Leumi Financial Instruments Ltd.) and Psagot Liability Certificates Ltd. (formerly Psagot Ofek Financial Products Ltd.) (jointly hereinafter: "the companies") in respect to indemnifications that the companies granted to their officers. In a case where the companies will be obligated to indemnify the recipients of the indemnification pursuant to the indemnity letter that they granted, the Bank will pay the companies any amount exceeding the amounts that were paid and/or will be paid by the companies, and this only in respect to actions or deeds that occurred prior to the consummation of the sale of the companies by the Bank. The exercise of the liabilities for actual indemnification is contingent on the occurrence of the following cumulative conditions: (1) the amounts of the realized indemnities pursuant to the indemnity letters of the companies and the amounts of the realization of the other indemnity letters to the Bank's officers and other employees of the Bank, cumulatively, will not exceed 10% (ten percent) of the Bank's shareholders' equity, as it is defined in directive 313 to the Directives of the Supervisor of the Banks, and (2) the payment of the amounts of the actual realization of the indemnities will not impair the minimal capital ratio that is required pursuant to directive 311 to the Directives of the Supervisor of the Banks.

(13) The Bank committed to indemnify York Global Finance I Pte. Ltd. and corporations on its behalf that carried out the acquisition (jointly hereinafter: "the buyer") in the framework of the transaction for the sale of the activities and the share capital of the member companies of the Psagot Ofek group, which was carried out subsequent to the reform in the capital market. The indemnity is in respect of any direct damage (net of any tax advantage) that will result to the buyer as a consequence of the claims by third parties that are attributed to the period prior to the date on which the transaction was consummated, from the breach of specific representations that were provided in the agreement, and from the tax liability that refers to the period preceding the date on which the transaction was consummated, where the indemnity in respect to tax liabilities is directly imposed on the holders of units in the trust funds is stipulated on the issuance of a verdict or a definitive decision by a court and/or a competent authority, pursuant to which the sellers, or one of them, must bear these liabilities (maximum indemnification was not determined).

In addition, the Bank committed to guarantee the financial liabilities of the member companies of the Psagot Ofek group (the sellers) toward the buyer in accordance with the sale agreement.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

M. (cont'd)

(14) The Bank committed to indemnify Promontory Financial Group LLC ("Promontory") in respect to a liability or loss that will be imposed on or realized by them, as well as in respect to legal and other expenses stemming from a claim that will be filed against them by any third party whatsoever in connection, among others, with actions by the Bank, Bank Leumi USA, a potential buyer of the Bank, their employees or officers, that stems from the Promontory's services as a consultant for the strategic matters of the Leumi Group USA. Maximum indemnification was not determined; however it is restricted to amounts that exceed the amount of the professional fees that were paid by the Bank to Promontory.

(15) The Bank committed to indemnify Harel Insurance Ltd. ("Harel"), in accordance with a transaction for the sale of five provident funds managed by Leumi Fund Ltd. and in accordance with a transaction for the sale of the assets of Leumi-Pia,, in the event a financial liability will be imposed on Harel in respect to the commitment to pay sale grants to employees and/or in connection with an investigation of the Israel Securities Authority, whichever the case may be.

(16) The Bank undertook to indemnify Tamir Fishman Trusteeships 2004 Ltd. ("Tamir Fishman") in connection with the options program and the offer of shares to employees of the Bank, Leumi Mortgage Bank Ltd., Arab-Israel Bank Ltd. and the Bank Leumi le-Israel Employees Restaurant Association ("the companies"). The companies are obliged to indemnify Tamir Fishman for any damage and /or expense and/or loss actually borne by Tamir Fishman (including lawyers' fees) following a final judgment verdict against Tamir Fishman in favor of any third party whatsoever, in connection with or as a result of it carrying out its duties in accordance with the trust agreements signed in the framework of these above programs, and in accordance with any law (no maximum indemnification has been decided).

(17) The Bank undertook to indemnify Visa International (Europe) in respect of carrying out the liabilities of Bank Leumi Romania S.A. concerning "Visa" credit card activity (no maximum indemnification has been decided).

(18) The bank has given an undertaking in the amount of 10 million euro in favor of the European Bank for Reconstruction and Development (henceforth – "EBRD") to secure a line of credit which will given by EBRD to Bank Leumi Romania S.A.

(19) The Bank undertook to indemnify the former representative of the Bank in Brazil, for a judgment verdict and reasonable lawyers' fees which will be imposed on him as a result of an investigation of legal proceeding against connected with the activities of the representative office during his period of duty (no maximum indemnification has been decided).

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

M. (cont'd)

(20) The Bank undertook to indemnify Leumi Securities and Investments Ltd., Leumi Management Ltd. and Leumi L.P. Ltd. in order to secure the payment of the liabilities of the companies in respect of their activities until the date of signing the indemnity (October 2007), when this date is reached.

(21) From time to time, and according to the customary terms and circumstances for banking transactions, it is the Bank's practice to provide restricted letters of indemnity and for an unrestricted period, all of which is in the Bank's ordinary course of business. Among others, these letters of indemnity are extended in the framework of agreements that were reached with S&P and NSA for the use of securities indices issued by them in the framework of the structured products issued by the Bank.

(22) From time to time, it is the Bank's practice to provide restricted letters of indemnity and for an unrestricted period, to secure indemnities granted by them to officers and legal advisors of those companies, and because of risks applying to the officers of the company.

N. Union Bank of Israel Ltd.

On 18 November 1999 the Bank entered into an agreement ("the agreement") with Shlomo Eliahu Holdings Ltd. ("Eliahu"), Sherodar Assets Ltd. ("Sherodar") and Y. Landau Holdings (1993) Ltd.("Sherodar") (hereinafter – "the controlling group"). Under the terms of this agreement, the Bank was granted a put option (hereinafter – "the put option") obliging the controlling group to purchase, and the controlling group was granted a call option (hereinafter – "the call option") obliging the Bank to sell all of the holdings in Union Bank - 5,703,618 shares of NIS 0.01 each par value, comprising some 11.5% of the issued and paid up share capital of Union Bank, as at 31 December 2003.

Under the terms of the agreement, the price of the put option is the price reflecting the proportionate part of the shareholders' equity, in accordance with the last relevant financial statements of Union Bank published before exercise of the option ("the determining financial statements") with the addition of linkage increments and interest at the rate of 5% per annum from the end of the period to which the determining financial statements relate until the date of exercise of the put option ("exercise price of the put option"), subject to certain adjustments. The exercise price of the call option under the terms of the agreement is equivalent to the exercise price of the put option plus 5%, subject to certain adjustments.

On 17 November, 2003 the Bank exercised part of the Put option, regarding the part of Eliahu only, for sale of 1/3 of the Bank’s shares in Bank Igud (approximately 4% of the share capital of Bank Igud), in the framework of the agreement and in accordance with the parties thereto. After receipt on 30 May, 2004 of the Supervisor of Bank’s approval to Eliahu to acquire from the Bank 3.85% of the share capital of Bank Igud, on 3 June, 2004 Eliahu acquired from the Bank 1,901,206 ordinary shares of Bank Igud in consideration for NIS 41.7 million.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

M. (cont'd)

Concurrently, on 17 November 2003 an agreement was signed between the Bank, Sherodar and Landau ("the extension agreement") on the extension of the period of the put option and the call option in the agreement relative to the balance of shares of Union Bank held by the Bank ("the balance of the shares"), for a period until 17 November 2010, at a price and with conditions fixed in the extension agreement. In accordance with the extension agreement, the exercise price of the put option regarding the balance of the shares will be as stated in the agreement, but not less than a price reflecting the proportionate shareholders' equity of Union Bank according to the reviewed financial statements of Union Bank for the period ended 30 June 2003, with the addition of linkage differences and interest at the rate of 2% per annum from 1 July 2003 until the date of the determining financial statements and with the addition of linkage and interest at the rate of 5% per annum from the end of the period to which the determining financial statements relate until the date of exercise of the put option, and subject to certain adjustments and deductions. Also, the extension agreement states that the exercise price of the call option regarding the balance of the shares will be equivalent to the price stated in the extension agreement for exercise of the put option with the addition of 7.5% and subject to certain adjustments and deductions. The shareholders' equity of Union Bank as of 30 June 2003 was NIS 1,117 million. In the event of transfer of control in Union Bank, different adjustments will be made in respect of exercise price of the options regarding the balance of the shares, on the basis of the financial statements of Union Bank for the quarter in which the options were exercised and as stated in the extension agreement.

O. Credit Cards

(1) In the Israel Credit Cards Ltd. (hereinafter - "ICC") ownership separation agreement between Leumi Financial Holdings Ltd. (a company wholly owned by the Bank) (hereinafter - "Leumi Holdings") and Israel Discount Bank Ltd. (hereinafter - "Discount Bank") that was signed on 3 January 2000, Leumi Holdings undertook to indemnify Discount Bank for various amounts that ICC and/or Diners Club Israel Ltd. (hereinafter - "Diners") might be obligated to pay for defined events, including for legal claims according to a defined list (including class actions). The indemnity is limited in amount to the consideration paid within the context of the transaction, plus the company's share in the dividend distributed on 4 January 2000, adjusted for certain deductions to be determined (where this amount is linked and bears interest as stated in the ownership separation agreement) and payment thereof is subject to various terms and conditions that were determined, as provided in the ownership separation agreement. The maximum indemnification in this item as of 31 December, 2007 is NIS 749 million.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

O. Credit Cards (cont'd)

(2) On 31 August 2006, a decision was rendered by the Antitrust Tribunal in the framework of Antitrust File 4630/01 regarding the question of determining the appropriate methodology for calculating the cross commission (the issuer's commission) ("the decision"), that would be paid by those using the acquiring services to the issuers of Visa cards, this following a request filed with the Tribunal to approve the restrictive arrangement signed between the Bank, Leumi Card, Israel Discount Bank Ltd., ICC, and First International Bank of Israel Ltd.

In the decision, the Tribunal rejected the claims of those requesting approval of the arrangement (the credit card companies and the banks controlling them) and determined that, as a rule, when the cross commission is calculated it is necessary to take the following components into account: the cost for approving the transaction, the cost for securing the payment and the cost for financing the credit.

Regarding the categories used in the cross commission rates, the Tribunal determined, contrary to the position of the credit card companies and the banks requesting the approval, that in determining the categories it is necessary to take into consideration the costs in securing the payments for the various transactions and in deriving profit from securing the payment.

In its decision, the Tribunal also determined that the rate for all of the costs comprising the issuer's commission must be determined by an outside and independent expert, based on the relevant data furnished to him.

On 1 February 2007, the Bank, Leumi Card and the others requesting the approval appealed the decision by the Supreme Court. A hearing on the appeal was set for 28 May 2008.

On 30 October 2006, an arrangement was reached between Isracard Ltd., Leumi Card Ltd. and Israel Credit Cards Ltd., and the banks controlling one of these companies, to regulate the cross-clearing for the Visa credit card and Mastercard ("the arrangement"). For the first time, the arrangement, which is in force for six and a half years, allows cross-clearing for the Visa and Mastercard brand names by the three major credit card companies in Israel, as distinguished from the cross-clearing arrangement as practiced until then which only arranged the Visa segment.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

O. Credit Cards (cont'd)

The arrangement, inter alia, includes determinations regarding the issuer's commission rates, the blueprint for the gradual reduction in the issuer's commission over the term of the arrangement, and the gradual reduction in the categorical structure as currently practiced in relation to the rate for the issuer's commission.

Further, the arrangement includes an outline, pursuant to which, at the end of the arrangement, the parties will act should they request to continue the cross-clearing among them, as well as the principles that were designated to assure that fair competition is maintained and the preclusion of cross-subsidizing of the competition between the credit card companies.

On 30 October 2006, the arrangement was submitted for approval by the Antitrust Tribunal and for the receipt of a provisional permit. Simultaneously, an urgent request was filed with the Antitrust Tribunal, with the approval of the Antitrust Commissioner, to grant a provisional permit, pursuant to which it will be possible to conduct cross-clearing pursuant to the principles of the arrangement. On October 31, 2006, the Antitrust Tribunal decided to grant a provisional permit for the arrangement. In addition, the Tribunal notified that in light of the consent of the parties, it intends to grant a provisional permit until May 31, 2008, or until a decision is reached on the request to approve the restrictive arrangement, whichever is earlier.

On 31 October 2007, the Tribunal decided to give a temporary permit for the arrangement. A request for the cancellation of the provisional permit submitted by some of those opposing the arrangement was rejected by the Tribunal.

