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

Annual Report 2008

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 2008

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Board of Directors

Eitan Raff, Chairman

Doron Cohen

Meir Dayan

Moshe Dovrat

Adv. Miriyam (Miri) Katz[1]

Zipora Gal Yam

Prof. Arieh Gans

Prof. Israel Gilead

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

Rami Avraham Guzman

Zvi Koren

Adv. Jacob Mashaal

Prof. Efraim Sadka

Nurit Segal

Moshe Vidman

[1] Elected on 5 June 2008.
Ms. V. Raichman served as a Director until 5 June 2008.

Bank Leumi le-Israel B.M.
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
Manager of Market Risks

Gideon Altman
Acting Head of Commercial Banking Division

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

Adv. Nahum Bitterman[1]
First Executive Vice President, Chief Legal Advisor, Head of Legal Division, Manager of Legal Risks

Yaacov (Kobi) Haber[2]
Executive Vice President, Head of Finance and Economics Division

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

Baruch Lederman
First Executive Vice President, Head of Banking Division

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

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

Adv. Jennifer Janes[3]
Executive Vice President, Group Secretary

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

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[1] Until 31 March 2008. See page 226 below.
[2] Member of Management and Head of the Finance and Economics Division as of 1 January 2009. Until 31 December 2008, Mr. Z. Nahari also served as Head of the Finance and Economics Division.
3 Until 30 April 2009. See page 226 below.

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

Directors' Report

The following is the fifty-eighth annual report of Bank Leumi le-Israel B.M. and the one hundred and seventh report of the business founded in 1902. This report will be presented to the Bank's fifty-eighth 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. This report is prepared in accordance with the public reporting directives of the Supervisor of Banks of the Bank of Israel.

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 107 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 251 branches located throughout Israel, and through 88 branches, agencies and representative offices in 22 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, and Capital Markets 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.

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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.

Some of the financial services are provided by means of subsidiary companies that operate in various fields, such as: credit cards, mortgages, leasing and underwriting.

Further, the Group invests in non-banking corporations operating in the fields of infrastructures, 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.

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 non-banking (real) holding companies (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 August 2009, as well as the sale of an additional non-banking (real) investment by 30 June 2009, as described on pages 142 to 144 of the Report.

Following the reform, the Group's capital market activities in Israel are focused mainly on the provision of investment counseling and pension counseling, on the provision of operating services to entities that are active in the capital market, and on underwriting and the distribution of private and public offerings – activities which are carried out by Leumi Partners Underwriting Ltd. (a subsidiary of a subsidiary).

Regarding the provision of pension counseling, see pages 36 to 37 above.

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

On the basis of banking system data as of 30 September 2008, as published by the Bank of Israel, the Leumi Group's market share in relation to the Israeli banking system was as follows:

	30.9.2008	**31.12.2007**	**31.12.2006**	**31.12.2005**	**31.12.2004**
	In percentages				
Total assets	**29.0**	30.0	30.1	30.0	30.0
Credit to the public	**29.0**	29.9	29.8	29.9	29.9
Deposits of the public	**29.5**	30.2	30.5	30.6	30.3
Operating profit before taxes**	**56.2**	37.9	27.5*	30.2	34.0
Operating profit after taxes**	**70.8**	38.4	25.6*	30.5	34.1

* 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.
**After neutralizing Bank Hapoalim’s losses of 37.6% and 30.4%, respectively.

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 and non-bank competitors such as insurance companies and other institutional entities.

In 2008, the world’s financial and capital markets were hit by a financial crisis which began with the crisis that had started in the mortgage market in the United States in 2007, especially in its weakest segment, the sub-prime sector. These loans, on the basis of which complex financial instruments were constructed, led the large banks in the United States and in additional countries throughout the world to revalue these instruments, and as a result thereof substantial losses were recorded. Against the background of 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 and Europe, central banks also reduced interest rates significantly, both in order to reduce the negative impact of the financial crisis on economic activity, and the governments were required to inject liquidity in the scope of hundreds of billions of dollars. The main impact of this crisis on Israel, as of now, is the slowdown in economic activity throughout the world and primarily in the United States.

Regarding the measures taken by the Bank of Israel and the Ministry of Finance, see pages 27 to 28 and 30 to 31 below.
Regarding the impact of the global crisis on the Leumi Group and additional details, see pages 55 to 65 in the Report.

Total assets under management of the Group (both balance sheet and off-balance sheet*) amounted to NIS 653 billion as at 31 December 2008, as compared with NIS 764 billion at the end of 2007, a decrease of some 14.5%.
The decrease results primarily from the collapse of markets in Israel and throughout the world.

Following the intensification of the global financial crisis, the continuing decline in stock market prices throughout the world and in Israel and the worsening condition of the Israeli economy, the Group's results deteriorated in 2008. The said crisis led to a significant increase in the provisions for doubtful debts, partially due to an increase in the volume of problem debts (primarily those that are classified as debts under special supervision) and to large provisions for declines in value and the realization of investments in securities and other investments.

The Group's operating loss was primarily affected by losses from the Bank's operations, from a decline in the profitability of a number of subsidiaries in Israel and abroad, and in light of the global financial crisis. Profits of overseas subsidiaries were also adversely affected due to the appreciation of the shekel against the foreign currencies.

The operating loss of the Group totaled NIS 158 million in 2008, as compared with a profit NIS 2,984 million in 2007.

The net profit of the Group totaled NIS 92 million, a decrease of 97.3% as compared with 2007.

See page 64 below for details regarding the decline in profit from extraordinary items.

Return on equity of net profit reached 0.5%, compared with 17.4% in 2007.

The net profit per share in 2008 was NIS 0.06, compared with NIS 2.37 in 2007. No dividend was distributed for 2008, as compared with a dividend of NIS 1.0 per share in 2007.

The following table sets out a breakdown of the contribution of profit centers in the Group to the net operating profit (loss):

	2008			2007		
	Scope of Investment	**Contribution to Net Profit**		Scope of Investment	Contribution to Net Profit	
		(1)	**(2)**		(1)	(2)
	NIS billions	**NIS millions**		NIS billions	NIS millions	
The Bank	**7.7**	**(644)**	**(453)**	8.7	1,934	2,127
Subsidiary companies in Israel	**5.6**	**432**	**432**	5.2	710	710
Overseas subsidiary companies	**4.1**	**(110)**	**(301)**	4.4	220	27
Companies included on the equity basis	**1.3**	**164**	**164**	1.2	120	120
Total	**18.7**	**(158)**	**(158)**	19.5	2,984	2,984

(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).

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

The following is a chart of the major subsidiaries and affiliated companies of the Bank:

THE BANK

Banking and Finance

- **Israel**
  - The Arab Israel Bank Ltd. (99.7%)
  - Leumi Mortgage Bank Ltd. (100.0%)
  - Leumi Leasing & Investments Ltd. (99.5%)
  - Leumi Finance Co. Ltd. (100.0%)
  - Leumi Industrial Development Ltd. (99.6%)
  - Leumi Agricultural Development Ltd. (100.0%)
  - Leumi Real Holdings Ltd. (1) (100.0%)
  - Leumi Financial Holdings Ltd. (2) (100.0%)
- **Abroad**
  - Bank Leumi USA (99.9%)
  - Bank Leumi (UK) plc (99.8%)
  - Bank Leumi (Switzerland) Ltd. (4) (84.1%) (4)
  - Bank Leumi (Luxembourg) S.A. (100.0%)
  - Bank Leumi Romania S.A. (99.9%)
  - Leumi International Investments N.V. (100.0%)

Capital Market and Financial Services

- Leumi Card Ltd. (80.0%)
- Leumi Partners Ltd. (5) (100.0%)
- Leumi Capital Market Services Ltd. (3) (100.0%)
- The Bank Leumi le-Israel Trust Co. Ltd. (100.0%)

Non-Banking (real) Companies

- **Companies included on the equity basis**
  - The Israel Corporation Ltd. (18.15%)
  - Keshet Broadcasting Ltd. (20.0%)
  - Paz Oil Co. Ltd. (15.73%)
- **In the available for sale portfolio**
  - Super-Pharm (Israel) Ltd. (18.0%)
  - Hot – Telecommunications Systems Ltd. (14.96%)
  - Migdal Insurance and Financial Holdings Ltd. (9.85%)

(1) A consolidated holding company, whose main holding is an investment in Paz Oil Co. Ltd.
(2) A consolidated holding company, whose main holding is Leumi Card Ltd.
(3) Previously Leumi Gemel, since 2006 engages in the provision of operating services to companies active in the capital market.
(4)93.9% of voting rights.
(5)Previously Leumi & Co. Investment House Ltd.

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 group.
- To be a group that provides the highest level of 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.

Background Conditions

Changes in the business environment

The competitive and business environment in which Leumi operates is complex and influenced by many and various exogenic factors: the world market, the Israeli economy, regulation in Israel and abroad, changes and trends in areas such as environmental protection, globalization, technology, innovation in the field, and more.

What began as a local crisis regarding sub-prime mortgages in the United States developed into a worldwide crisis regarding real estate, finance, the labor market and the global industrial economy. Governments and central banks throughout the world are taking far-reaching measures to solve the crisis – nationalizing banks, injecting billions of dollars of capital into banks and other financial and industrial companies, making substantial cuts in interest rates, and working to increase the liquidity in the system. The crisis, the changes in the world financial map, and the unprecedented involvement of the various governments in the crisis are expected to continue and also to have consequences for the financial system in Israel. The business and competitive environments expected to be affected significantly, as will be risk management and the rules of control and supervision.

Pension counseling – in the context of the legislation proposed by the Bachar Committee, after the banks sold the mutual funds and provident funds that they had held, the small and medium-sized banks began to provide pension counseling nationwide to the self-employed and to salaried workers. Bank Leumi received a licence to provide counseling to the self-employed and to salaried workers in peripheral areas; it began to provide such counseling and is expected to expand its activity in the field over the course of 2009. Beginning in 2010, Leumi and Bank Hapoalim will be permitted to operate on a full scale basis (including the provision of counseling regarding life insurance products).

Provident funds – the regulatory changes regarding pension savings, and particularly the changes concerning the provident funds, have created a new reality in the world of long-term savings. The cancellation of the right to withdraw money after 15 years, from the funds for the self-employed in respect of new savings, the cancellation of the ability to withdraw in a single lump-sum (another change concerning new savings), the obligation to provide for pensions and the increase in the management fees of the funds after their sale, following the Bachar Committee recommendations, led to a significant decrease in savings in this channel. In addition, due to the significant increase in the equity and corporate debenture components of the provident funds' asset portfolios in recent years, the financial crisis in the markets has led to negative returns for the provident funds in 2008. The fund members have increased the rate of withdrawals from the funds and have moved to more solid investments.

The competitive environment

Local banks:

In 2008, as a consequence of the global crisis, the Israeli banking sectors' profitability also suffered. The sector's exposure to the source of the crisis – the American residential property market – was relatively limited. The effects resulting from the development of the crisis in the American residential property market into a global financial crisis and to a crisis in the industrial economy as well are expected to be more extensive. This is due to of the banks' exposure to financial entities around the world, the adverse impact on customers' profitability and stability and the value of their collateral, and of the decline in income from capital market activity and in the profitability of non-financial holdings.

In this light, it appears that the stability of the banking system as a whole is also being given higher priority by the various regulators. According to the Bank of Israel's estimates, as expressed in the media by the Governor of the Bank of Israel, Israel's banking system remains strong.

Foreign banks

The profound crisis in the U.S. economy has led to dramatic changes in the map of U.S. investment banks, beginning with the collapse of two large investment banks - Bear Stearns and Lehman Brothers – and the purchase of an additional large investment bank – Merrill Lynch – by the Bank of America – and continuing with the transformation of Morgan Stanley and Goldman Sachs into commercial banks subject to government supervision. Since then, notwithstanding the massive support and the extensive measures taken by the various governments, the worldwide banking system has not yet stabilized. It appears that in light of the dramatic crisis in the financial world, efforts will focus on the stabilization of the system and less on expansion into various markets. Continued structural reorganization may therefore be expected, along with mergers and the creation of enormous global entities.

Non-banking competitors

- Financing from the capital market and institutional investors – after four successive years in which the volume of the capital raised by businesses through offerings on the capital market and through institutional investors has significantly exceeded bank credit, the market in debenture offerings underwent a drastic contraction in 2008. According to a Stock Exchange estimate, the volume of capital raised was some NIS 11 billion in the first half of 2008, as compared was NIS 70 billion during 2007. The financial crisis makes it difficult for companies – including large companies that had previously received high ratings – to raise funds on the capital market and they will have difficulty meeting the significant sums required for redemption of debentures that are due in the coming years.

- Capital market and brokerage activity – in addition to the competition felt during the last two years from investment houses, insurance companies, pension funds and additional institutional entities in the field of credit and investment, there has been an increase in their capital market and brokerage activity, with regard to both commercial and corporate customers, and they have brought an ever-increasing level of competition in these fields too. Here it is reasonable to assume that this trend may change in light of the crisis. It appears that there will be a return to basic products, at the expense of sophisticated high risk products.

Increased regulation

The impact of regulation on the banking sector is intensifying and expanding in Israel and throughout the world. The financial crisis is expected to further increase the power of the regulators, and supervisors in every respect and these will constitute a key element in the stabilization of the financial system.

As well as the local regulatory activities, the banks are also affected by global regulation. The local regulators adopt international treaties and directives, such as the "Basel II" directives, the IFRS (international accounting standards that do not apply to Israeli banks), the Sarbanes-Oxley Act, etc. Some of these apply specifically to banks and some to all business organizations. There may be changes in legislation, including in the Basel II directives, following the lessons learned from the financial crisis.