Commencing in December 2006 until February 2007, a number of objections to the approval of the restrictive arrangement were submitted on behalf of five companies. In addition, MasterCard International was joined to the process and informed the Tribunal that it supports approving the arrangement, provided that and restricting its courses of action if it wishes to interfere with the fixing of the cross commission. The Tribunal refused to approve the joining of Visa International to the proceedings. Regarding the Tribunal's request in this matter, the parties requesting the approval expressed their agreement to the joining of additional users of the acquiring services to the cross-acquiring of services, subject to the same conditions applying to those acquiring the services and subject to participation in the costs of establishing the joint interface.

After a preliminary hearing ordered by the Tribunal which took place on 2 November 2007, and after hearing the claims of the parties, the Tribunal decided on 11 November 2007 to appoint an expert to examine the estimate of the competitive consequences of the rate of cross-commission determined in the arrangement. In the decision it was stipulated an expert will be appointed and supervised directly by the Antitrust Authority.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

O. Credit Cards (cont'd)

The Tribunal determined that the expert will be required to show the Court and all the parties to the case his detailed methodology in implementing the decision regarding methodology determined in Antitrust File 4630/01. After the expert will have been questioned on his opinion, he will have to continue carrying out the examination, including checking the rate of cross-commission that will be arrived at in the implementation of the methodology. It was
also determined that the expert will have to complete his examination within eight months. An expert has currently been appointed in this matter. An appeal has been submitted to the Supreme Court against the Tribunal's decision of 11 November 2007 by Bank Hapoalim and Isracard Ltd. Similarly the above have submitted a request for a delay in carrying out the Tribunal's decision of 11 November 2007.
The total for the issuer's commissions received by the Bank in 2007 amounted to NIS 68 million, as compared with NIS 64 million during the corresponding period in the prior year.

(3) As a result of the announcement of Leumi Card regarding collection of new commissions from card holders, the representative of the General Director approached Leumi Card on 28 January 2002 with a request for receipt of detailed documents, data and information (hereinafter - "the information") regarding collection of these fees. All the information requested by the General Director was submitted by Leumi Card to the Authority as requested.

(4) In the framework of issuance of Leumi Visa credit cards to Bank customers, the Bank offered to part of its customers membership in "the faithful traveler" club, a joint club of Leumicard and El Al, without payment of membership fees to the club. As a result of a technical problem, approximately 3,500 of these customers were charged membership fees.

Upon ascertaining the error, the Bank acted to locate all of the customers in order to credit their account in the amount of the charge with the appropriate addition. In March 2002 the Supervisor of Banks informed the Bank that the relevant material in this regard was transmitted to the State Attorney in order to consider the need to open a police investigation in this regard.

(5) The Bank committed toward Visa International to take full responsibility for appropriate implementation of Leumi Card in accordance with all provisions and requirements included in the Articles of Visa International as in effect from time to time, to implement all required activity in order to fulfill this commitment and to inform Visa International immediately in writing regarding any material change in the agreement between the Bank and Leumi Card.

(6) The Bank has committed to World MasterCard and to all other Mastercard members to take full responsibility for carrying out all LeumiCard's obligations under the World MasterCard Regulations and its principles and to indemnify these entities for any loss, cost, expense or debt in respect of infringement of LeumiCard's aforesaid obligations.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

O. Credit Cards (cont'd)

(7) In the regular course of business, legal claims were submitted against Leumi Card including a request for approval of a class action. According to management of the Bank, based on the opinion of management of Leumi Card that is based on the option of Leumi Card’s legal advisors regarding the chances of the claims, including the request for approval of a class action, the financial statements include appropriate provisions as required to cover damages resulting from such claims.

P. In January 2005, the Parliamentary Committee of Enquiry Regarding the Tracing and Return of Property of Holocaust Victims (the “Committee”) published its concluding report. The report indicates that assets of Holocaust victims that had been deposited with the Anglo-Palestine Bank were transferred, pursuant to the directives in force at the time, to the British Custodian of Enemy Property, to the Israeli Custodian of Enemy Property, to the Administrator General or were returned to those entitled thereto. Nevertheless, the report recommended that the funds be revalued, together with retroactive linkage differentials, for the period in the past during which they were held by the Bank.

On 3 January 2006, the Assets of Holocaust Victims (Restitution to Heirs and Endowment for the purpose of Assistance and Commemoration) Law, 2006 (the “Law”) came into effect. The Law provides that a party who holds, in Israel, assets of Holocaust victims (as such terms are defined in the Law) must transfer them to the Tracing and Return of Property of Holocaust Victims Company Ltd. (the "Company"), which was established pursuant to the provisions of the Law, together with linkage differentials and interest in amounts determined by a special revaluating committee. The revaluating committee’s report was delivered to the Bank, and appropriate provisions were made, as estimated by the Bank.

At the beginning of July 2007, the Bank appointed the Honorable Supreme Court Justice (ret'd) Theodore Orr as an external examiner to carry out an independent and impartial examination of the Bank’s obligations pursuant to the Law, if any, and of the Bank’s conduct regarding the assets of Holocaust victims, as such are defined in the Law. The Bank announced that it would provide the examiner with any assistance required.

Additionally, out of sensitivity to public sentiment and to demonstrate its goodwill, the Bank transferred the sum of NIS 20 million to the Company, to be used for making payments to the heirs of victims and to survivors during their lifetime, in accordance with the provisions of the Law and pursuant to appropriate criteria to be established by the Company, as required by the Law.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

P. (cont'd)

The Bank has notified the Company that if it is determined that the Bank is not obligated to make any payments whatsoever (which is the Bank's position), or that it is required to make a payment which is lower than that which has been paid, any balance of the amount will be considered to be a donation to be used for the above purposes. If it is determined that the Bank is required to pay amounts to Holocaust survivors or to the heirs of Holocaust victims which are higher than the amount that has been paid, then the Bank will set off the payment made (linked to the CPI and bearing interest) against the amount of the liability.

On 4 March 2008, the Bank received a first demand from the Company for payment of a revalued amount of some NIS 148 million that the Company claims that the Bank is required to transfer to it according to the provisions of the Law. The Bank is examining the demand, but at this early stage the factual and legal basis of the demand and its accuracy cannot yet be evaluated, and therefore no provision has been made in the Financial Statements.

Q. Paz Oil Company Ltd.

Legal claims have been made against Paz and its subsidiaries, including class actions, and legal proceedings, supervision by the authorities and other dependent bodies are taking place concerning the petroleum, gas and service installation industry. Regarding these claims, in Paz's opinion and based on the opinion of its legal advisors, professional and others, it is not possible at this stage to evaluate the effect of that stated above on the financial statements, if at all, and so no provision has been made against them.

For further information concerning these proceedings, see Paz's financial statements as at 31 December 2007.

R. The Israel Corporation Ltd.

Legal claims have been made against subsidiary companies of the Israel Corporation Ltd. on the grounds that physical and property damage caused to the petitioners, derive from pollution of the Kishon River, in which the petitioners claim the above subsidiaries had a part and also concerning the demand of the Ministry for Protection of the Environment to bear the costs of removal of polluted sediment from the Kishon River.

The managements of the above companies, based on the opinion of their professional advisors, are unable to evaluate the amount of exposure in respect of the above claims and demand, if any, and no provisions have been included for them in the financial statements of the Israel Corporation Ltd. and its subsidiary companies.

For further information concerning these proceedings, see the financial statements of the Israel Corporation Ltd. as at 31 December 2007.

Note 19 - Interested and Related Parties of the Bank and its Subsidiaries

A. General

As from 31 October 1993 the State of Israel has a controlling interest in the Bank. On 31 December 2007 the State held 11.94% of the Bank's issued share capital and fully diluted 11.26% (31 December 2006 – 11.94% and fully diluted 11.26%) as well as 19.78% of the voting rights (18.66% fully diluted). The Bank is exempt from presenting the balances of the State and of companies under its control and accordingly these balances are not presented below.

Following is a description of the decrease in the holdings of the State in the Bank in 2006–2007:

On 24 November 2005 ("the date of the sale") the State sold to Barnea Investments B.V. ("Barnea") 9.99% of the Bank's capital. Of the shares acquired, shares constituting 4.99% of the Bank's shares are held in trust, and Barnea and the trustee signed legal empowerment authorizing the Committee appointed in accordance with Section 12 of the Bank Shares Law in the Arrangement (Interim Regulation), 1993 ("the Committee"), including any entity replacing the Committee in this role as determined in accordance with the said Law, or any other individual authorized by the Minister of Finance (1) to participate in all meetings of the Bank and to vote therein in accordance with the said shares and (2) to exercise the right to appoint directors in respect of all of the shares of the Bank held by Barnea.

Also, the State granted to Barnea an option to acquire an additional 10.01% of the Bank's capital in accordance with conditions provided in the option signed between the State, M.I. Assets Ltd. and Barnea on 23 November 2005 ("the option"), subject to, *inter alia*, receipt of all required approvals and permits for acquisition of the shares and the control in the Bank from the Bank of Israel and from other relevant regulatory authorities in Israel and abroad. The option, which is in effect as from the date of the sale, could have been exercised 180 days from the date of the sale, subject to extension of up to 12 months. On 24 May 2006 M.I. Assets Ltd. notified the Bank that a request had been received from Barnea on the same day to extend the aforementioned exercise period by an additional 12 months until 24 May 2007, and that in its request Barnea stated, *inter alia*, that it had submitted a request to Bank of Israel for a permit to control the Bank. On 6 July 2006 M.I. Assets Ltd. announced extension of the option’s exercise date until 24 May 2007.

On 21 May 2007, the Bank was advised by MIH that Barnea’s application for an additional extension of the exercise period of the option had not been granted.

The option therefore expired on 24 May 2007. According to the conditions of the sale procedure, Barnea is required to sell at least 4.99% of the shares of the Bank (of the 9.99% that it purchased) within a year.

Following the expiration of the option, MIH notified the Bank’s Management, at a meeting held in August 2007, that the Ministry of Finance intends to continue the privatization of the Bank through one of two methods: sale of the balance of the shares to an international banking institution through an investment bank, or the sale of the balance of the shares in one or more private bloc sales, the preferred method being a sale to a foreign banking institution. MIH and the Ministry of Finance chose N.M. Rothschild & Sons Ltd. to serve as a consultant for the purpose of the advancement of this method.

Regarding issuance of options by the Bank to employees in 2006, see Note 15(D), above.

Note 19 - Interested and Related Parties of the Bank and its Subsidiaries (cont'd)

A. General (cont'd)

As of 10 March 2008, the State holds 11.56% of the Bank's issued share capital (fully diluted 11.27%) and 19.15% of the voting rights (fully diluted 18.67%).
On 31 December 2007 Shlomo Eliahu Holdings Ltd. and its subsidiaries and related parties ("the Eliahu Group") held 9.9969% of the Bank’s issued capital and voting rights, (fully diluted – 9.43%), and as of 10 March 2008, 9.68% and 9.44% respectively.

On 31 December 2006 the Eliahu Group held 9.9969% of the Bank’s issued share capital.

On 31 December 2006, Otzar Hityashvuth Heyehudim Ltd., together with J.C.T. Trust Ltd., held 5.07% of the Bank’s issued capital and voting rights, (fully diluted – 4.78%). On 3 September 2007, the above companies ceased to be interested parties in the Bank.

Note 19 - Interested and Related Parties of the Bank and its Subsidiaries (cont'd)

Reported Amounts

B. Balances on consolidated basis

31 December 2007

	Interested						Related parties of the Bank			
	Shareholders		Directors and CEO (a)(b)		Others (f)		Unconsolidated subsidiaries		Others (g)	
	Balance as at 31 December	Highest balance (c)	Balance as at 31 December	Highest Balance (c)	Balance as at 31 December	Highest balance (c)	Balance as at 31 December	Highest balance (c)	Balance as at 31 December	Highest balance (c)
	NIS millions									
Assets										
Securities (d)	**-**	**88**	**-**	**-**	**99**	**116**	**-**	**-**	**655**	**655**
Credit to the public	**-**	**3**	**2**	**2**	**-**	**-**	**1,489**	**1,784**	**4,226**	**4,452**
Investments in companies included on equity basis (d)	**-**	**-**	**-**	**-**	**-**	**-**	**1,873**	**1,873**	**-**	**-**
Other assets	**-**	**52**	**-**	**-**	**-**	**-**	**3**	**5**	**33**	**34**
Liabilities										
Deposits of the public	**42**	**133**	**11**	**13**	**-**	**-**	**455**	**455**	**926**	**2,682**
Deposits from banks	**-**	**-**	**-**	**-**	**15**	**19**	**-**	**-**	**-**	**-**
Debentures, bonds and subordinated notes	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**5**	**243**
Other liabilities	**-**	**2**	**-**	**-**	**14**	**14**	**115**	**115**	**125**	**125**
Credit risk in off-balance sheet items (e)	**4**	**8**	**3**	**3**	**153**	**153**	**211**	**211**	**1,991**	**2,013**

(a) Including their spouses and minor children and companies controlled by them.
(b) As at 31 December 2007 the directors and CEO held Bank shares with a par value of NIS 193,460, and 279,303 options exercisable into Bank's shares.
(c) The highest balance based on end-of-month balances.
(d) For details, see Note 3 Securities and Note 6 Investments in companies included on the equity basis.
(e) Credit risk in respect of off-balance sheet financial instruments as calculated for purposes of per borrower debt limitations.
(f) Including other companies controlled by interested parties and affiliated companies.
(g) Including balances of provident funds and supplementary training funds.

Note 19 - Interested and Related Parties of the Bank and its Subsidiaries (cont'd)

Reported Amounts

B. Balances on consolidated basis (cont'd)

31 December 2006 (h)

	Interested						Related parties of the Bank			
	Shareholders		Directors and CEO (a)(b)		Others (f)		Unconsolidated subsidiaries		Others (g)	
	Balance as at 31 December	Highest balance (c)	Balance as at 31 December	Highest balance (c)	Balance as at 31 December	Highest balance (c)	Balance As at 31 December	Highest balance (c)	Balance as at 31 December	Highest balance (c)
	NIS millions									
Assets										
Securities (d)	88	88	-	-	116	116	-	-	425	425
Credit to the public	3	3	2	2	-	-	843	864	4,452	5,330
Investments in companies included on equity basis (d)	-	-	-	-	-	-	1,251	2,064	-	-
Other assets	-	52	-	-	-	4	1	2	22	34
Liabilities										
Deposits of the public	93	105	11	14	-	-	47	771	2,682	6,143
Deposits from banks	-	-	-	-	11	12	-	-	-	-
Debentures, bonds and subordinated notes	-	-	-	-	-	-	-	59	243	819
Other liabilities	-	3	-	-	1	1	1	4	14	56
Credit risk in off-balance sheet items (e)	4	142	3	3	130	130	14	268	2,013	2,473

(a) Including their spouses and minor children and companies controlled by them.
(b) As at 31 December 2006 the directors and CEO held Bank shares with a par value of NIS NIS 193,460, and 279,303 options exercisable into Bank's shares.
(c) The highest balance based on end of months balances.
(d) For details, see Note 3 Securities and Note 6 Investments in companies included on equity basis.
(e) Credit risk in respect of off-balance sheet financial instruments as calculated for purposes of per borrower debt limitations.
(f) Including other companies controlled by interested parties and affiliated companies.
(g) Including balances of provident funds and supplementary training funds (for Highest Balance also mutual funds).

Note 19 - Interested and Related Parties of the Bank and its Subsidiaries (cont'd)

Reported Amounts

C. Condensed results of operations with interested and related parties

	2007				
	Interested parties			**Related parties held by the Bank**	
	Shareholders	**Directors and CEO**	**Others**	**Companies included on equity basis**	**Others (c)**
	NIS millions				
Net interest income (expense) before provision for doubtful debts (a)	**(6)**	**-**	**(3)**	**42**	**140**
Operating and other income	**-**	**-**	**45**	**10**	**232**
Including management and service fees	**-**	**-**	**-**	**-**	**200**
Operating and other expenses (b)	**-**	**(26)**	**-**	**(11)**	**(1)**
Total	**(6)**	**(26)**	**42**	**41**	**371**

	2006				
	Interested parties			Related parties held by the Bank	
	Shareholders	Directors and CEO	Others	Companies included on equity basis	Others (c)
	NIS millions				
Net interest income (expense) before provision for doubtful debts (a)	(15)	-	(2)	10	95
Operating and other income	-	-	49	12	655
Including management and service fees	-	-	-	-	637
Operating and other expenses (b)	-	(23)	(1)	(13)	(2)
Total	(15)	(23)	46	9	749

(a) See details under E below.
(b) See details under D below.
(c) Including balances of provident funds, supplementary training funds and mutual funds.

Note 19 - Interested and Related Parties of the Bank and its Subsidiaries (cont'd)
Reported Amounts

D. Benefits to interested parties

	2007		2006	
	Directors and CEO		Directors and CEO	
	Total benefits	**Number of recipients**	Total benefits	Number of recipients
	NIS millions		NIS millions	
Interested parties employed in the Bank or on its behalf (a) (b)	**15**	**2**	14	2
Directors not employed in the Bank or on its behalf (a)	**(c) 5**	**14**	(c) 3	16

(a) Directors and officers have been insured by the Bank under a policy for insuring the liability of directors and other officers of the Bank, subsidiaries and companies included on equity basis. The aggregate insurance premium amounts to NIS 5,781 thousand (2006 - NIS 6,443 thousand).

(b) Does not include VAT on salaries.

(c) The amounts in NIS thousands: NIS 4,751 thousand in 2007 compared with NIS 3,477 thousand in 2006.

Note 19 - Interested and Related Parties of the Bank and its Subsidiaries (cont'd)

Reported Amounts

E. Results of financing activity (before provision for doubtful debts) on transactions by the Bank and subsidiaries with interested parties and related parties

	2007		2006		2005	
	Total Consolidated	**Including companies included on Equity basis**	Total Consolidated	Including Companies included on equity basis	Total Consolidated	Including companies included on equity basis
	NIS millions					
a) Income on assets						
Credit to the public	**336**	**68**	285	27	313	23
b) Expenses on liabilities						
Deposits of the Public	**(62)**	**(31)**	(74)	(11)	(301)	(1)
Deposit with banks	**(3)**	**-**	-	-	-	-
Debentures and subordinated notes	**(5)**	-	(14)	(1)	(63)	-
c) Income on derivative financial instruments						
Net income (expenses) in respect of ALM derivatives	**(95)**	**5**	(102)	(5)	(24)	3
d) Other						
Financing commissions	**3**	-	3	-	6	1
Other financing Expenses	**(1)**	-	(10)	-	(70)	(67)
Net interest income (expense) before provision for Doubtful debts	**173**	**42**	88	10	(139)	(41)

Note 20 - Net Interest Income Before Provision for Doubtful Debts

Reported Amounts

	2007	2006	2005
	NIS millions		
A. Income on assets (a)			
Credit to the public	**9,145**	7,863	13,525
Credit to governments	**3**	(8)	101
Deposits with Bank of Israel and cash	**(154)**	(34)	111
Deposits with banks	**(604)**	(464)	1,383
Debentures	**667**	417	3,101
Interest income from securities borrowed or purchased under agreement to resell	**14**	-	-
Total income on assets	**9,071**	7,774	18,221
B. Expenses on liabilities (a)			
Deposits of the public	**(1,322)**	(2,087)	(10,173)
Deposits from governments	**(66)**	(42)	(199)
Deposits from Bank of Israel	**(137)**	(44)	(5)
Deposits from banks	**11**	(84)	(5)
Debentures, bonds and subordinated notes	**(957)**	(476)	(1,172)
Interest expense from securities loaned or sold under agreement to repurchase	**1**	-	-
Total expenses on liabilities	**(2,470)**	(2,733)	(11,837)
C. Income on derivative financial instruments			
Ineffective part of hedge ratio (b)	**3**	(1)	(5)
Net income (expenses) in respect of ALM derivatives (c)	**21**	1,077	(599)
Net income in respect of other derivatives	**(15)**	(12)	18
Total from derivatives and hedging activities	**9**	1,064	(586)
D. Other income and expenses			
Financing commissions	**308**	282	253
Other financing income (d)	**730**	535	578
Total other income and expenses	**1,038**	817	831
Total net interest income before provision for doubtful debts	**7,648**	6,922	6,629
Including net exchange rate linkage differences	**16**	32	(38)

(a) Including effective component of hedge transactions.

(b) Excluding effective component of hedge transactions.

(c) Derivative instruments which constitute part of the Bank's assets and liability management system and were not designated for hedging relationships. According to directives of Bank of Israel, most of the transactions in derivative financial instruments are not considered to be hedge transactions, because according to these directives a transaction is considered to be a hedge transaction only if the hedge relates to a specific asset or liability and meets stringent compliance tests.
The income and expenses from assets and liabilities hedged by a general hedge (ALM) are included in the statement of profit and loss on the accrual basis, while the income and expenses on transactions in derivative financial instruments are included at market value (or fair value if no market price is available). As a result, the results of the transactions should be considered together with the interest income/expenses on the assets and liabilities. See Note 1.J.

(d) Including interest collected in respect of doubtful debts in the amount of NIS 461 million (2006 - NIS 325 million, 2005 - NIS 290 million).

(e) Including negative interest and exchange difference in respect of mortgage-backed bonds (MBS) in the amount of about NIS 216 million.

Note 20 - Net Interest Income Before Provision for Doubtful Debts (cont'd)

Reported Amounts

E. Details of the operating results of investments in debentures

	2007	2006	2005
	NIS millions		
Interest on debentures, on accrual basis:			
Held to maturity	**72**	123	285
Available for sale	**247**	110	2,363
Held for trading	**348**	184	453
Total, included in interest income on assets	**667**	417	3,101
Other financing income			
Gain on sale of debentures available for sale	**138**	32	95
Losses on sale of debentures available for sale	**(30)**	(3)	(4)
Realized and unrealized profits from adjustments of held for trading debentures to fair value, net (a)	**(22)**	73	13
Total, included in other financing income	**86**	102	104
Total from investments in debentures	**753**	519	3,205

F. Net effect of hedged derivatives on income from financing activity

	2007	2006	2005
	NIS millions		
Interest income (expenses) in respect of assets	**(6)**	9	(37)
Interest income (expenses) in respect of liabilities	**18**	(39)	(30)

(a) Of which part of the profit related to traded debentures still held as of balance sheet date in the amount of NIS 60 million (2006 - NIS 14 million, 2005 - NIS (78) million).

Note 21 - Operating Commissions

Reported Amounts

	2007	(b) 2006	(b) 2005
	NIS millions		
Ledger fees (a)	**255**	254	417
Payment transfer services (a)	**830**	764	604
Handling of credit and preparing agreements	**377**	318	227
Computerized services, information and confirmations	**38**	38	41
Foreign trade transactions and special foreign currency services	**138**	132	124
Income from securities transactions	**866**	733	698
Income from credit cards (a)	**672**	595	527
Interest margin and collection commission on deposits and credit from deposits on collection basis:			
Collection commissions on credit out of treasury funds	**43**	44	47
Other commissions and interest margins	**19**	19	15
Management fees and commissions on life assurance and on housing insurance	**48**	50	55
Other	**64**	66	64
Total operating commissions	**3,350**	3,013	2,819

(a) In respect of the decline in account management fees, compensatory commissions in the accounts payments' system services and credit card income.
(b) Restated.

Note 22 - Profits from Investments in Shares (a), Net

Reported Amounts

	2007	2006	2005
	NIS millions		
Gains on sale of shares available for sale	**250**	7	4
Losses on sale of shares available for sale (b)	**(32)**	(6)	(11)
Realized and unrealized losses from adjustments of held for trading shares to fair value, net (c)	**(2)**	(12)	(3)
Dividend on shares available for sale and on held for trading shares	**245**	139	53
Total from investments on shares	**461**	128	43

(a) Including mutual funds.
(b) Including provisions for decline in value.
(c) Of which the part of the gains (losses) relating to traded shares still held as at balance sheet date is NIS (9) million (2006 - NIS (1) million; 2005 - NIS 10 million).

Note 23 - Other Income

Reported Amounts

	2007	2006	2005
	NIS millions		
Income from provident funds (a)	**35**	245	233
Income from mutual funds (a)	**165**	391	429
Profits from severance pay funds	**63**	23	131
Provident funds operation fees	**43**	-	-
Other, net	**105**	81	72
Total other income	**411**	740	865

(a) From 2007 only distribution commissions.