The increased regulation creates material pressures in terms of expenses, in addition to the management inputs required for careful preparation and compliance with directives.

In addition, regulation has an impact on competition, as it imposes restrictions on the banks, such as the prohibition of the purchase of other banks 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, without being at a high risk level, the Leumi Group has set multi-year goals for increasing shareholder value through improved profitability, in both local and international activities. Improved profitability will be sought while managing the risk levels as reflected in the desired capital adequacy ratios and with the Group's risk management policy 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. The achievement of the strategic plan depends on many variables, including: the state of the markets in Israel and abroad, especially in light of the financial crisis, the security situation, employment relations within the Group, regulatory changes and the ongoing effects of regulatory changes, the extent of whose effects in the long term cannot yet be definitely defined.

In order to ensure continued growth and profitability in the long-term, Leumi is focusing its strategic efforts and its resources – capital, human and managerial - on business areas that produce high yields and/or require relatively little capital, while improving profitability in areas with low levels thereof. 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. 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, including the increased use by customers of direct channels, and by reaching a level of excellence in managing the customer’s experience with the Group.

2. Upgrading risk management within the Group – Bank Leumi has set a goal of continuing to lead in terms of the quality of risk management, and to strengthen its ability in this area. The importance of comprehensive, methodical and high quality risk management has increased greatly in light of the crisis in the markets, and Leumi sees the upgrading of risk management as an important element of its activity.

3. Leumi is continuing to seek to expand its international activity, on the basis of its existing geographic distribution, while leveraging the Bank’s strengths, and intensifying support for corporate and commercial customers and the service granted to wealthy clients.

4. Upgrading operational excellence – achieving savings, efficiency and optimization of the allocation of the organization's resources for the purpose of achieving its objectives.

5. Human resources – building up and development of human resources, so as to support the achievement of the Group's strategic objectives.

6. Applying technology to achieving the Group's goals – adapting technology to the strategic needs of the Bank and the Group.

7. Continued promotion of social responsibility to the community.

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

The above-mentioned Group objectives have been adjusted to the 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.

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 47 to 48 below.

Control of the Bank

On 31 December 2008, the State of Israel held 11.46% of the issued share capital of the Bank (fully diluted - 11.28%) and 14.20% of the voting rights in the Bank (fully diluted – 13.97%). On 1 March 2009 (following the expiry of the balance of the options in issue in February 2009), the State held 11.46% of the issued share capital of the Bank and 14.20% of the voting rights in the Bank.

Pursuant to the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993, in order to avoid involvement of the government in the ongoing management of the banks' business (during the period until the sale of the shares), while protecting the material interests of the State in the shares, a committee was established for each of the banks that were subject to the shares arrangement, the purpose of which was to participate in general meetings of shareholders of the bank, and to vote at such meetings by virtue of the shares held by the State. The term of office of the shares committee of the Bank expired at the end of October 2008. On 12 March 2009, the Bank Shares (Arrangement Shares) (Temporary Provision) Law (Appointment of Other Committees and Terms of Office) Directives, 2009, were published, pursuant to which other committees for the shares of the relevant banks (including the Bank) would be appointed for an additional term of three years (subject to the possible shortening of the term, as detailed in the said directives). On 24 March 2009, a shares committee was appointed for the Bank accordingly.

Sale of Shares in the Bank by the State

Further to the procedure for the sale of up to 20% of the State's shares in the Bank, published by the Accountant General in the Ministry of Finance and M.I. Holdings Ltd. ("MIH") in 2005, Barnea Investments B.V. ("Barnea") purchased 9.99% of the Bank's share capital.

The government also granted Barnea an option to purchase a further 10.01% of the capital of the Bank. The option expired on 24 May 2007. According to the conditions of the sale procedure, Barnea was required to sell at least 4.99% of the shares of the Bank (of the 9.99% that it purchased) within a year of said date. Consequently, on 18 May 2008, Barnea notified the Bank that on 15 May 2008 it had transferred 70,570,211 ordinary shares of the Bank to Gabriel Capital Corporation or its affiliates (together, "Gabriel Funds") in consideration for the interest of Gabriel Funds in Barnea S.a.r.l (the parent company of Barnea), and an undertaking of Gabriel Funds to make future payments to Barnea, subject to certain conditions and circumstances. In addition, Barnea notified the Bank that, following the above transaction, Mr. Ezra Merkin and the Gabriel Funds controlled by him do not hold any interest, directly or indirectly, in Barnea, which is wholly controlled by Mr. Stephen Feinberg, through the Cerberus private investment fund group.

In January 2009, MIH notified the Bank that at this stage it has no defined plan for the sale of the shares of the Bank.

For details regarding the issue of options to employees see page 22.

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 business line within the Group according to the nature of their activities and the characteristics of their customers.

The following are details of 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 number 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, pension savings, consumer and commercial credit and current account services, and improving the level of service to customers.

Commercial banking deals with middle-market 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.

Private banking deals with the population of wealthy private clients in Israel and worldwide. Activities are carried out 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, Romania, Uruguay and Jersey and the representative offices in Europe, Latin America, Canada, Hong Kong and Australia. 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 and the operation of all the Bank's dealing rooms for the purpose of securities trading and brokerage activities regarding foreign currency, interest rates, and derivatives. Financial management includes the development of financial and investment products, management of market risks, and the Bank's assets and liabilities management (ALM). The division also manages the relationship with overseas financial institutions and is responsible for providing services to customers 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. Private Banking	-	providing local and global financial services and solutions to private customers resident in Israel and abroad with large financial asset portfolios.
6. Financial Management and Capital Markets	-	the nostro activities and dealing rooms, the provision of services to institutional clients and the foreign financial institutions, including the operating results of the investments in non-banking (real) companies.
7. Others*	-	activities not assigned to other segments.

The segmented operations also include inter-segment activity, such as services that are provided to customers of 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.

Until 2007, construction and real estate was presented as a separate segment. Beginning in 2008, this segment has been classified among other segments, and is presented as a product within each segment in which such activity is included.

For further details, see page 105 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 (inclusive)
Small businesses	up to NIS 10 million (inclusive)

B. Private Customers According to Financial Assets:

Division/Segment	Israeli Residents	Overseas Residents
Private Banking	above NIS 5 million	above US$ 0.5 million
Households	up to NIS 5 million	up to US$ 0.5 million
Commercial	up to NIS 5 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.

As stated above, the Bank is organized according to business lines, and its policy is to attribute customers – to the extent possible – to the appropriate business line/operational segment, according to the customers' characteristics and activities. Nevertheless, it should be noted that 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 among the segments – i.e., so long as the customer does not receive service from the segment to which the customer should be attributed according to the above criteria, 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 and commercial banking.
- Leumi USA – to commercial banking, private banking and financial management.
- Leumi Switzerland and Luxembourg – to private banking.
- Leumi UK – to households, commercial banking and private banking.
- Leumi Romania – to households, small businesses, commercial banking and private banking.

The segment data provided here, on a consolidated basis, is 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 objectives:
- 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 Tier I 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 financial management and capital market 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 6,400 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 105 to 145 of the Directors' Report and Note 28 to the Financial Statements.

Measuring the return on capital

A calculation of the risk assets is calculated for each operational segment, and Tier I and Tier II capital is allotted to the segment based on the results of the calculation. The return on capital for the segment is calculated in accordance with the results that are obtained.

Capital Resources and Transactions in the Shares of the Bank

Shareholders' Equity of the Group at 31 December 2008 amounted to NIS 18,672 million, compared with NIS 19,549 million at the end of 2007, a decrease of 4.5%. The decrease in shareholders' equity mainly derives from the decline in the value of the available-for-sale securities portfolio, from adjustments for the translation of the financial statements of the companies included on the equity basis and from the dividend that was distributed, which was partially offset by the profit for the year, by the increase in capital due to the exercise of the options that had been issued to employees (see below for details) and by the capital adjustment because of the repayment of the loans given to employees for the purchase of shares. On the other hand, in February of 2009, 24,062,240 options - which employees had not exercised due to the fact that the share price had dropped below the exercise price - expired.

In the context of the issue of the options to employees according to the program described below, options were exercised in 2008 for a consideration of NIS 614 million, and capital increased accordingly.

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 profit and loss statement on the 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.

As a result of the global crisis and the decline in value of debentures in all the segments and of shares, a decrease in value of NIS 1,150 million, net, was recorded in shareholders' equity, compared with an increase in value amounting to NIS 121 million in 2007 (all of the amounts are net after the effect of related taxes).

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 2008 reached 6.0%, compared with 6.5% on 31 December 2007.

Shareholders' Equity relative to Risk Assets was 11.49% on 31 December 2008, compared with 11.52% on 31 December 2007. 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 7.51% on 31 December 2008, compared with 7.55% at the end of 2007.

For additional details regarding the components of equity and risk assets, see Note 13(C) to the Financial Statements.

Issue of Capital Notes and Commercial Paper

On 12 February 2008, Leumi Finance Company Ltd. ("Leumi Finance") carried out an offering of NIS 793,116,000 par value subordinated capital notes (Series H), for a consideration of NIS 815 million, made by way of expansion of a listed series (Series H), and the issue of NIS 1,700,000,000 par value subordinated capital notes (Series I), by means of a shelf offering report of 10 February 2008. The Series I capital notes are not linked to the CPI (principal and interest), bear annual interest of 6.29%, and are redeemable in a single payment on 12 August 2013.

During the period March to September 2008, the Bank raised a total amount of some NIS 600 million through four private offerings to institutional investors of commercial paper. The issues were carried out at variable interest – the Bank of Israel interest rate plus 0.18%. As of 31 December 2008, the amount of the commercial paper in issue was NIS 32 million. As of 8 March 2009, the entire amount of the commercial paper in issue had been paid up.

On 22 December 2008, Leumi Finance carried out an issue of subordinated capital notes of NIS 665,300,000 par value (Series J), through a shelf offering report of 21 December 2008. The principal and interest on the Series J capital notes are linked to the CPI, with the base index being the CPI for November 2008. The notes bear annual interest of 5.3% and are redeemable in a single payment on 23 January 2015.

With the objective of improving and strengthening capital adequacy, the Bank is planning to issue various capital notes during the course of 2009, including hybrid capital instruments. The terms and types of issues will be determined close to the dates of issue. The scope of the issues will be determined over the course of the year, subject to business developments.

Against the background of the global financial crisis, the Ministry of Finance informed the banking system that the State wished to encourage the banks to expand the supply of credit for activity in Israel and was therefore willing to guarantee the banks' liabilities to purchasers of capital notes (which are not convertible into shares) to be issued by the banks in accordance with the terms of the letter of guarantee issued to the banks by the Accountant General.

The Bank has notified the Accountant General in the Ministry of Finance that it has agreed to the terms of the letter of guarantee, which would apply to issues that the Bank may choose to carry out with the State's guarantee. According to the terms of the letter of guarantee, its provisions do not prevent the Bank from, at any time and at its discretion, issuing securities of any kind whatsoever, including capital notes, to which the State guarantee will not apply. The Bank's share in the plan is NIS 1.8 billion out of a total amount of NIS 6.0 billion. The Bank has an option to utilize this guarantee to the extent that the market conditions and prices for raising capital conform to the Bank's policy and expectations. This right remains in force until 30 June 2009, and if the Bank wishes to extend it until 30 September 2009, it is required to pay an "intent fee" to the Accountant General of 0.025% of the amount that the Bank wishes to utilize.

Interested Persons' Transactions in the Shares of the Bank

On 15 May 2008, Barnea Investments B.V. ceased to be an interested person in the Bank.

For details see "Control of the Bank" on pages 15 to 16 above.

Issue of Options to Employees

In February 2006, 84,853,960 options were issued to Leumi employees without consideration, exercisable in two tranches, pursuant to the option program outline published by the Bank in accordance with an agreement between the State and the Bank's employees regarding the Bank's privatization and the sale of the State's holdings of its shares in the Bank.

In February 2008, the employees exercised all of the 41,723,516 options that were in issue and which constituted the first tranche. Of the second tranche, 17,595,025 options were exercised by 12 February 2009, the last date for exercise. The balance of 24,062,240 options that were in issue, expired.

The adjusted exercise price on 31 December 2008 was NIS 10.555 and on 12 February 2009 it was NIS 10.489.

The Bank recorded 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, over a period of two years from the date of allotment. In 2008, the expense was reduced by NIS 16 million, as compared with an expense of some NIS 247 million in 2007.

As a result of the global crisis in the financial and capital markets, the prices of securities declined significantly, and the Leumi share price also decreased. During 2008, the share price declined by some 58%, and on 31 December 2008 it stood at NIS 7.9, as compared with NIS 18.7 at the end of 2007. Therefore, the value of the benefit to the employees declined and in 2008, the salary expenses were reduced by NIS 16 million, and deferred taxes in the amount of NIS 82 million were cancelled at the same time. The overall net negative effect on results for 2008 was some NIS 66 million.

The balance of the loans provided by Israel Discount Bank to Leumi employees in order to finance their exercise of the options was NIS 109 million as of 31 December 2006 (out of a total amount of NIS 277 million in loans that were provided in February 2008).

Further details are provided in Note 15 to the Financial Statements.

Increase of the Bank's Issued Share Capital

Up to 31 December 2008, 59,318,541 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 1,473,551,221 par value. There has been no change as of the date of the publication of the Report.