Note 24 - Salaries and Related Expenses

Reported Amounts

	2007	2006	2005
	NIS millions		
Salaries	**2,788**	2,485	2,357
Severance pay, provident fund, continuing education fund, pension, vacation and long service bonus	**445**	718	475
Expense deriving from share-based payment transactions settled with capital instuments	**250**	452	-
National insurance and VAT on salaries	**524**	489	498
Other related expenses	**162**	148	148
Adjustment of provisions for related expenses as a result of current changes in salaries in the current year	**49**	85	42
Voluntary retirement	**-**	175	107
Total salaries and related expenses	**(a) 4,218**	(a) 4,552	3,627
The above includes:			
Salaries and related expenses abroad	**514**	445	451

(a) Includes special salaries expenses in connection with the privatization and provisions for certain social benefits – as detailed in Note 15, above.

Note 25 - Other Expenses

Reported Amounts

	2007	2006	2005
	NIS millions		
Marketing and advertising	**265**	267	200
Legal, audit and professional consultancy	**270**	(c) 292	(c) 241
Communications - postage, telephone, delivery services, etc.	**152**	149	134
Computers (a)	**219**	(c) 224	(c) 219
Office expenses	**92**	92	86
Insurance	**26**	45	38
Training	**36**	18	12
Amortization of goodwill	**15**	13	3
Other (b)	**370**	(c) 395	(c) 352
Total other expenses	**1,445**	1,495	1,285

(a) The item includes outsourcing expenses and does not include the Bank's computer since the Operations Division since this Division is a part of the Bank and its expenses are recorded and classified under the various expense items.

(b) Regarding directors' fees of the Bank included in this item, see Note 19D.

(c) Restated

Note 26 - Provision for Taxes on Operating Profit

Reported amounts

A. Composition

	2007	2006	2005
	NIS millions		
Current taxes -			
In respect of current year	**1,660**	1,560	1,051
In respect of prior years	**39**	(2)	12
Total current taxes	**1,699**	1,558	1,063
Add (deduct) changes in deferred taxes -			
In respect of current year	**9**	(265)	8
In respect of prior years	**14**	(a) 27	(a) 122
Total deferred taxes	**23**	(238)	130
Total provision for taxes	**1,722**	1,320	1,193
Includes provision for foreign taxes	**166**	130	85

(a) Including adjustment of the balance of deferred taxes as at the beginning of the year due to change in tax rates (see (C) below) in 2006 - NIS 25 million, in 2005 – NIS 122 million.

Note 26 - Provision for Taxes on Operating Profit (cont'd)

Reported amounts

B. Reconciliation between the theoretical tax on the operating profit at the statutory tax rate applying to the Bank in Israel, and the actual provision for taxes on operating profit appearing in the statement of profit and loss:

(a)

	2007	2006	2005
Statutory tax rate applying to a bank in Israel	**38.53%**	40.65%	43.59%
	NIS millions		
Tax at the statutory tax rate	**1,744**	1,059	1,242
Tax (tax saving) resulting from:			
General and supplementary provisions for doubtful debts	**(51)**	12	(12)
Other non-deductible expenses	**26**	99	13
Income of foreign subsidiaries (b)	**142**	85	(88)
Income of Israeli subsidiaries	**(44)**	(23)	(24)
Inflationary depreciation adjustments	**(22)**	(2)	(14)
Inflationary addition (deduction)	**(140)**	16	(97)
Tax exempt and preferred income	**(39)**	(19)	(14)
Temporary differences for which deferred taxes have not been provided	**1**	2	(1)
Profit tax on VAT on salaries, net	**35**	33	33
Change in deferred taxes due to change in tax rates	**4**	27	14
Taxes in respect of prior years (c)	**53**	25	134
Other	**13**	6	7
Provision for taxes on operating profit	**1,722**	1,320	1,193

(a) Includes NIS (1) million in respect of issuance of options and sale of options to employees (2006 – NIS 52 million).

(b) Not including the impact on the provision for taxes in the year of account of the additions to shareholders' equity as at the beginning of the year.

(c) Including adjustment of the deferred taxes due to change in tax rates (see (C) below) in 2006 – NIS 25 million, 2005 – NIS 122 million.

Note 26 - Provision for Taxes on Operating Profit (cont'd)

C. On 27 June 2006 the Value Added Tax Order (Rate of tax on non-profit organizations and financial institutions) - 2006 was published. Following this amendment Value Added Tax and Profits Tax rates on financial institutions were reduced from 17% to 15.5%. The amendment took effect on 1 July 1006.

On 25 July 2005, the Knesset passed the Income Tax Ordinance (Amendment No. 147 and Temporary Provision) Law, 2005 (the "amendment"). The amendment provides for a gradual reduction of the tax rate for corporations from 34% in 2005 to 25% from 2010 and thereafter in the following manner: for the 2005 tax year the tax rate was 34%, for 2006 it will be 31%, for 2007 it will be 29%, for 2008 it will be 27%, for 2009 it will be 26%, and from 2010 and thereafter the tax rate will be 25%.

Due to the fact that the Bank is a "financial institution" for the purposes of the Value Added Tax Law profit tax, the reduction in company tax and in profits tax will result in a reduction of the overall tax rate that applicable to the Bank to a lower rate, so that for 2005 the overall tax rate was 43.59%, for 2006 - 40.65%, for 2007 - 38.53%, for 2008 - 36.80%, for 2009 - 35.93% and from 2010 and thereafter the overall tax rate will be 35.06%.

D. On 26 February 2008 the Amendment to the Income Tax (Adjustments for Inflation) Law, 5745 – 1985 was passed by the Knesset. The Amendment limits the application of the Law to the years 1985-2007 and determined transition instructions regarding the end of its applicability.

In the Bank's opinion, based on the capital entitled to protection as at 31 December 2007, every change of 1% in the CPI will have a net effect of about NIS 47 million on the taxation expenses of the Group.

Amendment No. 35 to the Value Added Tax Law which was passed by the Knesset on 26 February 2008 stipulates that VAT on salaries paid by a financial institution will be recognized as an expense for purposes of calculating profits tax, and also charges the employer's portion of National Insurance payments against VAT on salaries.

The Amendment came into force on 1 January 2008. In 2008 half the employer's portion of National Insurance payments will be charged against VAT on salaries, and half the VAT on salaries paid will be recognized as an expense for purposes of calculating profits tax.

In the Bank's opinion, the Amendment to the Law will reduce the joint net tax liability of the Group in 2008 by about NIS 13 million, and beginning in 2009 by about NIS 26 million. In addition deferred taxes will be calculated in accordance with the aforesaid Amendment. The effect of the change on the consolidated financial statements at the beginning of 2008 is a reduction of tax expenses on income in the amount of about NIS 45 million.

E. Final assessments have been issued to the Bank for all years up to and including the 2004 tax year. Principal subsidiaries have final assessments for the years up to and including 1999.

Note 26 - Provision for Taxes on Operating Profit (cont'd)

F. Amendment 11 to the Income Tax Law (Inflationary Adjustments), 5745-1985, states, inter alia, that all taxpayers subject to the said Amendment are required to pay tax on profits from securities traded on a stock exchange as at the date of their realization. The Amendment is effective as from 1999.
In the opinion of the tax authorities and the banks, taxation of securities on the basis of their realization is not appropriate for the activity of financial institutions. In this light, on 6 June 1999 the tax authorities submitted to the banks a draft proposed amendment to Article 6 of the said Law, according to which financial institutions will be taxed on the basis of the increase in value of the securities in accordance with the presentation of the securities in the financial statements of the financial institutions.

In cooperation with the tax authorities, the Bank is acting on the basis of the proposed Law and its tax provisions are made accordingly.

G. The amount of the inflationary adjustment of buildings, the depreciation of which will not be recognized as an expense for tax purposes, and in respect of which no deferred taxes have to be set up, is as follows:

	December 31		
	2007	2006	2005
	NIS millions		
Balance at the beginning of the year	**217**	230	252
Change in the current year (a)	**(14)**	(13)	(22)
Balance at the end of the year	**203**	217	230

(a) Including amounts not recognized as an expense in respect of depreciation and amounts deducted in respect of assets that were sold.

H. Certain subsidiaries have losses and deductions which were claimed or will be claimed for tax purposes in respect of which no deferred tax asset was created, amounting in the subsidiaries to approximately NIS 56 million (31 December 2006 - approximately NIS 31 million). These amounts will be realizable in the future provided that the subsidiaries in which the amounts are recorded will have taxable income.

Note 26 - Provision for Taxes on Operating Profit (cont'd)
Reported Amounts

I. Components of deferred tax assets and deferred tax liabilities are as follows:

	31 December	31 December	31 December	31 December
	2007	2006	**2007**	2006
	NIS millions		Average tax rate %	
Deferred tax assets				
From specific provision for doubtful debts	**246**	251	**38%**	38%
From provision for unutilized vacations and long service bonus	**242**	230	**34%**	34%
From excess of provision for severance pay and pension over amounts funded	**725**	715	**34%**	34%
From interest not credited to current income	**56**	53	**38%**	39%
From tax loss carryforward	**3**	16	**42%**	36%
From activity abroad	**9**	18	**35%**	35%
From adjustment of depreciable non-monetary assets	**31**	27	**37%**	37%
Other – from monetary assets	**1**	38	**37%**	39%
Other – from non-monetary assets	**27**	33	**31%**	29%
Share-based payment transactions	**270**	173	**33%**	30%
Total	**1,610**	1,554		
Reserve for deferred taxes				
From securities	**(254)**	(247)	**34%**	35%
From investments in investee companies	**(129)**	(126)	**12%**	12%
Adjustment of depreciable non-monetary assets	**(64)**	(74)	**28%**	31%
Other – from monetary assets	**(3)**	(3)	**37%**	40%
Other – from non-monetary assets	**(12)**	(14)	**26%**	26%
Share-based payment transactions	**(462)**	(464)		
Total	**1,148**	1,090		
Deferred taxes included: (a)				
In "Other assets"	**1,265**	1,194		
In "Other liabilities"	**(117)**	(104)		
Deferred tax assets, net	**1,148**	1,090		

(a) The balances of deferred taxes are shown in the consolidated balance sheet in accordance with the classification of the net balance in the books of the Bank and its consolidated companies.

I. Deferred taxes have been calculated at the tax rate applying to the companies at the time of utilization.

J. Changes in deferred taxes amounting to NIS 89 million (2006 - NIS (299) million; 2005 - NIS 35 million) derive from securities held for sale and have been charged to a separate item in the Group's shareholders' equity. In addition, deferred taxes deriving from a benefit in issuance of shares and options toemployees and others) have been charged to equity in the amount of NIS 4 million (2006 - NIS 40 million).

Note 26 - Provision for Taxes on Operating Profit (cont'd)
Reported Amounts

K. According to an arrangement with the tax authorities from 14 April 2005, as from 2004 the Bank is entitled to set off the tax liability in Israel in respect of income of a subsidiary abroad a cumulative amount of up to US$ 67 million or the tax liability in Israel, the lower of the two. The amounts not yet set off from the tax liability and in respect of which a future tax saving was not recorded in the balance sheet as of 31 December, 2007 is US$ 55 million. Utilization of these amounts in the future will be enabled if the total tax rate to which the Bank is subject on its income in Israel is higher than the tax rate to which the foreign subsidiary is subject.

Note 27 - Net Profit (loss) after Taxes from Extraordinary Items

Reported amounts

	2007	2006	2005
	NIS millions		
Net gain on realization of investments in investee companies and sale of activities	**564**	3,434	139
Elimination of extraordinary provisions (extraordinary provisions) in connection with fixed assets	**7**	-	4
Net gain (loss) from sale of buildings	**28**	12	(5)
Net profit (loss) before taxes	**599**	3,446	138
Provision for taxes on profit (loss) from extraordinary items:			
Current taxes	**222**	1,502	64
Deferred taxes	**-**	(136)	(3)
After-tax profit (loss) from extraordinary items	**377**	2,080	77
Share of profits of minority shareholders of consolidated companies, net of extraordinary items after taxes	**(4)**	-	-
After-tax profit (loss) from extraordinary items	**373**	2,080	77

Note 28 – Activity Sectors and Geographical Distribution

Bank Leumi in Israel is organized into four business lines, operated though four divisions, each headed by a member of the Management of the Bank. Each business line specializes in the provision of service to segments of customers with similar characteristics and needs. This specialization allows for the provision of a high level of professional service. In addition, there are a number of management units that provide various services to the business divisions.

The subsidiary companies in Israel and abroad have been assigned to the relevant divisions in the Bank according to the nature of their activities and the characteristics of their customers.

Principal Operational Segments

Pursuant to the Bank of Israel's directives, an operational segment is a component which has three characteristics:

1. it engages in business activities from which it is likely to produce income and bear expenses (including income and expenses from transactions with other segments at the Bank);

2. its operating results are regularly examined by the Management and the Board of Directors in order to make decisions relating to the allocation of resources to the segment and the appraisal of its performance;

3. there is separate financial information with regard to the segment.

The principal operational segments that have been determined under the directives of the Bank of Israel in accordance with the said characteristics are as follows:

1.	Households	-	providing comprehensive banking services to households and private customers .
2.	Small Businesses	-	providing banking services to small businesses.
3.	Corporate Banking	-	providing financial services to the major and international companies in the economy for their operations in Israel and abroad.
4.	Commercial Banking	-	providing financial services to middle market companies in the economy and to their connected parties.
5.	Construction and Real Estate	-	providing financial services to major construction companies and projects operating mainly in the construction and real estate sector.
6.	Private Banking	-	providing comprehensive global financial services and solutions to private customers resident in Israel and overseas with large financial asset portfolios.
7.	Financial Management	-	including principally the nostro activities of the Bank and the foreign currency trading rooms and including companies included on equity basis.
8.	Others	-	activities not assigned to other segments.

Note 28 - Description of Activity Sectors (cont'd)

Principal Operational Segments (cont'd)

* This includes other activities of the Group, none of which constitutes a profit center according to the directives of the Supervisor of Banks.

The segmented operations also include inter-segment activity, such as services that are provided to customers in another segment and also activities (products) such as mortgage loans, credit cards and the capital market.

It should be noted that attribution to a specific operational segment is sometimes carried out in accordance with additional criteria – i.e. the size of the obligo with regard to business customers, and financial wealth, in connection with private customers. Criteria such as the nature of a corporation’s business operations and the scope of its business, such as activity volumes, international trade volumes, complex and special transactions, complex projects and construction financing, can change the segmental attribution of a certain customer.

Also, segmental attribution is determined according to the sector in which the customer's account is actually operated, and so long as segmentation has not been carried out, the segmental classification does not change.

Financial Measurement System

To provide administrative support for the operations according to segments, an operating and administrative system exists in the Bank to manage profit centers according to business lines and additional classifications (the “Bahan” system).

The system’s objects:

- measuring the profitability of the various profit centers;
- measuring the business activity volume of the various profit centers according to various classifications;
- measuring performance against the goals in the work plan;
- uniformity in analyzing the business activity;
- overall control of the business activity and the profitability from such activity;
- directing the branches and other business units to achieve the Bank’s targets, including profitability targets;
- to provide a tool for allocating the Bank’s resources in a rational manner, on the basis of cost-benefit analysis;
- to provide a basis for appraisal and remuneration.

The basis of the Bank’s system is the “data warehouse” that centralizes all the Bank’s transactions and, with the assistance of an appropriate index, enables transactions to be sorted and classified between the various profit centers.

The data presented below regarding operational segments includes the Bank's data according to the principles of the Bahan system as explained below, while the segmented data of the subsidiaries in Israel and abroad has been taken from their financial statements, and as defined by them.

Note 28 - Activity Sectors and Geographical Distribution (cont'd)

Financial Measurement System (cont'd)

In measuring the profitability of overseas subsidiaries, the exchange rate differentials after the effect of taxes arising from financing the investment in overseas, subsidiaries are allocated to the net interest income of the overseas subsidiaries.

The attribution of income and expenses according to business lines at the Bank is effected as follows:

Income

Net Interest Income:

The profit center is credited with the interest received from the loans that it granted or is debited with the interest that is paid on deposits it raised.

At the same time, the profit center granting the loan is debited, and the profit center receiving the deposit is credited with transfer prices. The transfer prices are usually determined according to market prices following certain adjustments and generally reflect risk-free returns or the marginal costs of raising funds with the same linkage sector and currency and for a similar term. The effects arising from exchange rate differentials between the shekel/foreign currencies, including adjustments from translating data of overseas subsidiaries, and also changes in the CPI on surplus uses and/or sources are attributed in the Group to the financial management segment. With the method described above, the profit centers bear credit risks but do not bear market risks.

The profit and loss statements of each of the segments also take into account the capital allocated to the segment. Every profit center is credited on the capital that was allocated to it in respect of the risk assets in accordance with risk free yield and is charged in respect of the additional cost of the Tier II capital. In this way the Bank's available capital is credited with interest equal to the marginal cost of raising funds in accordance with the segment that it is financing, or invested in the capital market. The income from the management of the nostro is reflected in the financial management and capital markets segment.

The provisions for doubtful debts are charged to the profit center in which the customer's account is managed. The same applies to the additional provision required pursuant to the directives of the Bank of Israel.

Operating Income

All the operating income (commissions and other operating income) that the Bank charges its customers and/or subsidiaries in respect of various services is credited to the profit center in which the customer's account is managed. Income from nostro securities, profits of the severance reserve and dividends that the Bank receives are credited to the capital market - financial management profit center.

Expenses

The Bank's expenses are attributed to the various profit centers based on an "operations costing" system and according to the activity volumes (the amount of the operations of the profit center).

Note 28 - Activity Sectors and Geographical Distribution (cont'd)

Financial Measurement System (cont'd)

Costing is ABC (activity based costing) - a costing system which calculates the cost per transaction after considering the transaction type, line of business and distribution channel. The system costs some 6,200 transactions of different types.

Expenses that are not connected with the direct activities of the profit center (the activity segment), such as expenses in connection with the actuarial pension liability, are not charged to the profit centers and are reflected in the financial management segment.

Note 28 – Activity Sectors and Geographical Distribution (cont'd)

Reported amounts

A. Information on activity by banking sectors

Statement of profit and loss for the year ended 31 December 2007

	Household banking	Private Banking	Business Banking	Commercial Banking	Corporate Banking	Construction and real estate	Financial management	Other	Total consolidated
	NIS millions								
Net interest income (loss) before provision for doubtful debts									
From outside entities -	**(628)**	**(1,238)**	**1,016**	**1,739**	**2,412**	**1,519**	**2,806**	**22**	**7,648**
Intercompany operations -	**3,200**	**1,610**	**(170)**	**(419)**	**(928)**	**(877)**	**(2,352)**	**(64)**	**-**
Total	**2,572**	**372**	**846**	**1,320**	**1,484**	**642**	**454**	**(42)**	**7,648**
Operating and other income:									
From outside entities -	**1,679**	**444**	**436**	**485**	**515**	**43**	**305**	**315**	**4,222**
Intercompany operations -	**226**	**16**	**(27)**	**(29)**	**(152)**	**-**	**-**	**(34)**	**-**
Total	**1.905**	**460**	**409**	**456**	**363**	**43**	**305**	**281**	**4,222**
Total income	**4,477**	**832**	**1,255**	**1,776**	**1,847**	**685**	**759**	**239**	**11,870**
Provision for doubtful debts	**177**	**-**	**117**	**193**	**(28)**	**(33)**	**(19)**	**-**	**407**
Operating and other expenses	**3,456**	**637**	**883**	**788**	**646**	**110**	**375**	**42**	**6,937**
Operating profit before taxes	**844**	**195**	**255**	**795**	**1,229**	**608**	**403**	**197**	**4,526**
Provision for taxes on operating profit	**273**	**55**	**105**	**291**	**440**	**233**	**298**	**27**	**1,722**
Operating profit after taxes	**571**	**140**	**150**	**504**	**789**	**375**	**105**	**170**	**2,804**
Equity in after-tax operating profits of companies included on equity basis, net of related tax effect	**-**	**-**	**-**	**5**	**-**	**-**	**179**	**-**	**184**
Minority interest in after- tax operating losses (profit) of subsidiaries	**-**	**(5)**	**-**		**-**	**-**	**2**	**(1)**	**(4)**
Net operating profit	**571**	**135**	**150**	**509**	**789**	**375**	**286**	**169**	**2,984**
After-tax profit from extraordinary items	**278**	**6**	**29**	**16**	**17**	**1**	**-**	**26**	**373**
Net profit	**849**	**141**	**179**	**525**	**806**	**376**	**286**	**195**	**3,357**
Return on capital (percentage of profit from the proportionate capital according to share of sector in risk assets)	**22.0%**	**32.0%**	**16.6%**	**15.6%**	**16.1%**	**16.1%**	**10.2%**	**43.2%**	**17.4%**

Note 28 - Activity Sectors and Geographical Distribution (cont'd)

Reported amounts

A. Information on activity by banking sectors (cont'd)

For the year ended 31 December 2007

	Household Banking	Private Banking	business banking	Commercial banking	Corporate banking	Construction and real estate	Financial management	Other	Total consolidated
	NIS millions								
Average balance of assets	**54,620**	**8,290**	**16,509**	**45,082**	**55,890**	**22,807**	**87,512**	**5,443**	**296,153**
Including: investments in companies included on equity basis	**4**	**-**	**-**	**10**	**-**	**-**	**1,634**	**56**	**1,704**
Average balance of liabilities	**121,616**	**38,876**	**13,752**	**31,654**	**32,757**	**3,355**	**32,127**	**2,744**	**276,881**
Average balance of risk assets	**46,772**	**5,348**	**13,078**	**40,763**	**60,492**	**28,291**	**33,936**	**5,467**	**234,147**
Average balance of assets of provident funds, continuing education funds and mutual funds	**34,497**	**5,355**	**1,208**	**2,972**	**475**	**77**	**204**	**-**	**47,788**
Average balance of securities portfolios	**42,895**	**64,323**	**4,740**	**75,638**	**64,611**	**15,147**	**75,719**	**758**	**343,831**
Average balance of other managed assets	**8,381**	**417**	**475**	**1,222**	**422**	**136**	**-**	**-**	**11,053**
Margin of credit activities	**941**	**42**	**557**	**802**	**783**	**419**	**4,462**	**(61)**	**7,945**
Margin of deposit activities	**1,360**	**388**	**168**	**241**	**107**	**12**	**(4,353)**	**51**	**(2,026)**
Other	**271**	**(58)**	**121**	**277**	**594**	**211**	**345**	**(32)**	**1,729**
Total interest income (loss) before provision for doubtful debts	**2,572**	**372**	**846**	**1,320**	**1,484**	**642**	**454**	**(42)**	**7,648**

Note 28 - Activity Sectors and Geographical Distribution (cont'd)

Reported amounts

A. Information on activity by banking sectors (a)

Statement of profit and loss for the year ended 31 December 2006 (a)

	Household Banking	Private banking	business banking	Commercial banking	Corporate banking	Construction and real estate	Financial management	Other	Total consolidated
	NIS millions								
Net interest income (loss) before provision for doubtful debts									
From outside entities -	(1,277)	(1,151)	863	1,520	2,523	1,460	2,958	26	6,922
Intercompany operations -	3,601	1,505	(139)	(343)	(1,062)	(880)	(2,658)	(24)	-
Total	2,324	354	724	1,177	1,461	580	300	2	6,922
Operating and other income: (a)									
From outside entities -	1,470	388	346	405	413	47	126	686	3,881
Intercompany operations -	380	26	(14)	(12)	(124)	-	-	(256)	-
Total	1,850	414	332	393	289	47	126	430	3,881
Total income	4,174	768	1,056	1,570	1,750	627	426	432	10,803
Provision for doubtful debts	329	2	113	183	182	155	(31)	-	933
Operating and other expenses	3,580	628	731	779	649	107	570	223	7,267
Operating profit (losses) before taxes	265	138	212	608	919	365	(113)	209	2,603
Provision for taxes on operating profit	142	52	104	240	356	148	39	239	1,320
Operating profit (losses) after taxes	123	86	108	368	563	217	(152)	(30)	1,283
Equity in after-tax operating profits (losses) of companies included on equity basis, net of related tax effect	-	-	-	-	-	-	174	(3)	171
Minority interest in after- tax operating losses of subsidiaries	-	(2)	-	-	-	-	2	-	-
Net operating profit (loss)	123	84	108	368	563	217	24	(33)	1,454
After-tax profit (loss) from extraordinary items	1,127	76	54	74	32	1	718	(2)	2,080
Net profit (loss)	1,250	160	162	442	595	218	742	(35)	3,534
Return on capital (percentage of profit from The proportionate capital according to share of sector in risk assets)	36.2%	41.0%	19.5%	15.8%	12.3%	9.0%	31.6%	(7.7)%	20.1%

(a) Restated.