Increase of the Bank's Authorized Share Capital

On 7 October 2008, the General Meeting approved an increase of the Bank's authorized capital to NIS 2,215,000,000, through the creation of 500,000,000 ordinary shares of par value NIS 1 each, convertible into stock when issued and fully paid, for the purpose of issuing hybrid subordinated capital notes only. This was pursuant to the Bank's announcement in September 2008 according to which the Board of Directors had approved in principle a framework of up to NIS 3 billion for the issue of hybrid subordinated capital notes as Tier I capital, according to conditions to be determined and approved from time to time in the future. The conditions of the notes will include the possibility of compulsory conversion to ordinary shares, although only in most exceptional circumstances, and will bear CPI-linked interest at a rate to be determined close to the date of issue.

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 distribution of the dividend or the rates of dividends in the future).

As a result of the global crisis, the deterioration of the economic situation and the uncertainty regarding the scope and depth of the crisis' impact on the Israeli banking system, including on the Bank, the Board of Directors resolved on 30 March 2009 not to declare the distribution of a cash dividend for the year 2008 and in this way to strengthen the Bank's capital adequacy and stability.

B. The Dividend Policy for 2009

In light of the prevailing uncertainty in the Israeli economy regarding the regarding the scope and extent of the impact of the financial crisis on the Israeli banking system, including on the Bank, the Board of Directors resolved on 30 March 2009 not to set a dividend policy for 2009 at this stage.

C. 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.

The Annual General Meeting, which was held on 5 June 2008, approved the Board of Director's recommendation of 30 March 2008 with regard to the distribution of an additional cash dividend for 2007 of some 52.2% of the net profit of the fourth quarter of 2007 (some NIS 270 million), and at the rate of 18.373% of the paid-up capital. The dividend was paid on 30 June 2008, to shareholders of record on 17 June 2008 (the record date). The stock traded "ex" dividend on 18 June 2008. The dividend was at the rate of some 18.373 agorot for every ordinary share of NIS 1.0 par value.

The total dividends for 2007 amounted to NIS 1,684 million, which is some 50.2% of the net profit for 2007, and at the rate of NIS 1.18373 for every ordinary share of NIS 1.0 par value.

Certain declarations appearing 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 pages 46 to 47 below.

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

**	**2008**	2007	2006
1. Bank Leumi le-Israel B.M. - in NIS millions	**-**	1,684	2,500
2. The Arab Israel Bank Ltd. - in NIS millions	**80.0**	89.7	60
3. Various wholly-owned subsidiaries of the Group - in NIS millions	**36.8**	25	18
4. Leumi International – in US$ millions	**10**	-	-
5. Leumi Re – in US$ millions	**10**	5	5
6. Bank Leumi (UK) – in £ millions	**-**	5.7	37.6
7. Bank Leumi (Switzerland) – in CHF millions	**-**	-	62.8
8. Migdal Insurance and Financial Holdings Ltd. - in NIS millions***	**4.9**	62.1	42.0
9. Israel Corporation Ltd. – in NIS millions	**32.2**	45.3	54
10. Paz Oil Company Ltd. – NIS millions	**80.0**	14	17

* The Group's share in the dividend, 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.

** The dividend is for the year of the account.

*** 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

	2008	2007	2006	2005(c)	2004
	Reported amounts				
Income, expenses and profits (in NIS millions)					
Net interest income before provision for doubtful debts	**6,380**	7,648	6,922	6,629	6,359
Provision for doubtful debts	**2,145**	407	933	1,426	1,514
Total operating and other income	**2,800**	4,222	3,881	3,727	3,403
Total operating and other expenses	**7,003**	6,937	7,267	6,080	5,488
Of which: costs of voluntary retirement	**3**	-	175	107	14
costs of privatization (issue of shares and options to employees)	**(66)**	250	452	-	-
Operating profit before taxes	**32**	4,526	2,603	2,850	2,760
Net operating profit (loss)	**(158)**	2,984	1,454	2,059	1,904
Profit (loss) from extraordinary items after tax	**250**	373	2,080	77	(8)
Net profit	**92**	3,357	3,534	2,136	1,864
Net operating profit (loss) per share (in NIS)	**(0.11)**	2.11	1.03	1.46	1.35
Net profit per share (in NIS)	**0.06**	2.37	2.50	1.51	1.32
Dividends paid (in respect of the reported year)	**-**	1,684	2,500	1,103	1,004
Assets and liabilities at end of period (NIS millions)					
Total assets (total balance sheet)	**310,792**	302,151	289,341	276,119	260,531
Credit to the public	**213,215**	198,557	183,800	180,881	174,367
Securities	**44,910**	47,169	46,375	47,825	43,543
Deposits of the public	**244,783**	238,045	231,823	221,828	209,652
Debentures and notes	**20,636**	19,248	15,622	17,253	11,256
Shareholders' equity	**18,672**	19,549	17,491	16,000	14,986
Major financial ratios in annual terms (in %)					
Credit to the public to total balance sheet	**68.6**	65.7	63.5	65.5	66.9
Securities to total balance sheet	**14.5**	15.6	16.0	17.3	16.7
Deposits of the public to total balance sheet	**78.8**	78.8	80.1	80.3	80.5
Deposits of the public to total credit	**114.8**	119.9	126.1	122.6	120.2
Total shareholders' equity to risk assets (a)	**11.49**	11.52	11.56	11.55	11.25
Tier I capital to risk assets	**7.51**	7.55	7.53	7.46	7.53
Shareholders' equity (excluding minority interest) to total balance sheet	**6.0**	6.5	6.0	5.8	5.8
Net profit to average shareholders' equity (excluding minority interest)	**0.5**	17.4	20.1	13.5	12.6
Net operating profit to average shareholders' equity (excluding minority interest)	**(0.8)**	15.4	8.3	13.0	12.9
Rate of provision for tax from profit	**-**	38.0	50.7	41.9	45.1
Provision for doubtful debts from credit to the public	**1.01**	0.20	0.51	0.79	0.87
Provision for doubtful debts from total credit risk to the public	**0.67**	0.13	0.34	0.54	0.61
Net interest income before provision for doubtful debts to total balance sheet	**2.05**	2.53	2.39	2.40	2.44
Total income to total assets (b)	**2.95**	3.93	3.73	3.75	3.75
Total income to total assets managed by the Group (b)	**1.41**	1.55	1.55	1.62	1.98
Total operating and other expenses to total assets	**2.25**	2.30	2.51	2.20	2.11
Total expenses to total assets managed by the Group	**1.07**	0.91	1.05	0.95	1.11
Net profit to total average assets	**0.03**	1.13	1.29	0.82	0.75
Net operating profit to total average assets	**(0.05)**	1.01	0.53	0.79	0.77
Financial margin including income and expenses from derivative financial instruments	**1.63**	1.71	1.82	1.60	1.76
Operating expenses (excluding costs of voluntary retirement) to total income (b)	**76.3**	58.4	65.6	57.7	56.1
Operating and other income to operating and other expenses (excluding cost of voluntary retirement)	**40.0**	60.9	54.7	62.4	62.2
Operating and other income from total income (b)	**30.5**	35.6	35.9	36.0	34.9

(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. Other information

Principal Developments in the Economy*

General

In 2008, the Israeli economy grew at a real rate of some 4.0%, after growth rates of 5% and more in each of the preceding four years. During the first half of 2008, the economy continued to grow at a fast pace. However, the impact of the global financial crisis on the Israeli economy made its appearance, and during the third quarter and especially in the last quarter of the year, there was a significant slowdown in economic activity, and gross domestic product shrunk by some 0.5%, in annual terms, compared with the third quarter of the year. The slowdown in economic activity during the second half of the year was reflected in private consumption, in exports and imports and in most sectors of the economy. This was reflected, *inter alia*, in a significant adverse effect on the State's revenues from taxes, while the global financial crisis, which also affected the Israeli capital market, led to a sharp drop in revenues from taxation of the local capital market. The decline in the State's revenues from taxes led to a deviation from the planned budget deficit. The deficit amounted to some 2.1% of GDP as compared to a planned deficit of 1.6% of GDP.

The shekel appreciated against the dollar during 2008 by some 1.1%, although volatility was high. During the third quarter of the year, the Bank of Israel increased its intervention in the foreign currency market, which began in March 2008 with the purchase of some US$ 100 million on a daily average. This measure led to an increase of some US$ 13.8 billion during the past year in the foreign currency reserves, which amounted at the end of 2008 to some US$ 42.3 billion, and to a devaluation of the shekel of 11.1% during the fourth quarter of the year.

Inflation in the economy amounted to 3.8% in 2008, a deviation from the price stability target of 1% to 3%. In light of this, the Bank of Israel raised the interest rate during the second and third quarters of the year. At the same time, in October 2008, with the worsening global financial crisis and the concern at the possibility of a severe economic slowdown increasing significantly, the Bank of Israel began to reverse this process and to reduce the interest rate. Thus began a process of sharp reductions in the interest rate, to 2.5% in December 2008. At the beginning of 2009, with the publication of additional negative data regarding the condition of the global economy and of the Israeli economy, the interest rate was reduced at the end of the months of January, February and March, down to 0.50% (effective for the month of April 2009).

On the stock market, sharp declines of some 46.4% were recorded for 2008 in the shares and convertible securities index. Most of these declines took place during the second half of the year, against the background of the worsening global financial crisis which impacted negatively on the local market as well. The market for CPI-linked corporate debentures recorded sharp declines of some 16.6%, with a significant increase in the gap between yields to maturity of these debentures compared with government debentures, following the significant worsening of the financial situation.

The Global Crisis and its Implications for the Israeli Economy

The global financial crisis worsened during the second half of 2008, after signs of a slowdown in global economic activity had increased during the first half of the year. This was against the background of the continuing crisis in the residential real estate market and in the mortgage market in the United States and the United Kingdom, which had begun in the middle of 2007, and also had a negative impact on the banking and financial systems. This was manifested in significant write-offs by major banking groups worldwide, including the major investment houses. During the second and third quarters of the year, uncertainty regarding the financial strength of these institutions grew rapidly, which led to the bankruptcy

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

of some of them. Consequently, lack of confidence and lack of liquidity developed in the global banking system, which led to coordinated intervention by governments and central banks throughout the world by means of exceptional and significantly large "rescue plans". The measures that were taken included, *inter alia*, significant reductions of interest rates by central banks (the Federal Reserve Bank in the United States reduced the rate to 0-0.25%), the injection of liquidity into the system, assistance through the granting of government guarantees for deposits and bank debentures in order to support the functioning of the inter-bank market and the financial markets, and the enlargement of the banks' capital basis by the governments (bank nationalization). These measures began to be implemented during the fourth quarter of 2008.

During February 2009, following the new US administration's taking of office, a government plan was presented involving some US$ 789 billion for expansion of economic activity and job creation. The central elements of the approved plan were tax reductions for households, and investments in infrastructure and science and in the fields of health, education and energy.

The Bank of Israel estimates that the global financial crisis is impacting on the Israeli financial system and is being manifested through a significant increase in volatility and uncertainty in local capital markets, declines in prices on the Tel Aviv Stock Exchange and increased risk margins for debentures, especially corporate debentures.

The Central Bank also estimates that the crisis is expected to impact economic activity through declining securities prices in Israel and the world, which will cause an erosion of the value of assets held by the Israeli public and a decline in private consumption is therefore anticipated. Additionally, in the event of a slowdown in growth or a worldwide economic recession, especially in developed countries, Israel's exports will decline and this will lead to a reduction in the economy's income. An expected result would be a decline in private consumption. Against this background, in March 2009, the Central Bank updated its real macro-economic forecast, and it now projects that the rate of growth in 2009 will be negative:
- 1.5%, and that the business sector will also have a negative growth rate: -2.5%. In light of this, it should be noted that in March 2009, the International Monetary Fund (IMF) adjusted its global growth forecast for the year 2009 downward, and it now estimates that growth in the United States and in the euro zone in 2009 will be -2.6% and -3.2%, respectively, as compared with 1.1% and 0.9%, respectively, in 2008. The expected negative effect on exports and consumption in Israel, as well as the difficulty in raising capital and credit in global markets, is expected also to have a significant adverse impact on local investments.

The Government's Plan for Handling the Financial Crisis

On 19 November 2008, the Ministry of Finance announced an "acceleration program", which included a package of measures for acceleration of activity in the economy, in light of the global recession.

The government program, as presented by the Ministry of Finance, includes, *inter alia*, the following measures:

1. Government investment in infrastructure projects in the amount of some NIS 21.7 billion in 2009, while granting immediate budget provision for committing some NIS 10 billion to available projects.

2. Expansion of credit sources to the business sector of some NIS 3.3 billion. In this context, a fund has been established in the amount of some NIS 1.3 billion, the purpose of which is to provide credit to medium-sized businesses.

3. Continuing with the existing plan for reducing taxes.

4. An additional NIS 250 million for investment in R&D, and the granting of up to some NIS 100 million for investment in accordance with the Encouragement of Capital Investment Law.

5. Various steps to strengthen the labor market.

6. Removal of obstacles in the real estate market.

7. In the context of the government program, it has been decided that a tender will be issued for the establishment of a number of investment funds ("leverage funds"), which will specialize in refinancing debt of companies in need thereof, and in providing assistance for credit arrangements for such companies. NIS 5 billion have been budgeted for this through a spending authorization, and the funds will invest in companies whose main operations are in Israel.

8. An additional element of the program is the acceleration of the provision of a State guarantee in the amount of some NIS 6 billion to the banking system. On 19 January 2009, the Ministry of Finance announced that this guarantee would be granted to the banking system in order to enable the banks to raise funds by issuing subordinated capital notes. The objective is to enable a significant expansion of credit in the economy, without impacting on the banks' capital adequacy.