Note 28 - Activity Sectors and Geographical Distribution (cont'd)

Reported amounts

A. Information on activity by banking sectors (a) (cont'd)

For the year ended 31 December 2006 (a)

	Household Banking	Private banking	business banking	Commercial banking	Corporate banking	Construction and real estate	Financial management	Other	Total consolidated
	NIS millions								
Average balance of assets	50,691	8,112	12,962	38,574	57,074	23,949	83,038	5,009	279,409
Including: investments in companies included on equity basis	-	-	-	-	-	-	1,372	34	1,406
Average balance of liabilities	120,674	37,942	10,597	26,840	34,749	3,139	24,450	3,528	261,919
Average balance of risk assets	43,037	4,866	10,354	34,923	60,451	30,318	29,273	5,633	218,855
Average balance of assets of provident funds, continuing education funds and mutual funds	60,471	5,067	4,343	4,417	3,202	161	9,883	3,572	91,116
Average balance of securities portfolios	35,918	61,207	2,662	54,891	51,059	11,671	66,451	3,666	287,525
Average balance of other managed assets	8,752	453	418	1,271	627	131	-	-	11,652
Margin of credit activities	777	44	473	681	894	408	3,352	(46)	6,583
Margin of deposit activities	1,352	391	146	206	139	9	(4,294)	92	(1,959)
Other	195	(81)	105	290	428	163	1,242	(44)	2,298
Total interest income before provision for doubtful debts	2,324	354	724	1,177	1,461	580	300	2	6,922

(a) Restated.

Note 28 - Activity Sectors and Geographical Distribution (cont'd)

A. Information on activity by banking sectors (a) (cont'd)

Statement of profit and loss for the year ended 31 December 2005

	Household Banking	Private banking	business banking	Commercial banking	Corporate banking	Construction and real estate	Financial management	Other	Total consolidated
	NIS millions								
Net interest income before provision for doubtful debts									
From outside entities -	(732)	(848)	797	1,373	2,208	1,585	2,243	3	6,629
Intercompany operations -	2,762	1,165	(173)	(337)	(639)	(935)	(1,893)	50	-
Total	2,030	317	624	1,036	1,569	650	350	53	6,629
Operating and other income:									
From outside entities -	1,328	355	366	340	286	38	174	840	3,727
Intercompany operations -	518	29	(38)	14	(53)	-	-	(470)	-
Total	1,846	384	328	354	233	38	174	370	3,727
Total income	3,876	701	952	1,390	1,802	688	524	423	10,356
Provision for doubtful debts	177	2	70	188	818	157	14	-	1,426
Operating and other expenses	2,925	626	593	643	643	90	312	248	6,080
Operating profit before taxes	774	73	289	559	341	441	198	175	2,850
Provision (benefit) for taxes on operating profit	315	35	126	229	115	191	58	124	1,193
Operating profit (loss) after taxes	459	38	163	330	226	250	140	51	1,657
Equity in after-tax operating profits of companies included on equity basis, net of related tax effect	-	-	-	-	-	-	381	(3)	378
Minority interest in after- tax operating (profits) losses of subsidiaries	-	4	-	-	-	-	20	-	24
Net operating profit	459	42	163	330	226	250	541	48	2,059
Cumulative effect of change in accounting method	-	-	-	-	-	-	76	1	77
After-tax profit (loss) from extraordinary items	459	42	163	330	226	250	617	49	2,136
Net profit									
Return on capital (percentage of profit from the proportionate capital according to share of sector in risk assets)	14.7%	12.0%	22.9%	13.9%	5.0%	10.7%	31.6%	11.1%	13.5%

(a) Restated.

Note 28 - Activity Sectors and Geographical Distribution (cont'd)

Reported amounts

A. Information on activity by banking sectors (cont'd)

For the year ended 31 December 2005 (cont'd)

	Household Banking	Private banking	Small business banking	Commercial banking	Corporate banking	Construction and real estate	Financial management	Other	Total consolidated
	NIS millions								
Average balance of assets	49,777	7,728	11,312	34,951	57,383	25,885	73,025	5,030	265,091
Including: investments in companies included on equity basis	-	-	-	-	-	-	1,843	23	1,866
Average balance of liabilities	117,458	34,699	8,930	24,192	35,535	2,830	22,256	3,117	249,017
Average balance of risk assets	40,700	4,592	9,328	31,126	59,237	30,566	25,515	5,789	206,853
Average balance of assets of provident funds, continuing education funds and mutual funds	54,256	3,317	4,219	4,805	4,501	192	8,972	4,118	84,380
Average balance of securities portfolios	28,028	56,031	1,742	37,114	39,989	9,304	61,194	3,724	237,126
Average balance of other managed assets	8,964	491	404	1,200	679	38	-	-	11,776
Margin of credit activities	694	40	428	628	1,001	482	8,920	8	12,201
Margin of deposit activities	1,125	304	110	159	151	7	(10,816)	43	(8,917)
Other	211	(27)	86	249	417	161	2,246	2	3,345
Total interest income before provision for doubtful debts	2,030	317	624	1,036	1,569	650	350	53	6,629

Note 28 - Activity Sectors and Geographical Distribution (cont'd)

Reported amounts

B. Information on activity by geographical distribution (a)

For the year ended 31 December 2007

	Israel	United States	Great Britain	Switzerland	Luxembourg	Romania	Others	Total outside of Israel	Total consolidated
	NIS millions								
Total income (b)	**10,682**	**431**	**276**	**225**	**50**	**97**	**109**	**1,188**	**11,870**
Net profit (loss)	**3,308**	**(37)**	**45**	**9**	**26**	**(29)**	**35**	**49**	**3,357**
Total assets	**257,326**	**22,427**	**11,027**	**3,110**	**5,893**	**1,790**	**578**	**44,825**	**302,151**
Credit to the public	**173,598**	**13,371**	**7,860**	**2,192**	**135**	**942**	**459**	**24,959**	**198,557**
Deposits of the public	**203,243**	**17,774**	**9,033**	**543**	**5,861**	**1,148**	**443**	**34,802**	**238,045**

For the year ended 31 December 2006

	Israel	United States	Great Britain	Switzerland	Luxembourg	Romania	Others	Total outside of Israel	Total consolidated
	NIS millions								
Total income (b)(c)	9,751	337	324	236	19	37	99	1,052	10,803
Net profit (loss)	3,465	(85)	138	(1)	14	(20)	23	69	3,534
Total assets	244,956	24,461	10,600	2,960	4,748	1,044	572	44,385	289,341
Credit to the public	161,577	12,776	6,584	1,859	147	443	414	22,223	183,800
Deposits of the public	195,787	19,886	8,501	555	5,877	735	482	36,036	231,823

For the year ended 31 December 2005

	Israel	United States	Great Britain	Switzerland	Luxembourg	Others	Total outside of Israel	Total consolidated
	NIS millions							
Total income (b)(c)	9,357	930	195	148	(45)	(229)	999	10,356
Net profit	1,815	258	60	(62)	4	61	321	2,136

(a) The classification was done based on the location of the office.
(b) Interest income before provision for doubtful debts and operating and other income.
(c) Restated.

Note 29 - Earmarked Deposits, Credit and Deposits from Earmarked Deposits

Reported Amounts

	31 December 2007	31 December 2006
	NIS millions	
Credit and deposits from earmarked deposits		
Total credit to the public	**636**	735
Earmarked deposits		
Deposits of the public	**20**	3
Deposits from the Government	**873**	982
Total	**893**	985

Note 30 - Condensed Financial Statements of the Bank

Reported Amounts

A. Balance sheets of the Bank as at 31 December 2007

	31 December 2007	31 December 2006
	NIS millions	
Assets		
Cash and deposits with banks	**62,488**	62,886
Securities	**35,723**	31,686
Securities borrowed or purchased under agreement to resell	**655**	-
Credit to the public	**133,729**	125,456
Credit to governments	**642**	1,020
Investments in subsidiaries and companies included on equity basis	**12,258**	12,778
Buildings and equipment	**2,807**	2,584
Other assets	**6,179**	4,734
Total assets	**254,481**	241,144
Liabilities and equity capital		
Deposits of the public	**208,422**	200,128
Deposits from banks	**5,457**	3,578
Deposits from governments	**936**	1,248
Securities loaned or sold under agreement to repurchase	**173**	-
Subordinated notes	**4,542**	4,821
Other liabilities	**15,402**	13,878
Total liabilities	**234,932**	223,653
Shareholders' equity	**19,549**	17,491
Total liabilities and equity capital	**254,481**	241,144

Note 30 - Condensed Financial Statements of the Bank (cont'd)

Reported Amounts

B. Statements of profit and loss for the year ended 31 December 2007

	For the year ended 31 December		
	2007	2006	2005
	NIS millions		
Net interest income before provision for doubtful debts	**6,602**	5,533	5,034
Provision for doubtful debts	**318**	734	1,280
Net interest income after provision for doubtful debts	**5,744**	4,799	3,754
Operating and other income	**2,756**	(a) 2,389	(a) 2,442
Operating and other expenses	**5,059**	(a) 5,388	(a) 4,334
Operating profit before taxes	**3,441**	1,800	1,862
Provision for taxes on operating profit	**1,314**	943	892
Operating profit after taxes	**2,127**	857	970
Bank's equity in after-tax operating profits of subsidiaries and companies included on equity basis, net of related tax effect	**857**	597	1,089
Net operating profit	**2,984**	1,454	2,059
Cumulative effect of change in accounting method			
After-tax profit (loss) from extraordinary items	**373**	2,080	77
Net profit	**3,357**	3,534	2,136

(a) Restated.

Note 30 - Condensed Financial Statements of the Bank (cont'd)

Reported Amounts

C. Statements of cash flows for the year ended 31 December 2007

	For the year ended 31 December		
	2007	2006	2005
	NIS millions		
Cash flows generated by operating activities:			
Net profit for the year	**3,357**	3,534	2,136
Adjustments to reconcile net profit to net cash flows generated by operating activities:			
Profit on sale of investments in investee companies and sale of activities	**-**	(666)	(79)
Equity of Bank in undistributed losses (profits) of subsidiaries and companies included on equity basis	**1,078**	(1,557)	(693)
Other, net	**633**	1,370	1,577
Net cash inflow generated by operating activities	**5,068**	2,681	2,941
Cash flows generated by activities in assets:			
Additional investments in shares of subsidiaries	**(219)**	(366)	(56)
Proceeds from sale of investments in investee companies and sale of activities	**-**	1,100	139
Other	**(21,966)**	(4,708)	(6,357)
Net cash outflow generated by activities in assets	**(22,185)**	(3,974)	(6,274)
Cash flows generated by activities in liabilities and capital			
Issue of subordinated notes	**134**	-	799
Dividend paid to shareholders	**(2,500)**	(1,103)	(1,004)
Other	**12,316**	11,536	10,162
Net cash inflow (outflow) generated by activities in liabilities and capital	**9,950**	10,433	9,957
Increase (decrease) in cash	**(7,167)**	9,140	6,624
Balance of cash at beginning of year	**40,155**	31,015	24,391
Balance of cash at end of year	**32,988**	40,155	31,015

D. Information on the basis of nominal values for tax

	31 December **2007**	31 December 2006
	NIS millions	
Total assets	**253,016**	239,744
Total liabilities	**234,890**	223,614
Shareholders equity	**18,126**	16,130
Net profit for the year ended (a)	**3,288**	3,312

(a) Not including income of companies included on equity basis as required by generally accepted accounting principles.

Note 31 – Legislation and Proposed Legislation

A. Concerning the Capital Market

On 9 November 2004 the team which was appointed by the Minister of Finance for the purpose of examining and recommending the steps required in order to intensify competition in the Israeli capital market, published its recommendations. The team's recommendations were approved by the government.

Following their recommendations, on 10 August 2005 three laws implementing a substantial reform of the capital market were published. These were:

The Intensification of Competition and Reduction of Concentration and Conflicts of Interest in the Israeli Capital Market (Legislative Amendments) Law, 2005;
The Financial Services (Control) (Engagement in Pension Counseling and Pension Marketing) Law, 2005 (the “Pension Counseling Law”);
The Financial Services (Control) (Provident Funds) Law, 2005 (the “Provident Funds Law”).

The above-mentioned legislation (the "Capital Market Reform") obligated the Bank to dispose of its holdings in mutual fund and provident fund management companies, and it allows the Bank to provide pension product counseling, after obtaining a license from the Supervisor of Capital Markets, and to continue to engage in investment counseling regarding financial products.

With regard to the above activities, the Bank is entitled to receive distribution commissions from institutional entities which manage mutual funds and supplementary training funds. After the Bank obtains a pension counseling license, the Bank will also be entitled to receive such fees from institutional entities which manage additional types of provident funds. The Bank may also provide operating services to institutional entities and may receive operating commissions from them.