9. On 15 February 2009, the Ministry of Finance announced that it intended to allow the local financial system's foreign currency balances to be deposited in a designated deposit with the Accountant General. The deposit would be carried out through a number of tenders through which the interest rate that the deposit will bear would be established, with the duration of the deposit ranging from 12 to 36 months.

At this stage, it is not possible to estimate the impact of the economic measures on the Bank's activity.

Business Product and Economic Sectors

The business sector product rose at a real rate of some 4.4% in 2008, following a rapid rate of growth of more than 6%, according to Central Bureau of Statistics data, in each of the years 2004 to 2007. This growth rate is the result of the rapid growth in the first half of the year and a sharp slowdown during the second half of 2008. In particular, during the fourth quarter of the year there was a sharp slowdown in growth in the business sector, which contracted at an annual rate of some 1.6% compared with the third quarter. The source of the slowdown is the contraction of activity in the industrial, commercial, accommodation and food services, and financial and business services sectors.

The Bank of Israel's companies' survey for the fourth quarter of 2008 pointed towards an intensification of the slowdown and even to a reduction in business activity, pursuant to the trend towards a slowdown which had become significant by the third quarter of the year. There was a marked reduction in activity in all sectors. The expectation is for a continuation of reduced activity in all sectors in the next quarter as well, while it is expected that the reduction of activity will worsen in the construction, services and hotels sectors.

The tourism sector continued to expand during 2008, particularly with regard to incoming tourism into Israel. The volume of overnight hotel stays (tourists and Israelis) increased by 5.4%, in comparison with 2007, and it reached an all-time record level of some 21.6 million overnight stays. Tourist overnight stays increased by some 21.2% compared to 2007, and hotel room occupancy also increased in all regions and reached an average of some 67%, a rate which was last exceeded in 1995.

The State Budget and its Financing

The State Budget deficit (excluding net credit granted) amounted in 2008 to some NIS 15.2 billion which is some 2.1% of the GDP, as compared to a planned deficit of some 1.6% of the GDP. This is an (upwards) deviation from the target deficit established in the State budget, following four years in which the actual deficit was lower than the target. The primary explanation for the deviation this year is, according to Ministry of Finance announcements, the significant increase in expenses in December 2008, as compared to the month of December in previous years, due to, *inter alia*, the acceleration and advancement of expenses in an effort to accelerate activity in the economy and to ease matters for the Ministries with respect to their activities at the beginning of 2009, as the budget has not yet been approved. In addition, there was a significant reduction in revenues and the deficit for December therefore amounted to some NIS 13.9 billion, i.e. almost the entire annual deficit. The decline in State revenues, against the background of the marked slowdown in economic activity, caused the State's annual total revenues from taxes to amount to some NIS 184.1 billion, compared with the original forecast of some NIS 190.6 billion used in constructing the 2008 budget, i.e. a shortfall of NIS 6.5 billion.

Foreign Trade and Capital Flows

Israel's trade deficit in 2008 amounted to some US$ 13.7 billion, an increase of some 35% in comparison with the deficit in 2007. In addition, the source of the deficit's expansion is the increased cost of energy products due to their increased prices throughout the world for most of the past year. Imports and exports expanded by some 15% and 11% respectively. These data reflect the development over the entire year, but there was a significant change in the trend during the last months. The data for exports of goods, and in particular the data for industrial exports, indicate a decline in volume, while an analysis of industrial exports according to technological intensity shows a contraction of all components other than exports of traditional industrial technology which maintained stability in terms of its level. This reflects a reduction in demand throughout the world for Israeli exports, which developed against the background of the expanding crisis and the impact of the drop in the prices of some of the raw materials, the increases in which at the beginning of the year served to expand the dollar revenues from exports in certain sectors (for example, the chemical industry). As to imports, the decline in energy prices and in the prices of other raw materials impacts on the reduction of their dollar value, and therefore on the size of the expenditure on imports.

The current account data for the balance of payments indicate a surplus of some US$ 1.6 billion (0.8% of GDP) in 2008, compared with some US$ 4.2 billion (2.6% of GDP) in 2007. A key explanation for this deterioration is the increase in foreign currency expenses related to fuel imports, due to the rise in global prices at that time. This increase was only partially set off by an increase in the surplus in the services account.

An examination of the overall situation concerning the development of the key components of the capital flows in 2008 (after neutralizing the impact of the large transaction involving the acquisition of a foreign company by an Israeli pharmaceutical company), indicates the different character of the key components: the financial capital flows contracted significantly, while foreign residents realized investments and Israelis reduced investments, and the direct investment components, which reflect decisions of a long-term character, have indicated until now that there is a slowdown in investments by Israelis overseas and a moderate increase in the investments of foreigners in Israel. Overall, it appears that the contraction in investments by foreigners in Israel since the beginning of the year has been mostly offset by the contraction of the investments made by Israelis abroad. Since these are primarily the financial investment components, the explanation for this is the financial crisis throughout the world and in Israel.

These data indicate that the impact of capital flows supported the shekel's relative stability.

Exchange Rate and Foreign Currency Reserves

2008 ended with a slight appreciation of 1.1% in the rate of shekel against the dollar and an appreciation of some 6.4% against the euro. At the same time, during the course of the year, the volatility of the exchange rate increased significantly, influenced by, *inter alia*, development of the exchange rate of the dollar against world currencies. Thus, the exchange rate of the shekel against the dollar reached a low of some NIS 3.2 to the dollar and a high of some NIS 4 to the dollar.

In March 2008, the Bank of Israel began purchasing dollars in the foreign currency market for the first time since 1998, in the framework of a program for increasing reserves over the next two years by some US$ 10 billion (some US$ 25 million per day) - a program announced by the Central Bank on 20 March 2008.

On 10 July 2008, the Bank of Israel announced that beginning on that date it would increase the rate of its foreign currency purchases and would purchase US$ 100 million on a daily average. In its announcement, the Central Bank explained that the decision to accelerate the purchases had been made after the program for increasing its balances had been examined against the background of the market conditions at that time, and of the rapid accumulated change in the shekel's exchange rate. After the Bank of Israel's announcement, the shekel began a process of depreciation and its exchange rate, which on 9 July had been NIS 3.23 to the dollar, reached NIS 3.802 to the dollar by the end of the year. This devaluation was affected by, *inter alia,* the actions of the Bank of Israel and the strengthening of the dollar throughout the world. The devaluation continued at the beginning of 2009, and at the end of February 2009, the dollar's exchange rate had reached NIS 4.162.

On 30 November 2008, the Central Bank announced that it had updated the size of the desired foreign currency reserves which now stand at US$ 40 to 44 billion. At the end of December 2008, the foreign currency reserves at the Bank of Israel stood at some US$ 42.3 billion, compared with some US$ 28.5 billion at the end of 2007.

Inflation and Monetary Policy

The CPI rose by 3.8% in 2008, which exceeded the upper limit of the government's price stability target of 1% - 3%. An analysis of the CPI according to its key items indicates marked rises in prices in two items: housing, which rose by 12.1% and contributed some 2.5 percentage points to the overall rise in the CPI, and food, which rose by some 9.1% and contributed some 1.3 percentage points. In effect, the contribution of these two categories amounts to the entire increase in the CPI during the past year (3.8%), while the contribution of the increases and decreases in the other items were minor and offset each other. The increase in the housing item this year reflected a combination of excess demand in housing and the end of the linkage of prices to the dollar (which weakened against the shekel during most months of the year) along with a transition to renewed lease contracts (on the basis of which the housing item is estimated) of which today only some 20% are linked to the dollar, compared with some 90% until a few years ago. The rises in prices in the food item are the result of the impact of significant increases in the prices of raw materials throughout the world during the first half of the year. Since then, price decreases have been recorded, of which only a small portion have been reflected in the food item until now.

There was a high degree of volatility in the development of Bank of Israel's interest rates during the year. At the beginning of the year, the Bank of Israel raised the interest rate from 4.0% in December 2007 to 4.25% in January 2008, and later in the first quarter, the Central Bank began a process of reducing the interest rate, down to 3.25% in April. Beginning in June 2008, in light of the increased inflationary environment which deviated significantly from the price stability target, the Bank of Israel began raising the interest rate, up to 4.25% in September 2008, in order to restore the rate of inflation to the price stability range. As the global financial crisis worsened, and concerns increased regarding a significant economic slowdown, the Bank of Israel began a process of reducing interest rates. Thus, in a number of reductions, the rate for the month of December 2008 reached 2.5%. The sharp reductions in the interest rate continued at the beginning of 2009, and the rate for the month of April 2009 stood at 0.50%.

On 24 December 2008, the Bank of Israel announced a series of monetary tool measures to improve the liquidity situation in the economy:

1. Since January 2009, the Bank of Israel has reduced the absorption of liquidity surpluses that has been carried out through the issuance of *Makam*.

2. Monetary loans for longer terms than the one week or one day currently granted to the banking system within the framework of tenders are being added.

3. The Bank of Israel's interest spread at the credit window and at the commercial banks' deposits window dropped from plus/minus 1.0% to plus/minus 0.5% on 23 February 2009. In the context of the March interest rate decision, the Bank of Israel announced that this spread had dropped to plus/minus 0.25%.

4. The repo tenders for commercial banks and institutional entities will be offered for longer periods than the current period of one week.

Beginning on 17 February 2009, the Bank of Israel has been using an additional tool for executing monetary policy. In this context, the Bank of Israel carries out transactions in the secondary market in various types of government debentures, with varying periods to maturity. The purpose of this measure, according to the Bank of Israel, is to increase the liquidity that will be available to financial institutions, businesses and households, and to increase the effectiveness of the monetary policy.

The Capital Market

In 2008, the share and convertible securities index declined by some 46.4%, following a rise of some 22.9% in 2007. The sharp declines in prices are the result of the global financial crisis which impacted on the stock market in Israel, and as the crisis deepened during the second half of the year, the price declines accelerated, reaching some 39%. Trading turnovers also declined, particularly in the fourth quarter of the year, although on a cumulative basis during all of 2008, the trading turnover for shares and convertible securities on and off the Tel Aviv Stock Exchange amounted to some NIS 1.96 billion, on daily average – a figure which reflects a decrease of some 5%, compared with the average for 2007. This followed double-digit increases in recent years.

The debenture market was characterized in 2008 by differing developments for government debentures and for corporate debentures. Thus, during the past year, CPI-linked government debentures stood out; their prices rose by some 9.6%, as a result of the significant increase in inflation over the course of the year and the concerns regarding the growth of the budget deficit and the increased demands for assets with low risk as compared to other financial instruments. In particular, the prices of the long-term (7-10 years) debentures rose by some 12.5%, while the yields to maturity (of the 7 year debentures) reached an average of some 3.0 % during 2008, as compared with some 3.3% in 2007 and some 3.8% in 2006. The unlinked government debentures (*"Shahar"*) index rose at a significant rate of some 12.5% during the same period. In contrast with government debentures market, prices for CPI-linked non-government debentures (corporate debentures) declined sharply during the reported period at a rate of some 16.6%, in light of concerns that the companies would have difficulty in repaying their debts, which were reflected in the increased gap between the yields to maturity of corporate debentures as compared with the yields of government debentures, due to the worsening of the economic situation. During the last quarter of the year, as the global financial crisis intensified, this index declined by some 14.3%.

At the beginning of 2009 (until 16 March), the shares and debentures indices experienced price rises: the Tel Aviv 100 Index rose by some 7.8% and the CPI-linked government debentures index rose by some 2.6%.

Key Capital Market Indices – Rate of Periodic Change in 2008

	First quarter	Second quarter	Third quarter	Fourth quarter	Annual
	Percentages				
Tel Aviv 100	(19.6)	6.4	(18.6)	(29.8)	(51.1)
Ma'of	(18.1)	8.9	(18.3)	(26.2)	(46.2)
Government debentures index	2.7	2.0	-	4.6	9.5
Bank shares index	(18.7)	3.9	(25.5)	(28.6)	(55.1)

Yield to Redemption – Monthly Averages

	December 2007	March 2008	June 2008	September 2008	December 2008
	Percentages				
Makam – 1 year to redemption	4.6	3.8	4.3	4.3	2.0
Shahar – 3 years	5.5	4.4	4.9	4.9	3.4
Shahar – 7 years	6.0	5.5	5.9	5.8	5.0
Galil – 5 years	3.2	2.3	2.6	3.0	3.1
Galil – 10 years	3.5	3.0	3.1	3.4	3.4

Financial Assets of the Public

The portfolio of financial assets held by the public amounted at the end of December 2008 to some NIS 1,885 billion, a decrease of some 8.4% (some NIS 173 billion) compared with their level at the end of December 2007. This decrease was moderated by the inclusion since the beginning of February 2008 in the CPI-linked portfolio, of the government's undertaking to assist the long-established pension funds in the amount of some NIS 72 billion – which led to an increase of some 3.5% in the value of that portfolio. Thus, if the inclusion of this element is neutralized, there was a nominal decline of some 12% in the portfolio’s value. An examination of the portfolio’s components indicates an erosion of the value of the shares held by the public as a result of the price declines in Israel and abroad, due to the global financial crisis and a decline in the value of the foreign currency-linked assets due to the appreciation in the exchange rate of the shekel, in particular against the dollar and the euro. In contrast, the non-linked elements and the CPI-linked elements rose, also due to the accumulation of assets due to the continued growth in the economy.

The public’s financial assets managed by the **Group** (deposits of the public, debentures and capital notes, securities portfolios, including securities of mutual funds, provident funds and supplementary training funds held in custody), in relation to which operation management and custody services are provided, amounted at the end of December 2008 to some NIS 607.5 billion, compared with some NIS 719.2 billion at the end of December 2007, a decrease of 15.5%.

Bank Credit

The year 2008 was characterized by a change in direction in the credit market in the Israeli economy. Non-bank credit, which had undergone a sharp expansion in recent years, contracted because of the decline in the value of debentures which constitute the lion’s share of this type of credit. The scope of debentures issues, which constitute an alternative to bank credit, amounted to some NIS 11-13 billion (according to an estimate based on Tel Aviv Stock Exchange data) – a sharp decline in comparison to issues amounting to close to NIS 70 billion in 2007. Moreover, most of the funds raised during the past year were raised during the first half of the year, while the volume of debenture issues in the second half was very low. The financial crisis and the global economic slowdown, which also affected the Israeli economy during the second half of the year, caused concern among investors – most of whom are institutional investors – that the ability of the borrowers (the companies that issued the bonds) to repay the loans would be adversely affected. The yields to redemption of these debentures therefore rose significantly and the companies had difficulty raising capital. As a result, bank credit again became the main source of loans for the business sector, after a number of years in which the importance of such credit had declined. According to Bank of Israel data, bank credit provided to the business sector grew by some 7.6% in 2008 and credit provided to households grew by some 8.8%. This is in contrast with expansion rates in 2007 of some 6.1% and 7.8%, respectively. The explanations for this seem to be the increase in economic activity, mainly during the first half of the year, and the business sector’s difficulty in enlarging the credit granted to it by the non-bank market.

Development of credit in the economy (rates of quarterly change) in 2008:

	First quarter	Second quarter	Third quarter	Fourth quarter	January – December 2008	Credit balances at end of December 2008
Rate of change	In percentages					(NIS billion)
Business sector credit	**1.0**	**2.2**	**(1.6)**	(1.8)	(0.3)	**737.8**
From banks	1.4	2.6	1.5	1.9	7.6	407.7
Non-bank credit	0.6	1.7	(4.9)	(6.1)	(8.6)	330.1
Credit to households	**1.1**	**3.1**	**4.0**	**0.1**	**8.5**	**284.1**
From banks	1.2	3.2	4.1	0.2	8.8	278.6
of which: housing credit + designated credit	0.4	2.7	2.9	-	6.1	220.5
of which: consumer credit	4.4	5.2	8.9	0.7	20.4	58.1

Source: Bank of Israel, Information and Statistics Division

The **Bank's** credit to the public amounted at the end of December 2008 to some NIS 144.6 billion, an increase of some 8.1% as compared with the end of 2007.

Development of credit to the public at the Bank according to quarters in 2008:

	First quarter	Second quarter	Third quarter	Fourth quarter	Annual total:
Rate of change	In percentages				
Non-linked	**4.0**	**5.6**	**0.5**	**1.2**	**11.5**
CPI-linked	**1.2**	**(0.8)**	**2.3**	**(7.3)**	**(4.8)**
Foreign currency and foreign-currency linked	**(4.1)**	**(10.2)**	**7.8**	**18.5**	**9.9**
Total	**1.6**	**1.0**	**2.2**	**3.2**	**8.1**
Foreign currency and foreign-currency linked in US$ millions	**3.8**	**(4.8)**	**5.6**	**6.5**	**11.2**

Credit Rating of the State of Israel and of Bank Leumi

On 11 February 2008, the Fitch credit rating agency announced that it was raising Israel's credit rating from 'A-' to 'A', with a rating outlook of "stable". The rise in the rating was explained by the rapid decline in the public debt/GDP ratio, which reached just over 80% in the past year, its lowest level ever. On 14 February 2008, the agency announced that it was raising the Bank's credit rating from 'BBB+' to 'A-', with the rating outlook of "stable". This was further to the State's improved credit rating and the agency's view that the State's ability to provide support to the Bank, if needed, had strengthened.

On 17 April 2008, the Moody's credit rating agency announced that it was raising Israel's foreign currency and local currency credit ratings from 'A2' to 'A1'. The increased rating reflects Israel's resilience in the face of economic and political shocks, its budgetary discipline and the continued financial and political support from the United States and from world Jewry. On 22 April 2008, the agency announced that it was raising the Bank's credit rating from 'A2' to 'A1', following the raising of the State's credit rating. On 16 December 2008, the agency announced the downgrading of both the financial stability rating of the Bank (FSR) and the ratings outlook for long-term local currency deposits from "stable" to "negative". On 12 March 2009, the agency announced that certain ratings would be downgraded for a number of Israeli banks, including Leumi, in light of concerns regarding the banks' financial stability as a result of the worsening economic situation in Israel which may lead to a higher rate of provisions for doubtful debts than had been the case previously. The change for Leumi included, *inter alia,* downgrading the rating for local currency deposits to 'A1'.

On 30 October 2008, the S&P rating agency announced that it was downgrading the credit rating outlook for Israel from "positive" to "stable." The 'A' credit rating remained unchanged. This outlook was ratified on 20 January 2009.

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

On 26 June 2008, the agency announced a downgrading of its rating for the subordinated capital notes issued by the Bank, from 'AAA' to 'AA+'. This was a result of S&P Maalot's adjustment to S&P's international rating methodology for all its ratings relating to issues made by the Israeli banking system. Accordingly, the agency determined that subordinated capital notes of Israeli banks which it had rated in the past would now be rated at one rating level lower than the issuer's rating. On 15 December 2008, the agency announced that it was confirming the 'AA+' rating for subordinated capital notes to be issued by Leumi Finance in an amount of up to NIS 2 billion.

In December of 2008, the Midrug agency announced a downgrading of the Bank's subordinated capital notes from 'Aaa' to 'Aa1'. The rating was given in the context of the issue of subordinated capital notes and debentures in an amount of up to NIS 4 billion which the Bank intends to utilize gradually, and for all remaining subordinated capital notes that had been rated in the past.

Foreign and local ratings agencies' credit ratings

	Rating agency	Short-term rating	Long-term rating	Long-term ratings forecast
State's rating in foreign currency	Moody's	P-1	A1	stable
	S&P	A-1	A	stable
	Fitch	F1	A	stable
Leumi's rating in foreign currency	Moody's	P-1	A1	negative
	S&P	A-2	A-	stable
	Fitch	F2	A-	stable
Leumi's rating in local currency	Moody's	P1	A1	negative
Leumi's rating in local currency for subordinated capital notes	Maalot		AA+	
	Midrug		Aa1	
Leumi's rating in local currency for debentures and standard deposits	Maalot		AAA	
	Midrug		Aaa	

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

	31 December				
	2008	2007	2006	2005	2004
	NIS				
Exchange Rate of:					
US dollar	**3.802**	3.846	4.225	4.603	4.308
Euro	**5.297**	5.659	5.564	5.446	5.877
Pound Sterling	**5.548**	7.710	8.288	7.941	8.307
Swiss Franc	**3.565**	3.420	3.465	3.498	3.806
Consumer Price Index:	(points)				
November – known CPI	**106.5**	101.9	99.1	99.4	96.8
December – CPI in respect of	**106.4**	102.5	99.1	99.2	96.9

The following are the exchange rates for 16 March 2009 :
US$ – 4.135, GBP – 5.867, Euro – 5.388, CHF – 3.495.

The following table sets out the rates of change

	For the year ending 31 December				
	2008	2007	2006	2005	2004
Rate of change	In percentages				
US dollar	**(1.1)**	(9.0)	(8.2)	6.8	(1.6)
Euro	**(6.4)**	1.7	2.2	(7.3)	6.2
Pound Sterling	**(28.0)**	(7.0)	4.4	(4.4)	5.8
Swiss Franc	**4.2**	(1.3)	(0.9)	(8.1)	7.2
Consumer Price Index:					
November – known CPI	**4.5**	2.8	(0.3)	2.7	0.9
December – CPI in respect of	**3.8**	3.4	(0.1)	2.4	1.2

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 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

On 27 August 2008, the Bank received a pension counseling license. Pursuant to the terms of the license, the Bank may provide pension counseling throughout the country to the self employed, to individuals aged 55 and above who are not salaried employees and to minors, with respect to the categories of products listed in paragraphs 1-4 and 9 of the definition of "categories of pension products" in the Pension Counseling Law, that is with regard to provident funds, pension funds and supplementary training funds.

The Bank may provide pension counseling to the entire population (i.e., to salaried employees and the self employed) with regard to the mentioned products and at the places as specified in the Schedule to the Counseling Law ("branches in the periphery").

At this stage, the Bank is not permitted to provide pension counseling regarding insurance funds or regarding risk life insurance or loss of earning capacity insurance ("managers' insurances") ("Insurance Products").

The Bank has been permitted to offer pension counseling regarding Insurance Products in peripheral areas as of 1 January 2009 and throughout the rest of the country as of 1 April 2009.

The Bank is preparing for the creation of computerized interfaces with the institutional bodies that manage provident funds, for the purpose of simplifying the process of transferring information and the execution of transactions carried out pursuant to the pension counseling and pursuant to, later on, the counseling regarding supplementary training funds in the context of investment counseling.

In light of the fact that there are no computerized interfaces between institutional bodies and distributors of Insurance Products and as the Ministry of Finance has not dealt with single values on its website – "BituachNet" – which would allow for the products to be examined and identified, there is no practical possibility of providing insurance counseling. Without single values for Insurance Products, the Insurance Products cannot be ranked for the purpose of providing counseling. Similarly, in the absence of single values, as stated, and in the absence of interfaces with the institutional bodies, it is not possible to monitor the realization of the counseling recommendations, vis-à-vis the institutional bodies.

Leumi is working, through the Banks Association, towards a regulation of the issue and is looking for a solution to be agreed upon the counselors, the institutional bodies and the authorities.

As of 1 August 2010, the Bank will be permitted to provide pension counseling to the entire population, in all parts of the country, and in effect, as of that date, the Bank will be permitted to provide counseling to the entire population regarding all categories of pension products.

For additional details, see page 108.

Distribution commissions in relation to provident funds, including supplementary training funds, and in relation to pension funds, were established in regulations. The maximum distribution commission rate regarding new deposits made as from 1 January 2006 is 0.25%, and it is 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. This balance does not include the premiums that are transferred for insurance coverage in a provident fund for pension.

Additionally, no regulations have yet been enacted with respect to the payments of distribution commissions for counseling regarding Insurance Products.

In September 2008, a draft amendment of the Control of Financial Services Regulations (Provident Funds) (Distribution Commissions) was submitted to the Knesset Finance Committee for approval. Pursuant to the draft, the possibility of receiving a distribution commission for the accumulated balance in provident funds that are insurance funds will be regulated. The maximum rate for a distribution commission for such funds will be identical to the rate established in relation to the provident funds that are not insurance funds, as described above. However, according to the draft, no distribution commission will be paid for payments that were deposited in a guaranteed-return insurance fund up until 31 December 1991. Similarly, no distribution commission will be paid for payments in loss of earnings capacity and life insurance plans which are included in another pension product or which are sold with such product.

On June-July 2008, a number of private members' bills were tabled before the Knesset for the amendment of the Pension Counseling Law, 2005. The proposed amendments relate primarily to the subject of distribution fees paid to banks engaged in pension counseling.

Regulation of Operating Services and Commissions for Such Services

Pursuant to a circular published by the Supervisor of the Capital Market, Insurance and Savings (the "Supervisor") in 2006, the maximum annual rate that the Bank may collect for providing operating services to provident funds is 0.1%. In the context of providing operating services to the provident funds, the Bank continues to provide services to members that accompany the operating services, including informational services and services with regard to withdrawals and ongoing deposits.

Coming into Effect of Amendment No. 10 of the Regulation of Engagement in Investment Counseling and Marketing and in the Management of Investment Portfolios Law and the Proposed Regulation of Engagement in Investment Counseling and Marketing and in the Management of Investment Portfolios (Amendment No. 11) Law, 2008

Upon completion of the sale of the provident funds and mutual funds that had been under the Leumi Group’s management and the reorganization of the Employees’ Funds following the legislation implementing the recommendations of the Bachar Committee, Amendment No. 10 of the Regulation of Engagement in Investment Counseling and Marketing and in the Management of Investment Portfolios Law (“Amendment 10”) went into effect.

In Amendment 10, enacted in the context of the Intensification of Competition and Reduction of Concentration and Conflicts of Interest in the Israeli Capital Market (Legislative Amendments) Law, 2005 a distinction was made for the first time between “investment counseling” and "investment marketing” with the banks serving as investment counselors, other than with respect to structured products, options and futures contracts which they produce, for which they act as marketers. In addition, without detracting from the law’s provisions regarding disciplinary offenses, disciplinary proceedings and penalties, a chapter was added to the law which allows the chairman of the Israel Securities Authority to impose civil fines for certain violations of the Law's provisions on license-holders and banking corporations.

The proposed Amendment 11, published in July 2008, primarily regulates the ability of foreign entities that 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.

According to the proposal, an Israeli bank will be able to contract with a foreign entity regarding their engaging in counseling in Israel.

The proposal also deals with the expansion of the types of sophisticated clients regarding whom counselors are subject to less stringent requirements in the counseling process, such as being exempt from signing a counseling agreement 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 shareholders' equity exceeding NIS 50 million, and individuals, the value of whose financial assets and securities exceeds NIS 15 million.

Actions Taken by the Bank following the Capital Market Reform Legislation

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

- the Bank sold it activities in the field of management of provident funds, including supplementary training funds and mutual funds and signed on distribution agreements and agreements to provide operating services in relation to the sold funds.

- On 31 July 2008, the structural change in the benefits funds of Bank Leumi's employees and of Leumi Mortgage Bank's employees (the “Employees Funds”), was completed and these funds have come to be funds that are managed by a management company held by the members of the funds. The Bank continues to provide the management company with all the services it needs, as permitted by the legislation. The completion of this process paved the way for obtaining the pension counseling license.