Regulation of the Engagement in Pension Counseling, in accordance with the above-mentioned Legislation and according to the Outline agreed upon between the Supervisor of Capital Markets, Insurance and Savings and the Chairman of the Knesset Finance Committee

According to the Pension Counseling Law, a pension counseling license given to a banking corporation is restricted such that during the period established in the law (the “Restriction Period”), and which is longer for the Leumi and Hapoalim groups than for other banking groups, the banks may only counsel regarding certain pension products – i.e., provident funds providing payments, pensions or compensation which are not insurance funds – and they may not provide counseling regarding insurance funds or life insurance products included in or accompanying provident funds.

The Restriction Period for the Leumi and Hapoalim Groups, as established in the Pension Counseling Law when it was enacted in 2005, was five continuous years from the date on which each of the banks complied with the conditions entitling them to obtain a pension counseling license. For other banks, the Restriction Period was to continue until the date on which such a bank meets the conditions for obtaining a pension counseling license, but not before 31 December 2009.

Note 31 – Legislation and Proposed Legislation (cont'd)

A. Concerning the Capital Market (cont'd)

During the Restriction Period, the Bank must notify any customer that the pension counseling which it provides is restricted with regard to the types of products it may cover, but the law nevertheless provides that when choosing which product is most suitable for a customer, the license holder must examine all types of pension products – both those which are permitted and those that are restricted. However, the only products that may be chosen as being most appropriate for the customer must be unrestricted ones, provided that the product which is indeed the product which is most appropriate for the customer, is among the unrestricted products.

The Pension Counseling Law was amended in January 2008, and the Restriction Period was shortened, after the Chairman of the Knesset Finance Committee and the Supervisor of Capital Markets, Insurance and Savings agreed upon an outline which allows the large banks (Leumi and Hapoalim) to engage in pension counselling.

The outline provides that:

Upon obtaining the license to engage in pension counseling, each of the large banks will be permitted to provide pension counseling to self-employed customers (including minors and customers above the age of 55, who are not salaried employees) throughout the country, and to salaried employees in the peripheral areas, which are listed in a supplement to the amended law;

As of 1 January 2009, the large banks will also be able to provide counseling regarding insurance funds and life insurance products that are included in or which accompany provident funds, to customers who live in periphery areas;

As of 1 April 2009, the large banks will also be able to provide counseling to self-employed customers, throughout the country, regarding insurance funds and life insurance products that are included in or which accompany provident funds;

And as of 1 August 2010, the large banks will be permitted to provide pension counseling regarding all pension products, to any customer in Israel (the other banks can provide such services as of 1 January 2009).

Regulation of Distribution Commissions

Distribution commissions for the distribution of mutual funds and provident funds are governed by regulations. With regard to mutual funds, four levels of maximum rates of distribution commission were established, which are to be calculated in respect of the mutual fund units held through the distributor, according to type of mutual fund, being: 0.125% regarding money market funds, 0.25% in respect of funds investing mainly in short-term, low risk investments, 0.8% in respect of funds investing mainly in equities and 0.4% in respect of other funds. The regulations establish the circumstances and types of funds regarding which the banks are not entitled to receive distribution commissions.

In relation to provident funds, including supplementary training funds, and in relation to pension funds, the maximum distribution commission rate is 0.25% regarding new deposits made as from 1 January 2006, and 0.1% regarding deposits made up to and including 31 December 2005, excluding monies in a fund controlled by a banking corporation on 10 August 2005, and monies to be transferred, as from 1 April 2006, from a fund that

Note 31 – Legislation and Proposed Legislation (cont'd)

A. Concerning the Capital Market (cont'd)

was controlled by a banking corporation on 10 August 2005, to another fund. In both of these cases, monies deposited prior to 31 December 2005 will bear the maximum commission rate of 0.25%. The commission calculation will be made with regard to the value of the fund assets deposited, transferred or that remain in the fund following continuation of membership as a result of advice that will be given to the member, including profits accrued thereto, and in a provident fund for pension, the value of the assets standing against the obligations of the fund to the customer.

Regulation of Operating Services and Commissions for Such Services

In 2006 the Supervisor of the Capital Market, Insurance and Savings (the “Supervisor”) distributed a circular intended to regulate operating agreements between a pension counselor and an institutional entity. According to the circular, the maximum annual rate to be collected by a pension counselor in respect of providing operating services to provident funds will not exceed 0.1%.

In December 2007, the Supervisor issued a draft circular the purpose of which was to establish the framework for the services that a banking corporation may provide to the members of provident funds of a management company that had been purchased from it, or which had purchased provident funds from the banking corporation (a “Purchasing Management Company”). According to the draft, in order to enable a Purchasing Management Company to prepare for the provision of services to members of the provident funds it manages, the continued provision of the services that are currently provided will be permitted, but on a temporary basis only. The services that may be provided temporarily by the selling banking corporation include the provision of information to members, the intake of information from members and employers, and the handling of deposits and withdrawals of monies by members, as part of the operating services that it provides. According to the draft, the banking corporations may continue to provide these services until the end of 2009. The draft circular does not relate to the manner in which the matters detailed therein are to be managed following said date, although pursuant to the stated purpose of the circular, the assumption is that the Purchasing Management Companies will thereafter be prepared to provide the services themselves, while at the same time, some of the services will be provided as part of pension counseling to be provided.

Amendments to the Joint Investment Trust Regulations

During 2007, various amendments of the regulations enacted pursuant to the Joint Investment Trusts Law were published in the Official Gazette (*Reshumot*). These amendments provide that beginning from January 2008, it will be possible to establish types of mutual funds which did not exist in Israel prior to the amendments, including money market funds and exchange traded funds.

Note 31 – Legislation and Proposed Legislation (cont'd)

A. Concerning the Capital Market (cont'd)

Draft of the Regulation of Engagement in Investment Counseling and Marketing and in the Management of Investment Portfolios Law (Amendment Number 11), 2007

The above-mentioned draft was signed by the Minister of Finance in December 2007, and was approved by the Ministers' Committee for Legislation, and it deals primarily with two issues:

1. Allowing foreign entities, who have been licensed to engage abroad in investment counseling and marketing and in the management of investment portfolios, to engage in these occupations and to provide such services to parties in Israel, without obtaining an Israeli license.

   The draft provides that an Israeli bank can contract with a foreign licensee regarding their engaging in counseling in Israel.

2. An expansion of the types of sophisticated clients regarding whom consultants are subject to less stringent requirements in the counseling process, such as being exempt from having a counseling agreement signed and from certain disclosure requirements when providing counseling to institutional investors acting for themselves only, so as to include counseling provided to institutional investors acting for others and corporations with equity capital exceeding NIS 50 million, and individuals the value of whose financial assets and securities exceeds NIS 15 million.

Appointment of the Committee for the Development and Strengthening of Competition in Israel

On 22 November 2007, the Minister of Finance and the Governor of the Bank of Israel announced the appointment of the Committee for the Development and Strengthening of Competition in the Israeli Capital Market. The committee is chaired by the Director-General of the Ministry of Finance.

The letter of appointment requires the Committee to examine and make recommendations regarding the measures needed to develop the capital market and to increase its ability to attract overseas capital. This is with a view to positioning the Israeli capital market as a significant global player and increasing its levels of competition and efficiency.

The Committee is to submit its recommendations by 31 August 2008.

Actions Taken by the Bank following the Capital Market Reform Legislation

Following the said legislation, the Bank has taken the following actions:

- In 2006, the Bank sold it activities in the field of the management of provident funds and mutual funds. On 31 January 2007, the sale to Prisma Provident Funds Ltd. of the operations of provident funds, the largest of which were Sion, a Central Severance Pay Fund, Tzur and Sagi, was completed, at a price of some NIS 418 million, following a price reduction arising from adjustments agreed to between the parties. The Bank's net profit, following adjustments and tax provisions, was some NIS 257 million. Together with the signing of the agreements with the purchasers of the provident funds, distribution agreements and agreements for the provision of operating services were signed with Leumi Gemel.

Note 31 – Legislation and Proposed Legislation (cont'd)

A. Concerning the Capital Market (cont'd)

- In July 2007, the sale of the supplementary training funds' activities was completed. The Bank's share of the consideration was some NIS 150 million and the net profit of some NIS 93 million was recorded in the third quarter of 2007. In April 2007, the Bank entered into an agreement for the provision of operating services by the Bank to the supplementary training funds that had been sold, and also entered into a distribution agreement.

- The Bank has completed, together with the employees' representatives, most of the preparations required for the pension funds of the Bank's employees and the employees of Leumi Mortgage Bank (the "Employees Funds"), for the purpose of complying with the provisions of the permit given to the banks under the legislation, for the engagement in management of provident funds, all the members of which are employees of a bank or employees of a corporation controlled by it, and the Employees Funds will be placed under the management of a management company owned by the members of the funds.

- The Bank set up central severance pay funds for its employees and the employees of additional companies in the Group, which are managed by a wholly-owned subsidiary of the Bank.

- In light of new legislation regarding underwriting of securities offerings, which impose material restrictions on underwriting firms controlled by a bank, the Group's securities underwriting activity has been concentrated in a new company in which the Bank holds a 19.99% interest. For this purpose, Leumi & Co. Investment House Ltd. entered into a contract with Psagot Ofek Finances Ltd. regarding collaboration in the field of underwriting, to be carried out in the framework of new company, Psagot Leumi & Co. Underwriting Ltd. Psagot Leumi & Co. Underwriting Ltd. commenced operations during the third quarter of 2007.

Effect of the Capital Market Reform Legislation on the Bank and the Group

- The reform legislation has a material effect on the Group's activities in the capital market. The Group has until now engaged both in managing assets on the capital market for the public, and in counseling and distribution, as well as in underwriting and in providing additional capital market services. Following the reform, which limits the Group's activity in the Israeli market, and as a result the ability to spread risk, the Group's activities in Israel will focus mainly on the provision of investment counseling, the provision of pension counseling when the Bank receives a license to engage in such activities, and the provision of operating services and banking and financial services to entities active in the capital market.

- The legislation has restricted the banks' activities in various ways which may make it difficult to compete with non-bank financial entities which are not subject to the said restrictions.

Note 31 – Legislation and Proposed Legislation (cont'd)

A. Concerning the Capital Market (cont'd)

Furthermore, the disposal by the Bank of its holdings in

- mutual fund, provident fund and supplementary training fund management companies will cause a reduction in the Bank's current income from these fields of activity. On the other hand, the legislation allows, as mentioned above, the receipt of distribution commission from institutional entities, and the receipt of commission in respect of operating services to institutional entities, and these commissions will, to a partial extent, reduce the expected adverse effect.

- The following is the effect on the Group's operating income.

	2007	2006	Change
	NIS millions	NIS milllions	%
From mutual funds	**165**	391	(57.8)
From provident funds	**16**	216	(92.3)
From supplementary training funds	**19**	29	(34.5)
Total	**200**	636	(68.5)

At the same time it should be noted that operating expenses decreased by some NIS 181 million.

- The amendments to the Joint Investment Trust Regulations could have indirect effects on the banks, since, as stated, these regulations allow for the establishment of money market funds, which are solid funds making short term investments of less than one year. In his letter to the Knesset Finance Committee regarding the approval of the regulations, the Minister of Finance noted that the money market funds will make a considerate contribution to the development of non-bank credit, both in terms of demand and in terms of supply.

- An additional amendment to the Provident Funds Law entered into force in January 2008, which changes the character of existing provident funds and the regulations for the withdrawal of funds from them, and which allows the deposit of monies in central severance pay funds only until the end of 2010. The Bank is examining the effect of the Law's amendment.

Note 31 – Legislation and Proposed Legislation (cont'd)

B. Amendment of the Banking (Service to Customers) Law regarding Commissions

In early July 2007, following the publication of the recommendations of the Parliamentary Committee of Enquiry regarding bank commissions, an amendment to the Banking (Service to Customers) Law, 1981 was enacted with regard to bank commissions.

The amendment to the law is a combination of a number of proposed laws which were discussed in the Knesset Economics Committee, the purpose of which was to increase the transparency of the list of commissions that the banks charge their retail customers (individuals and small businesses, as determined in rules by the Bank of Israel – “Retail Customers”), to transfer the authority to impose supervision on bank commissions to the Bank of Israel, and to deal with the issue of movement of customers from one bank to another.

Pursuant to the amendment to the law, the Governor of the Bank of Israel must establish a list of services for which a banking corporation may charge commissions from its Retail Customers.

In January 2008, the Governor of the Bank of Israel published the Banking Rules (Service to Customers) (Commissions) 2008 in the Official Gazette (*Reshumot*). To these rules was attached a list of commissions for such customers, and three abbreviated lists relating to a number of services provided to such customers.