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

- The Bank has a subsidiary, Leumi Partners Underwriters Ltd., which acts as a distributor of securities and is registered in the Underwriters Register. It should be noted that the Securities Regulations (Underwriting) (Amendment), 2007 impose significant restrictions on the management of public offerings by underwriting firms in which banking corporations hold 20% or more.

For further details, see pages 160 to 161.

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 its ability to spread risk, the Group's activities in Israel focuses mainly on investment counseling, pension counseling, and 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 funds, has caused 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 commissions from institutional entities, and the receipt of commission in respect of operating services to institutional entities, and these commissions have, to a partial extent, reduced the adverse effect. The Bank and the Arab-Israel Bank Ltd. have entered into distribution agreements regarding most of the mutual funds and most of the provident funds, including supplementary training funds and pension funds. In addition, the Bank has entered into operating agreements with institutional entities regarding the provident funds under their management, and has entered into such contracts with the purchasers of the provident funds, including the supplementary training funds, that the Bank had sold.

- An additional amendment to the Provident Funds Law entered into force in January 2008, which revokes the possibility of continuing to deposit in provident funds for pension. The provident funds for pension have become provident funds that do not pay out pensions. Monies (other than severance pay amounts) may not be withdrawn from these funds, until they are transferred to pension paying provident funds, and subject to conditions that will apply to pension paying provident funds. Furthermore, the amendment limits the ability to allocate monies to central severance pay funds until the end of 2010. The Bank is examining the effect of the Law's amendment.

The following is the effect on the Group's operating income, including the consequences of the crisis in the capital market:

	2008	2007	Change	
	NIS millions		NIS millions	%
From mutual funds	**123**	165	(42)	(25.5)
From provident funds	**2**	10	(8)	(80.0)
From supplementary training funds	**2**	19	(17)	(89.5)
Total	**127**	194	(67)	(34.5)

The Reform of Bank Commissions

On 1 July 2008, a material reform regarding commissions went into effect.

The reform was established by Amendment Number 12 (enacted in July 2007) to the Banking (Service to Customers) Law, 1981.

As the Law provides, its purpose was to establish a new commission price list for individuals and small businesses. In establishing this price list, "the Governor of the Bank of Israel will take steps to ensure a fair and comprehensive presentation of the commissions, with the objective of ensuring that customers can compare the cost of managing an account and of means of payment." The legislation followed the establishment of a Parliamentary Committee of Inquiry regarding Bank Commissions - a committee whose letter of appointment indicated that its main purposes were the creation of transparency in the system of commissions and to make that system comprehensible to the customers, as well as to increase competition between the banks.

In the framework of the reform, the Banking Supervision Department established a uniform and mandatory list of banking services for which banking corporations are permitted to charge commissions from individuals and small businesses, as defined in the legislation (the "Complete Price List").

A number of objectives were thereby achieved:

Reduction in the number of commissions – the number of commissions for consumer services provided to individuals and small business customers was reduced by some two thirds, through the consolidation and cancelling of commissions.

Establishment of uniform names for banking services – identical services are to be given identical names by all the banks, to facilitate comparison.

Establishment of basic price lists – in addition to the complete price list, common banking services were grouped together in three basic price lists, each of which includes a single central topic: current accounts, mortgages, and credit cards. The grouping of the common commissions in the basic price lists makes examination and comparison of commissions in different banks easier.

One of the main changes made by the Bank of Israel with respect to the commissions price list for individuals and small businesses was the consolidation of the most common operations in current accounts under the heading "operation through a teller" or the separate heading "operation by direct channel."

In early May 2008, in accordance with the Supervisor's instructions, Leumi submitted to the Banking Supervision Department its new price list for individuals and small business customers (the "New Price List"), which includes the rates established by Leumi. Following the response of the Banking Supervision Department, a number of changes were made to the price list. It should be clarified that pursuant to the Bank's determination, a different price list applies to customers that are not individuals or small business.

In addition, on 26 August 2008, the Governor of the Bank of Israel published an amendment to the Banking (Service to Customers) (Commissions) Rules and to the full commissions price list attached to those rules. The amendment states, *inter alia,* that customers who are "senior citizens" or disabled will be entitled to have four teller operations carried out each month at the price of an operation by direct channel, which is materially lower than the price of an operation through a teller. The amendment took effect on 1 September 2008.

Another change that was made to the reform is the transfer of the supervision of the prices for the banking services from the Supervisor of Prices to the Supervisor of Banks.

After the commissions' reform went into effect, various private members' bills were submitted to the Knesset, with the aim of imposing additional restrictions in connection with the collection of commissions from individuals and small businesses, including, *inter alia*, limiting the collections of such commissions under certain conditions.

Leumi estimates that, in light of the circumstances currently known to it, and in light of the amount of the income from commissions collected since the implementation of the reform, and before examining the above-mentioned private members' bills, that the adverse effect on the Group's income from commissions, as a result of the reform, in annual terms, will amount to some NIS 85 million.

Property of Holocaust Victims

In January 2005, the Parliamentary Committee of Inquiry Regarding the Tracing and Return of Property of Holocaust Victims 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 provisions that were in force at the time, to the British government's Custodian of Enemy Property, to the Israeli Custodian of Enemy Property, to the Administrator General, or were returned to those entitled to them. 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.

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 and on 18 September 2008, the Bank received two requests from the Company for the payment of amounts which the Company claimed that the Bank is required to transfer to it according to the Law. The amount of the two requests, after having been reduced by the company and revalued to 31 December 2008, is some NIS 186 million. The Bank responded to these two requests while rejecting the claim that it has any financial liability with respect to the majority of the assets included in the requests.

The Bank appointed the Honorable Supreme Court Justice (ret'd) Theodore Orr as an external examiner to carry out an independent and impartial investigation 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. In the report that he delivered to the Bank, the examiner reinforced the Bank's position with regard to the main points of disagreement between the Bank and the Company. The examiner refers to the dormant accounts, details of which were published by the Bank in 2000 on its website, in coordination with the Administrator General, as "unclaimed accounts". The examiner states that the legal obligation to prove whether these funds belong to Holocaust victims is borne by the Company, and that it will be difficult to prove this. The examiner recommends that the Bank grant the Company a certain amount, as a gesture of goodwill, such to be estimated by the Bank in the future, following the submission of all the Company's requests. The examiner mentions the amount already transferred by the Bank, as referred to above, and that such amount may constitute all or part of this grant. Following submission of all the Company's requests, and once it has all the relevant data, a discussion will be held by the Board of Directors, while taking into account this recommendation.

At this stage, the Bank estimates that no additional provision in respect of the above-mentioned requests or in respect of the contents of the examiner's report is necessary.

On 11 February 2009, the Bank received an additional request from the Company, for the payment of a revalued amount of some NIS 120 million. The Bank is examining this request. At this stage, it is not yet possible to evaluate the factual and legal basis for this request.

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 17 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 Israeli shekel was added to the group of currencies settled through CLS on 26 May 2008.

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.

In 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 been 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 aggregate 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 was valid for one year from the date it was first given. In 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 even 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.

In January 2009, the Authority announced that in order to be able to keep with current developments that have taken place in the area of the joint provision of credit, and in light of the request that it had received from various banks in connection with the conditions, the Authority is re-examining the conditions for banks to combine in a credit consortium. In light of this, the Authority has extended the force of the conditions from March 2007 and the notice of non-enforcement for an additional 6 months – i.e., until 3 July 2009.

Legislation Affecting the Banking System

Proposed Prohibition of Money Laundering (Amendment Number 7) Law, 2007

A government sponsored proposed law (the "Proposed Law") for the amendment of the Prohibition of Money Laundering Law**,** 2000 ("the Law") was approved by the Knesset in a first reading in July 2007.

The proposed amendments include the following:

- The imposition of the money-laundering prohibition regime on the precious stone trader sector;
- Amendments relating to criminal aspects of the Law, including an amendment of the clause regarding the offenses against the prohibition of money laundering, amendments relating to lien on property, and amendments relating to the restrictions on disclosing the identity of the reporter;
- Amendments relating to the authorization of the various regulators regarding the issuance of orders pursuant to the Law, the significance of which is the expansion of the details which financial service providers, such as banks, will be required to obtain from their customers. Among other things, the amendment refers to the obtaining of details regarding a "founder" with respect to a trust, and an expansion of the concept of "control" with regard to corporations.
- In addition, the Proposed Law contains authorization to include in the orders, the duty to report transactions that have not been completed.
- Amendments relating to the expansion of the list of offenses that serve as a "source offenses" pursuant to the Law, to be included also as additional offenses pursuant to the Value Added Tax Law, 1975.
- Amendments relating to the functions of the Prohibition of Money Laundering Authority at the Justice Ministry.

Prohibition on Investment in Corporations that Maintain Business Relations with Iran, 2008

The above-mentioned Law was enacted by the Knesset in April 2008.

The purpose of the law is to prevent investments by Israeli financial institutions (including banking corporations) in corporations that maintain a material business relationship with Iran.

An investment is defined in the Law as including loans, provided that these are loans for a fixed period of time of not less than five years, and that the amount of the loan is not less than five percent of the shareholders' equity of the corporation in which the investment is being made.

The Law's prohibition on investment applies to an investment in a corporation which maintains a material business relationship with Iran, this relationship being defined as a relationship in the energy field or with a corporation that is connected to the development of unconventional weapons by Iran, and which appears on a list to be published pursuant to the Law by the government committee whose establishment for this purpose is required by the Law. The list may also include corporations regarding whom restrictions have been imposed by foreign countries; in such a case, it will also be possible to include in the list corporations that maintain an economic connection with Iran for its benefit or within its territory.

According to the Law, if a financial institution has invested in a corporation which is afterward included in the list, the financial institution will be required to sell its holdings in the said corporation within a period determined in the Law (for this purpose only, a loan is not considered to be an investment).

An investment in a corporation included in the list, or a failure to sell the holdings in such a corporation, will constitute criminal offenses. The Bank is carrying out appropriate preparations such when the list is published it will be prepared for compliance with the Law's provisions.

Proposed Law to Increase Competitiveness in the Credit Field (Divesting the Ownership of Credit Card Companies from the Banks), 2007
Proposed Banking (Licensing) (Amendment – Holding of Corporations That Issue Credit Cards) Law, 2007

The two above-mentioned proposed laws deal with the same issue: the divestment of the banks' ownership of the credit card companies in order to increase competitiveness in the area of retail credit. (It may be assumed that the two proposed laws will be combined into one).

The following is a discussion of the main points of the first proposal, which is more detailed:

All the information which is owned and held by the credit card companies, including regarding all the transactions of credit-card holders would remain under the ownership of the credit card company even after the bank's sale of the means of control.

The sale of all the banks' means of control of the credit card companies would take place gradually up until 1 January 2012, when two years before then (January 2010), no banking corporation would allow to have control of a credit card company, and three years before then (after January 2009), the banks would not participate in or vote for resolutions at a credit card company when such resolutions relate to the provision of credit to the public.

The bank would be prohibited from adversely affecting a credit card company's clearing possibilities and of the grant of credit to the public in relation to such transactions.

Within one year from the sale of the means of control of the credit card company, the Supervisor of Banks would grant the banks a license to provide credit to the card-holders.

Charge Cards (Amendment Number 4) Law, 2008

On 6 December 2008, Amendment Number 4 to the Charge Cards Law entered into effect, the main points of which are the following:

The amendment to the Law exempts the card-owner from responsibility for the card's abuse by a third party after the card-owner gives the card to another person and such other person loses the card or it is stolen from him..

The periods for crediting customers in cases in which they are to be credited (such as, for charges resulting from transactions carried out when the charge card is abused) have been shortened to ten business days.

Unlike the previously situation, an issuer will end a charge to the customer if the asset was not provided to him on time or if the supplier has permanently stopped providing assets of the same type as the purchased asset, provided that the customer has cancelled the transaction.

If the issuer is served with an application that has been submitted to the court for an order of asset receivership/liquidation order/bankruptcy order against the supplier, the issuer will immediately stop crediting the supplier for that transaction.

A section was included which instructs the issuer to stop charging the customer for a standing order if the customer so instructs. The new section effectively anchors the customer's ability to cancel a standing order given with a credit card, in a manner similar to the cancellation of a standing order in an account.

Draft Bill – Proposed Amendment of the Banking (Licensing) Law

The draft bill under discussion proposes various amendments to the Banking (Licensing) Law. Most of these relate to the credit card market and follow the recommendations of the Committee for the Examination of the Market Failures in Credit Card Clearing in Israel.

In this proposed law, it is proposed to establish that the clearing of transactions carried out through a credit card will be done only by parties licensed for that purpose by the Governor of the Bank of Israel and that the Supervisor of Banks will be able to require a large clearer (as defined in the proposed law) to clear transactions of issuers with various suppliers.

In addition, the Supervisor will also be authorized to require a large issuer (as defined in the proposed law) which is also a clearer to allow other clearers to clear transactions that were carried out with credit cards that it has issued.

It is also proposed that the Supervisor be enabled to supervise the rate of the interchange fees (the fee paid by the clearer to the issuer).

The following additional issues are included in the draft bill and are not related to credit cards:

- The Banking (Licensing) Law includes provisions allowing the banking corporations exclusive rights to carry out certain activities, which include a provision to the effect that only a banking corporation may accept monetary deposits or carry out issues of securities that require a prospectus together with the granting of credit. The exceptions to the definition of "granting credit" include the granting of long-term credit to a person whose name appears in a prospectus or for the purpose of purchasing a banking corporation's rights against its borrowers. It is now proposed to include as an additional exception from the definition of "granting credit", the granting of similar credit on a short-term basis.

- Foreign banks and branches of foreign banks, which in the opinion of the Supervisor of Banks do not engage in significant retail activity, will be able to participate in the ownership and asset management of provident funds and mutual funds. (Currently, the volume of retail activity of such banks is determined on the basis of quantitative criteria).

- It is proposed to transfer the authority to issue or revoke a banking corporation's branch permit from the Governor of the Bank of Israel to the Supervisor of Banks.

- Penalty provisions regarding violations related to the clearing of credit cards, such as clearing without a license, were enacted..

- It is proposed that the authority of the Supervisor of Banks be made comparable to the authority of the Supervisor of Insurance, to determine up to seven office holders subject to the Supervisor of Bank's approval in all types of banking corporations.

- An additional amendment to the Banking Ordinance is proposed so as to allow the Supervisor of Banks to transfer documents and information that he has received to other departments within the Bank of Israel.

Amendments to the Sales (Apartments) (Securing Investments of Apartment Buyers) Law and a uniform text for the guarantee for apartment buyers

On 6 October 2008, Amendments 4 and 5 to the Sales (Apartments) (Securing Investments of Apartment Buyers) Law, 1974 entered into effect. The amendments had been published in March and April 2008, and dealt with the regulation of guarantees for purchasers of apartments, imposing duties as well on the banking corporations that provide financing through the project finance method ("the Lending Banks.")

The new legislation and regulations require Lending Banks to issue coupons for each project financed by them, and to use these coupons as the sole method for receiving payments to be credited to the project's account against the price of the apartments, and to issue sales guarantees pursuant to the above-mentioned law for all payments made with the coupons, as stated.

Additional grounds have been added for exercising guarantees pursuant to the above-mentioned law: absolute prevention of delivery the apartment and an inability to deliver the apartment because of a stay of proceedings order.

Banks that provide financing for the purchase of apartments to which the above-mentioned law applies, must notify the borrowing purchasers of the above-mentioned law and ascertain that they are receiving securities or commitments to provide securities pursuant to the above-mentioned law.

These amendments join the two Proper Banking Management Directives published by the Bank of Israel and which have been in force since 1 June 2008: Directive 326 – Project Finance, which details the main points of the coupons arrangement and Directive 456 – Sales Guarantees, which establishes a uniform text for the sales guarantees pursuant to the above-mentioned law, which binds all banking corporations.

The violation of any of the provisions relating to the use of the coupons arrangement by the Lending Bank or of those relating to the Lending Bank's duty to ascertain the guarantees will constitute a criminal offense, punishable by a fine. Financial sanctions may also be imposed.

Amendments of the Execution Law, 1967

The amendment to the Law includes many modifications, including, *inter alia*: the grant of authority to the Enforcement Office Registrar, under certain circumstances, to request and receive information regarding a debtor from various entities, with the aim of assisting the creditor in collecting the debt; a shortened procedure for collecting debts in an amount not exceeding NIS 10,000. The purpose of the shortened procedure is to bring about the collection of the debt with minimal involvement of the creditor with the enforcement office system being the party acting to collect the debt by attaching a vehicle or funds owed to the debtor by a third party; In cases where the shortened procedure is used, the creditor will not be granted attorney's fees; the granting of authorization to the Enforcement Office Registrar to take measures, in certain circumstances, to impose restrictions on a debtor (as stay of exit order, preventing the debtor from using credit cards, founding corporations, receiving a driving license and more).

It was also determined that alternative housing will be provided for a debtor in the event of the foreclosure of a mortgage or the realization of a pledge, if he has no other reasonable housing alternative and is financially unable to pay the costs of reasonable housing, and this is to ensure that the debtor and his family members will not be left homeless. If the mortgage deed or pledge state that the alternative arrangement will be in accordance with the Amendment of the Law, and the significance thereof has been explained to the debtor in clear language that he understands, the alternative housing shall be provided, for no more than 18 months; the Enforcement Office Registrar has the authority to extend that period under special circumstances.

The Amendment of the Law will come into effect 6 months after its legally required publication, with the above provisions regarding alternative housing applying only to mortgage or pledge agreements that are entered into after the Amendment of the Law enters into force. Regarding pledge or mortgage agreements that are entered into before the Amendment of the Law enters into force, the creditor is exempt of providing alternative housing to the debtor if the mortgage deed or pledge agreement states that and the debtor's right to alternative housing and the waiver of such a right was explained to him.

Memorandum Banking (Licensing) (Amendment) Law, 2009

In March 2009, the Ministry of Finance distributed a legal memorandum for the amendment of Section 24A of the Banking (Licensing) Law. Pursuant to the memorandum, it is proposed that the restriction imposed on banking corporations allowing them to hold only a single non-banking (real) holding corporation (conglomerate) will not apply to the holdings of a banking corporation that do not exceed 1% of the means of control in the non-banking holding corporation. It is also proposed to determine that an insurer will be viewed as acting in a single economic sector, the insurance sector, regardless of whether the insurer has passive financial investments in other corporations, as such an approach conforms to the insurer's true occupation. It is further proposed that the term "acts" in economic sectors be defined explicitly, such that a corporation will be considered to be a non-banking (real) holding corporation only if it has a significant ability to influence more than three economic sectors. It is therefore proposed to determine that a holding in a corporation of less than 5% will not be considered to be the equivalent of "acting" for the purpose of section 24a. The memorandum also provides that a banking corporation will be permitted to hold more than 1% of the means of control in a single insurer, whose capital exceeds NIS 2,000 million. In addition, a change is proposed with regard to the manner in which the amounts in section 24a of the Banking Law (Licensing) are updated.

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 assessments 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 assessments are generally based on economic forecasts, assessments 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 assessments and which have been discussed by the Board of Directors, Management and the joint auditors:

Provision for Doubtful Debts and Classification of Problem Loans

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 and in accordance with procedures, 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, in light of the characteristics of the risk or as a result of the economic/market conditions that are likely to impact on the borrowers' condition, so as to improve their position. An assessment of the extent of the problem is made while exercising business judgment, by the business entities dealing with the borrower, and by the credit department of the corporate division, as well as an honest evaluation of the difficulties that have been identified, in order to determine the risk level, and where necessary, to make specific provisions.

As part of the measures used by the Bank to manage credit risk, the methodology for identifying and classifying problem loans has been updated, and the Bank is preparing to implement it in all its business lines. The methodology includes a structured quarterly work process in the context of which a through review of the credit portfolio is carried out on the basis of a number of criteria that give advance warning of a debt becoming problematic. An additional aspect of the methodology being used deals with a methodical examination of the appropriateness of the provision for doubtful debts in respect of the debts regarding the collection of which the Bank has doubts, while establishing basic criteria for the manner in which the provisions for doubtful debts are to be calculated. The calculation is made in accordance with the characteristics of the debt, the evaluation of the customer's business condition and ability to continue to operate, the business environment in which the customer operates and the degree to which the customer meets its obligations, in combination with past experience and a realistic examination of the collateral and the ability to realize same, in the judgement of the Bank's Management. The Credit Risk Management Units (the RMU's) participate in the process of examining the appropriateness of the provision.

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

The classification of the loans and the size of the provisions for principal and/or interest are determined pursuant to the Supervisor of Banks' Proper Banking Management Directive no. 314.

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 Financial Statements Review Committee and the Board of Directors discuss the provisions for doubtful debts so as to approve their amount. Data on the debts and collateral of the major customers in respect of whom a provision is required, as well as the amounts of provision proposed by Management, are made available to the Directors as background material.

The control process concludes with the decisions regarding classification or the making of a provision.

Specific provisions in respect of housing loans granted by Leumi Mortgage Bank and Leumi 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 in accordance with the Bank of Israel directive, 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 loans 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 loans 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 reporting of the Supervisor of Banks, the Bank applies FAS 133 and 138, as amended, with regard to the treatment and presentation of derivatives. In accordance with these, 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 was determined on the basis of price quotations represent some 0.4% of total derivatives and some 0.01% of the Bank's assets as at 31 December 2008.

Securities

Securities, other than debentures held to maturity, are presented in the balance sheet at fair value. Shares in respect of which the fair value is not available are presented at cost.

The fair value is determined according to the price on an acceptable securities exchange, or in another acceptable trading system such as the trading systems operated through Bloomberg or Reuters, or according to data collected by an independent body which is engaged in the business of collecting market data for purposes including use for reporting in financial statements (The Financial Times). Regarding the portfolio of CLO asset-backed securities, where there is no active market, the fair value is determined by an international company which is not engaged in any trading activity whatsoever and which operates as an external, independent valuer, which carried out the valuation solely for the purpose of the Financial Statements, for consideration which was established in advance and is not dependent on the valuation. For securities that are Israeli corporate debentures which are not traded the fair value is determined with reference to the value determined by the “Sha’arei Ribit” company through a valuation carried out by a subsidiary of the Group. This resulted, on average, in a reduction in the value as compared with the value established by “Sha’arei Ribit.” In other cases of securities that are not traded, which amount to some NIS 2.0 billion, a price quotation is obtained 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 page 88 of the Report.

The Bank’s policy is to recognize a decline in value as being non-temporary in nature at least with respect to declines in value of each security regarding which one or more of the following conditions are met:

1. A security that was sold by the date of the publication of the Report to the public.

2. A security that the Bank intends to sell, as of a time close to the date of the publication of the Report to the public.

3. A debenture whose rating was significantly downgraded between the date of its purchase by the banking corporation and the date of the publication of the Report.

4. A debenture which, after its purchase, was classified as problematic by the Bank.

5. A debenture regarding which there was a credit failure which was not corrected within a short period of time.

6. A security, the fair value of which has been lower than the value at which it was purchased, for a period of at least nine months prior to the end of the reported period, and at the end of the reported period and also on a date close to the publication of the Financial Statements it is at least 35% lower than its cost (regarding debentures – lower than adjusted cost). Exceptions are allowed in such cases, if the Bank has objective and solid evidence and a cautious analysis of all relevant factors, which establishes, with a high degree of certainty, that the decline in value is of a temporary nature. These principles conform to the guideline issued by the Supervisor of Banks.

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 0.6% and 8.6%. Any 0.25% change in the capitalization rate of the above-mentioned obligations will cause an increase/decrease of some NIS 287 million in the total of the obligations, and any change of 0.25% in salary levels will cause an increase/decrease of some NIS 109 million in the total obligations.

The actuarial models include assumptions regarding life expectancy tables, disability rates, turnover rates etc. Although the parameters have been 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.

An updated valuation of the expected salary increase for the various age groups and regarding departure rates was carried out for the Financial Statements for 2008. The impact of the above-mentioned changes on the Financial Statements was not material.

The actuarial changes resulting either from changes of actuarial parameters or from the change in the yield of the reserves that are used to cover liabilities are recorded in the profit and loss statement. In contrast, at the U.S. and British subsidiaries, these changes are charged to capital fund, in accordance with the accounting rules in those countries. For the purpose of the consolidated Financial Statements, the recording in the capital fund is cancelled and the amount is recorded in the profit and loss statement.

In February 2007, the Chief Actuary of the Capital Market, Insurance and Savings Department of the Finance Ministry published circulars to the pension funds and insurance companies, which applied to the financial statements as at 31 December 2006, under which pension and life insurance reserves were to be evaluated on the basis of new life expectancy tables. The Bank adopted these tables.

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

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 were determined in a conservative manner in accordance with Management's assessments, based on legal opinions.

A quarterly discussion is held by the Financial Statements Review Committee in respect of provisions for claims above a certain amount that have been filed against the Bank.

To assess the risks in legal proceedings 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 assessment, and which are often open to possible conflicting interpretations and claims.

The assessment 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

The Bank's buildings and equipment are presented in the Financial Statements at cost, less accrued depreciation and a provision for a decrease in value. Buildings offered for sale are presented at the lower of their cost or realization value. The realization value is determined by assessors. Changes in the valuation of the asset may affect the amount of the provision for decrease in value.

Depreciation is calculated on the basis of 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 Assets") 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 period 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 owned by the Bank. 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

Since 2004, the Bank has implemented Accounting Standard No. 19, "Taxes on Income" (the "Standard"). The Standard determines 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:

- The amounts of adjustments for changes in the purchasing power of the shekel relating mainly to structures according to the rules determined by the Israeli Accounting Standards Board in Standard 19. See Note 26G.
- 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 realizing the benefit in the foreseeable future 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 determined that entities subject to the Securities Law, 1968 would prepare their financial statements in accordance with the Standard. This does not apply to banking corporations.

See Note 1 W (1) 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.

The Procedure for Approval of the Financial Statements

The Bank's Board of Directors is responsible for ultimate supervision within the Bank and for the approval of the Bank's Financial Statements. All the members of the Board of Directors have accounting and financial expertise, as described on pages 143 to 146 below, and possess the qualifications of external directors (as required by the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993).

In September 2008, the Board of Directors established a Financial Statements Review Committee, composed of members of the Board, the function of which is to discuss the Financial Statements and recommend their approval to the Board of Directors.

Before the Financial Statements are submitted to the Financial Statements Review Committee for discussion, they are discussed by the Bank's Financial Statements Disclosure Committee. The Disclosure Committee is a Management committee comprised of all the members of the Bank's Management, as well as the Acting Head of the Commercial Banking Division, the Group Secretary and the Head of the Risk Management Control Department. The Chief Internal Auditor and additional senior managers of the Bank participate in the discussions of the Committee. The Disclosure Committee examines, *inter alia*, whether the information in the Financial Statements is accurate, complete and appropriately presented. (The Disclosure Committee was established as part of the implementation of a 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 235 of the Report).