Among other things, these rules define a “small business” for the purpose of determining the application of the above-mentioned legislation.

In this price list, the Supervisor of Banks reduced the number of commissions for retail customers by cancelling and consolidating various commissions.

The Law provides that the above-mentioned rules, including the price list, are to come into force during April 2008, although the Governor of the Bank or Israel, with the approval of the Knesset Economics Committee, may postpone their coming into force for an additional three month period. On 24 March 2008, the Knesset Economics Committee approved the postponement of the coming into effect of the rules to 5 June 2008, for the purpose of the completion of the preparations required for their implementation. If required, an additional postponement of the coming into effect of the rules may be requested, until 5 July 2008.

The Bank and the subsidiaries have begun preparations for the implementation of the above-mentioned rules and are examining the implications of the changes proposed in the above-mentioned rules on their future income from commissions.

At this stage, the Bank estimates that the Group’s income from commissions could decline by an amount of some NIS 200 million, in annual terms. This amount is an estimate, based on the volume of activity and the Bank's income from commissions in 2007, and which does not take into account possible changes in the commission structure. The Bank is examining the meaning of the legislation and the rules and its overall implications on its activities, and at this stage, it is not possible to evaluate such implication exactly.

Note 32 - Post-Balance-Sheet Events

After the balance-sheet date and up until shortly before the publication of the Financial Statements the high volatility in the capital and money markets persisted, and found expression, *inter alia*, in changes on the capital markets in Israel and worldwide, and in the continuing trend of volatility in the shekel *vis-à-vis* most foreign currencies.

These events will have adverse effects on the Financial Statements for the first quarter of 2008, mainly with respect to the matters specified below:

1. Negative exchange rate differentials in respect of the investments abroad (which do not constitute part of the tax base and are not recognized as an expense for tax purposes), will cause higher tax provisions.

2. The income less expenses in or linked to foreign currencies (which are translated according to a current exchange rate), will cause a reduction in income, compared with their translation according to the exchange rate on 31 December 2007.

3. The declines in prices on the various stock exchanges, and particularly the declines in prices of debentures in Israel and abroad, will cause a reduction in the fair value of the above-mentioned investments, which, for the most part, is recorded in capital reserve.

4. The changes in the exchange rates affect the gap between the assets and liabilities in and linked to foreign currency.

It is emphasized that should there be further developments at a later date, they may have financial effects on the Financial Statements for the year 2008, whose extent is dependent on future developments in these markets.

CONDENSED FINANCIAL STATEMENTS OF MAJOR SUBSIDIARIES IN ISRAEL AND ABROAD

Bank Leumi USA

Chairman of the Board: E. Raff
Chief Executive Officer and President: U. Rosen

Condensed Consolidated Balance Sheet as at 31 December 2007
(U.S. $ millions)

	2007	2006
Assets		
Cash and deposits with banks	**137**	168
Securities	**1,948**	2,287
Loans	**3,453**	3,000
Buildings and equipment	**19**	22
Other assets	**257**	274
Total assets	**5,814**	5,751
Liabilities and Equity Capital		
Deposits	**4,888**	4,787
Other liabilities	**371**	448
Capital notes	**100**	100
Capital resources	**455**	416
Total liabilities and capital resources	**5,814**	5,751

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2007
(U.S. $ millions)

	2007	2006
Income from financing operations before provision for doubtful debts	**110**	93
Provision for doubtful debts	**2**	3
Income from financing operations after provision for doubtful debts	**108**	90
Operating and other income	**49**	48
Operating and other expenses	**108**	100
Operating profit before taxes	**49**	38
Provision for taxes	**18**	12
Net profit	**31**	26

Bank Leumi (Switzerland) ltd.

Chairman of the Board: G. Maor
General Manager: A. Zaindenberg*

Condensed Consolidated Balance Sheet as at 31 December 2007
(CHF millions)

	2007	2006
Assets		
Cash and deposits with banks	**89**	131
Loans	**635**	532
Securities	**184**	192
Other assets	**48**	48
Total assets	**956**	903
Total Customers' Investments (off-balance sheet)	6,398	6,229
Liabilities and Equity Capital		
Deposits from banks	**512**	436
Deposits and other accounts	**227**	247
Subordinated capital notes	**50**	-
Capital resources and reserves	**167**	220
Total liabilities and capital resources	**956**	903

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2007
(CHF millions)

	2007	2006
Net interest income	**14**	14
Other operating income	**51**	48
Expenses	**51**	50
Operating profit before taxes	**14**	12
Provision for taxes	**3**	-
Net profit	**11**	12
Dividend Paid	**-**	63

* Until November 2007, Mr. S. Oren served as General Manager.

Bank Leumi (UK) plc

Chairman of the Board: E. Raff
Director and General Manager: M*. Friedman

Condensed Consolidated Balance Sheet as at 31 December 2007
(Pounds sterling millions)

	2007	2006
Assets		
Cash and deposits with banks	**275**	316
Loans	**1,007**	788
Securities	**114**	156
Equipment and buildings	**4**	4
Other assets	**23**	13
Total assets	**1,423**	1,277
Liabilities and Equity Capital		
Deposits	**1,190**	1,044
Deposits from banks	**73**	96
Subordinated capital notes	**43**	35
Other liabilities	**22**	11
Capital resources	**95**	91
Total liabilities and capital resources	**1,423**	1,277

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2007
(Pounds sterling millions)

	2007	2006
Net interest income before provision for doubtful debts	**28**	26
Recoveries of doubtful debts	**3**	-
Net interest income after provision for doubtful debts	**25**	26
Operating and other income	**12**	11
Operating and other expenses	**20**	18
Operating profit before taxes	**17**	19
Provision for taxes	**5**	6
Net profit	**12**	13
Dividend paid	**6**	37

* Until October 2007, Mr. B. Lederman served as General Manager.

Bank Leumi (Luxembourg) S.A.

Chairman of the Board: Z. Itskovitch
General Manager: Y. Moscovitz

Condensed Balance Sheet as at 31 December 2007
(Euro millions)

	2007	2006
Assets		
Cash and deposits with banks	**295**	274
Securities	**217**	211
Credit to the public	**24**	26
Other assets	**11**	7
Total assets	**547**	518
Liabilities and Shareholders' Equity		
Deposits of the public	**505**	473
Deposits from banks	**7**	11
Other liabilities	**6**	5
Total liabilities	**518**	489
Shareholders' equity	**29**	29
Total liabilities and shareholders' equity	**547**	518

Condensed Statement of Profit and Loss for the Year Ended 31 December 2007
(Euro millions)

	2007	2006
Interest income	**27.8**	22.9
Interest expense	**24.5**	20.0
Operating and other income	**4.2**	3.6
Operating and other expenses	**4.6**	4.3
Operating profit before taxes	**2.9**	2.2
Provision for taxes	**0.6**	0.4
Net profit	**2.3**	1.8

Leumi Mortgage Bank Ltd.

Chairman of the Board: A. Zeldman
General Manager: J. Burshtein*

Condensed Balance Sheet as at 31 December 2007
Reported amounts (NIS millions)

	2007	2006
Assets		
Cash and deposits with banks	**5**	17
Credit to the public	**35,790**	33,036
Buildings and equipment	**46**	42
Other assets	**191**	** 198
Total assets	**36,032**	33,293
Liabilities and Shareholders' Equity		
Deposits of the public	**7,591**	8,181
Deposits from banks	**22,326**	19,584
Deposits from the government	**29**	448
Debentures	**83**	102
Subordinated notes	**3,731**	2,819
Other liabilities	**248**	** 359
Total liabilities	**34,008**	31,493
Shareholders’ equity	**2,024**	1,800
Total liabilities and shareholders' equity	**36,032**	33,293

Condensed Statement of Profit and Loss for the Year Ended 31 December 2007
Reported amounts (NIS millions)

	2007	2006
Net interest income before provision for doubtful debts	**456**	381
Provision for doubtful debts	**43**	191
Net interest income after provision for doubtful debts	**413**	190
Operating and other income	**127**	127
Operating and other expenses	**241**	210
Operating profit before taxes	**299**	107
Provision for taxes on operating profit	**80**	57
Net profit	**219**	50

* Until march 2008, Mr. Y. Gavish served as General Manager.
** Reclassified

The Arab Israel Bank Ltd.

Chairman of the Board: S. Sussman
General Manager: Y. Eyal

Condensed Balance Sheet as at 31 December 2007
Reported amounts (NIS millions)

	2007	2006
Assets		
Cash and deposits with banks	**939**	1,045
Securities	**529**	570
Credit to the public	**2,663**	* 2,239
Buildings and equipment	**47**	39
Other assets	**39**	34
Total assets	**4,217**	3,927
Liabilities and Shareholders' Equity		
Deposits of the public	**3,160**	3,002
Deposits from banks	**568**	445
Other liabilities	**155**	* 145
Total liabilities	**3,883**	3,592
Shareholders’ equity	**334**	335
Total liabilities and shareholders' equity	**4,217**	3,927

Condensed Statement of Profit and Loss for the Year Ended 31 December 2007
Reported amounts (NIS millions)

	2007	2006
Net interest income before provision for doubtful debts	**216**	199
Provision for doubtful debts	**12**	9
Net interest income after provision for doubtful debts	**204**	190
Operating and other income	**97**	81
Operating and other expenses	**160**	158
Operating profit before taxes	**141**	113
Provision for taxes on operating profit	**52**	51
Net profit	**89**	62
Dividend Paid	**90**	60

* Reclassified

Leumi & Co. Investment House Ltd.

Chairman of the Board: E. Raff
General Manager: A. Zeldman

Condensed Consolidated Balance Sheet as at 31 December 2007
Reported amounts (NIS millions)

	2007	2006
Assets		
Cash and deposits with banks	**274**	22
Securities	**912**	699
Credit to the public	**-**	-
Investment in companies included on the equity basis	**62**	* 49
Fixed assets	**1**	1
Other assets	**4**	8
Total assets	**1,253**	779
Liabilities and Shareholders' Equity		
Loans from banks	**-**	30
Other liabilities	**89**	12
Total liabilities	**89**	42
Subordinated notes	**672**	472
Shareholders' equity	**492**	265
Total liabilities and shareholders' equity	**1,253**	779

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2007
Reported amounts (NIS millions)

	2007	2006
Net interest income	**(6)**	1
Operating and other income	**220**	47
Operating and other expenses	**31**	29
Operating profit before taxes	**183**	19
Provision for taxes on operating profit	**50**	5
Net operating profit after taxes	**133**	14
Company's equity in the net profit (loss) of companies included on the equity bas	**1**	* (1)
Net profit	**134**	13

* Reclassified.

Leumi Leasing and Investments Ltd.

Substitute of Chairman of the Board: E. Katzav *
General Manager: T. B. Davidovitch

Condensed Consolidated Balance Sheet as at 31 December 2007
Reported amounts (NIS millions)

	2007	2006
Assets		
Cash and deposits with banks	**57**	231
Investments	**30**	28
Credit to the public	**976**	671
Other assets	**8**	8
Total assets	**1,071**	938
Liabilities and Shareholders' Equity		
Deposits from banks	**300**	210
Other liabilities	**3**	4
Total liabilities	**303**	214
Shareholders’ equity	**768**	724
Total liabilities and shareholders' equity	**1,071**	938

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2007
Reported amounts (NIS millions)

	2007	2006
Net interest income	**58**	41
Other income	**2**	1
Operating expenses	**9**	7
Operating profit before taxes	**51**	35
Provision for taxes on operating profit	**7**	11
Net profit	**44**	24

* Until May 2008, Mr. J. Burshtein as served chairman of the board .

Leumi Finance Company Ltd.

Chairman of the Board: M. Eisenthal
General Manager: T. B. Davidovitch

Condensed Balance Sheet as at 31 December 2007
Reported amounts (NIS millions)

	2007	2006
Assets		
Cash and deposits with banks	**9,688**	6,343
Total assets	**9,688**	6,343
Liabilities and Shareholders' Equity		
Debentures and subordinated notes	**9,530**	6,186
Other liabilities	**1**	2
Total liabilities	**9,531**	6,188
Shareholders' equity	**157**	155
Total liabilities and shareholders' equity	**9,688**	6,343

Condensed Statement of Profit and Loss for the Year Ended 31 December 2007
Reported amounts (NIS millions)

	2007	2006
Net interest income	**16**	15
Operating and other expenses	**3**	3
Operating profit before taxes on income	**13**	12
Provision for taxes on income	**3**	5
Net profit	**10**	7