Prior to the discussion of the Financial Statements by the full Board of Directors, discussions are held by the Financial Statements Review Committee, with the participation of the President and Chief Executive

Officer, the Senior Deputy Chief Executive Officer, the Chief Accounting Officer, the Chief Internal Auditor and others.

The background material sent to the members of the Financial Statements Review Committee prior to the discussion includes the minutes of the discussion of the Disclosure Committee and its decisions, the draft Directors' Report and the draft Financial Statements. The Committee members also receive details regarding new disclosure requirements (to the extent there are any) that apply to the Bank. Information regarding the Bank's exposure to legal claims and a description of new legal claims, and background material for the discussion on the appropriateness of the classification of problem customers and on the provisions for doubtful debts, being confidential and sensitive information, is made available for advance review by the Committee members at the Bank's offices.

During its proceedings, the Committee discusses the appropriateness of the provisions and of the classification of the Bank's problem loans, following the President and Chief Executive Officer's presentation to Committee of the scope of the provisions and the classification of problem loans, and the changes and trends in this field, and after other senior managers have presented the scope of the provisions and classifications within their areas of responsibility. 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 Senior Deputy Chief Executive Officer presents to the Committee 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, and the Committee also discusses these matters.

Following the discussions of the Committee, there is discussion by the full Board of Directors of the final draft of the Financial Statements, with the participation of the President and Chief Executive Officer, the Senior Deputy Chief Executive Officer, the Chief Accounting Officer, the Chief Internal Auditor, and when the discussion concerns the approval of the annual Financial Statements, the other members of the Bank's Management also. As background material for the discussion, the Directors receive the draft Financial Statements 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 President and Chief Executive Officer reviews the results of the Leumi Group's operations and the Senior Deputy Chief Executive Officer presents and analyzes the results of the Group's operations in Israel and abroad, including a description of risk exposure and compliance with the limits established with regard to such risks. Thereafter, the full Board of Directors discusses the Financial Statements and approves them.

All the discussions of the Board of Directors, the Financial Statements Review Committee and the Disclosure Committee regarding the Financial Statements are held with the participation of representatives of the Bank's joint auditors, who are available to the participants to answer questions and provide clarifications. The Financial Statements are approved by the Board of Directors following presentation by the joint auditors to the Board of Directors of any material weaknesses that may have arisen during the audit processes that they carried out, and after the Board is presented with the certifications of the President and Chief Executive Officer and of the Senior Deputy Chief Executive Officer regarding evaluation of the Bank's disclosure controls and procedures for the Financial Statements.

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

Development of Income, Expenses and the Tax Provision[1]

The global financial crisis, which is characterized by the persisting falls in prices on the world's stock exchanges and in Israel, by the collapse of the Lehman Brothers investment bank and the American bank, Washington Mutual, as well as the deepening global recession, had an adverse impact on the state of the economy in Israel, and on the Leumi Group's businesses in Israel and abroad. The direct consequences of this crisis were a material increase in the provisions for doubtful debts, losses from the realization of part of the investments in securities abroad and considerable provisions for the decline in value of investments in securities in Israel and abroad. The increase in the contribution of the companies included on the equity basis partially offset the negative effects.

Notwithstanding all of the above, the Group concluded the year 2008 with a profit.

The Leumi Group's net profit in 2008 totalled NIS 92 million, compared with a profit of NIS 3,357 million in 2007 – a decline of NIS 3,265 million. The operating loss in 2008 totalled NIS 158 million, compared with a profit of NIS 2,984 million in 2007.

The following table presents the principal changes in the Group's net profit in 2008:

	2008	2007	Change	Change
	NIS millions			%
- Net profit	**92**	3,357	(3,265)	(97.3)
- Net operating profit (loss)	**(158)**	2,984	(3,142)	–

The decrease in the net profit in 2008 compared with 2007 is mainly explained by the following factors*:

1. a decline in net interest income, before provision for doubtful debts, in the sum of NIS 1,268 million, a 16.6 % decline before the effect of taxes, mainly due to the decline in value of and/or losses from investments in debentures, which totalled NIS 1,255 million, compared with income of NIS 86 million in 2007;

2. an increase in the provisions for doubtful debts in the amount of NIS 1,738 million, before the effect of taxes;

3. a decline in operating and other income in the amount of NIS 1,422 million, a decrease of 33.7% before the effect of taxes, mainly resulting from losses from the decline in value of investments in shares and funds in the sum of NIS 1,043 million, compared with a profit of NIS 216 million last year;

4. an increase in operating and other expenses (including salaries) in the amount of NIS 66 million, an increase of 1.0% before the effect of taxes;

5. a decline in the profit from extraordinary items in the amount of NIS 123 million, as detailed below;

6. the effective tax rate decreased the profit by some NIS 409 million, as a result of expenses not recognized for tax purposes, exchange rate differentials in respect of investments abroad that are not recognized for tax purposes, and timing differentials in deferred taxes.

* Before minority interests.

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[1] The Financial Statements are prepared in reported values. The known Consumer Price Index rose by 4.5% in 2008. The shekel appreciated in nominal terms by 1.14% against the U.S. dollar and by 6.4% against the euro. The representative rate of exchange of the U.S. dollar on 31 December 2008 was NIS 3.802.
For further details see Note 1(C) to the Financial Statements.

On the other hand, the increase in the Group's share in the profits of companies included on the equity basis, in the amount of NIS 65 million, net, partially offset the said declines.

The Group concluded the fourth quarter of the year with a net loss of NIS 1,183 million, compared with a net profit of NIS 517 million in the fourth quarter of 2007.

Following are the main factors contributing to the loss in the fourth quarter and to the decline in profitability:

1. a decline in net interest income, before the provision for doubtful debts, in the amount of NIS 805 million, before the effect of taxes, mainly due to the decline in value of and/or losses from investments in debentures in the amount of NIS 682 million, compared with income of NIS 33 million last year;

2. an increase in the provisions for doubtful debts in the amount of NIS 811 million, before the effect of taxes;

3. a decrease in operating and other income in the amount of NIS 647 million, a decline of 54.3% before the effect of taxes, mainly resulting from a decline in value of and/or losses from investments in shares and funds in the amount of NIS 480 million, compared with a profit of NIS 147 million last year;

4. a decrease in the Group's share in the profits of companies included on the equity basis in the amount of NIS 260 million, net.

For further details, see pages 66 to 69 below and Exhibit H to the Management Review.

Net Interest Income Before Provision for Doubtful Debts of the Leumi Group amounted to NIS 6,380 million in 2008, compared with NIS 7,648 million in 2007 – a decline of 16.6%.

The losses in respect of investments in debentures totalled NIS 1,255 million, compared with a profit of NIS 86 million in 2007. Without this effect, the net interest income from financial intermediary operations increased by the rate of 1.0%.

The decline in the Group's net interest income before provision for doubtful debts, derives mainly from:

	2008	2007	Change	Change
	NIS millions		%	%
Current activities	**6,778**	6,958	(180)	(2.6)
Collection and reduction of interest in respect of problem loans	**507**	461	46	10.0
Provisions for decline in value of available-for-sale debentures	**(1,328)**	(28)	(1,300)	–
Profits realized from the sale and adjustments to market value of debentures for trading	**73**	114	(41)	(36.0)
Adjustments of derivatives to fair value	**34**	(47)	81	+
Effect of the known CPI	**316**	190	126	66.3
Total	**6,380**	7,648	(1,268)	(16.6)

As stated, the majority of the decline in net interest income derives from losses caused by the sale of debentures and by adjustments of debentures to market value, which were partially offset by the effect of the known CPI.

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

The following are additional details regarding the change in net interest income:

1. the entire decrease in net interest income arises from provisions for declines in value and losses from investments in available-for-sale debentures.
2. the total interest margin decreased by 0.08%, and contributed to a reduction of some NIS 310 million.
3. on the other hand, the increase in the volume of activities of 8.9% contributed to an increase of some NIS 717 million.
4. The amounts mentioned in 2 and 3 above are before the offset of the negative effects of the valuation of options and other derivatives which totaled NIS 298 million in 2008, compared with a positive difference of NIS 75 million in 2007.

For a breakdown by sector of the changes in net interest income before the provision for doubtful debts, see also Note 28 (A) to the Financial Statements, and Exhibit C to the Management Review.
For details regarding changes in net interest income during the interim periods, see page 66 of the Report.

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

Segment	**2008**	2007*	Change
	NIS millions		%
Households	**2,637**	2,569	2.6
Small businesses	**906**	868	4.4
Corporate banking	**1,883**	1,708	10.2
Commercial banking	**1,389**	1,439	(3.5)
Private banking	**362**	477	(24.1)
Financial management – capital markets	**(783)**	630	-
Other	**(14)**	(43)	(67.4)
Total	**6,380**	7,648	(16.6)

* reclassified

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

	2008			2007			Changes in net interest income	
	Scope of activity in %	**Contribution to income* %**	**Contribution to income* NIS millions**	Scope of activity in %	Contribution to income* %	Contribution to income* NIS millions	NIS millions Effect of quantity	NIS millions Effect of price
Israeli Currency:								
Unlinked	**40**	**61**	**3,869**	34	42	3,284	764	(185)
CPI-linked	**15**	**16**	**1,043**	15	13	958	(49)	134
Foreign currency, including foreign-currency linked	**45**	**32**	**2,036**	51	30	2,293	2	(259)
	100		**6,942**	100		6,535	717	(310)
Options and other derivatives**		**(5)**	**(298)**		1	75		
Financing commissions		**5**	**337**		4	308		
Other financing income (expenses), net		**(9)**	**(601)**		10	730		
Total		**100**	**6,380**		100	7,648		

* Including financing income/expenses from activity in derivatives.

** The cover for these losses is activities in the various linkage segments.

The ratio of net interest income before provision for doubtful debts, to the average balance of financial assets was 2.29% in 2008, compared with 2.75% in 2007.

Total Interest Margin (excluding transactions in derivatives) was 2.49% in 2008, compared with 2.31% in 2007 (at the Bank – 2.57% in 2008, compared with 2.34% in 2007). The interest margin, including transactions in derivatives, was 1.63% in 2008, compared with 1.71% in 2007 (at the Bank – 1.49% in 2008, compared with 1.58% in 2007).

For further details on income and expense rates according to the different sectors, see Exhibit C to the Management Review.

Financing Commissions totalled NIS 337 million in 2008, compared with NIS 308 million in 2007, an increase of 9.4%. These commissions include mainly the income from off-balance sheet activity, such as guarantees for the granting of 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, and also provisions for the decline in value of a non-temporary nature of securities classified in the available-for-sale portfolio, commission income from early repayments of credit, collection of interest in respect of doubtful debts from previous years and a reduction of the provisions for interest. The net expenses in respect of these activities totaled NIS 601 million in 2008, compared with income totaling NIS 730 million in 2007.

The following table presents the principal changes in other interest income and expenses:

	2008	2007	Change
	NIS millions		%
Profit/loss from the sale of available-for-sale debentures	**(9)**	136	–
Provision for decline in value of available-for-sale debentures*	**(1,328)**	(28)	–
Profit/loss from the sale and adjustments to market value of debentures for trading	**82**	(22)	+
Collection/reduction of interest in respect of doubtful debts	**507**	461	10.0
Commissions from early repayment of credit	**141**	148	(4.7)
Other	**6**	35	(82.9)
Total	**(601)**	730	–

For further details, see Note 20 to the Financial Statements.

* Of which, NIS 341 million in respect of SCDO, NIS 435 million in respect of CLO, NIS 298 million in respect of corporate debentures and NIS 245 million in respect of bank debentures.

The provision for doubtful debts in the Leumi Group in 2008 totalled NIS 2,145 million, compared with NIS 407 million in 2007 – an increase of NIS 1,738 million. The provision for doubtful debts at the Bank in 2008 totalled NIS 1,751 million, compared with NIS 318 million in 2007 – an increase of NIS 1,433 million.

The specific provisions for doubtful debts in the Leumi Group increased in 2008 by NIS 1,516 million, of which, an increase of NIS 1,243 million at the Bank.

The increase in the specific provisions for doubtful debts in 2008 was mainly influenced by the global crisis and the deterioration in the state of the Israeli economy, which caused a deterioration in the repayment power of some borrowers and the erosion of the value of some borrowers' collateral.

The principal provisions for doubtful debts in 2008 were made mostly in the industry, construction and real estate, financial services and trade sectors of the economy and to private individuals.

The following table presents the specific provisions for doubtful debts according to the principal sectors of the economy:

	2008		2007	
	NIS millions	**% of total**	NIS millions	% of total
Industry	**641**	**30.9**	148	26.6
Construction and real-estate	**430**	**20.8**	102	18.4
Trade	**206**	**9.9**	94	16.9
Communications and computer services	**12**	**0.6**	38	6.8
Financial services	**372**	**18.0**	(79)	(14.2)
Private individuals – housing loans	**97**	**4.7**	50	9.0
Private individuals – other	**280**	**13.5**	173	31.1
Other	**34**	**1.6**	30	5.4
Total	**2,072**	**100%**	556	100%

Pursuant to directives of the Supervisor of Banks from 1992, an additional provision for doubtful debts is made, in addition to the specific provision, in respect of unidentified risks in the credit portfolio, based upon the risk characteristics of the credit portfolio, and in respect of a sectoral excess of credit (at the Bank, there is an actual sectoral excess only in credit to the construction and real estate sector at the rate of 2.27%). 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 sectoral excess, in accordance with a formula established in the said directive. Since the Bank's minimum capital ratio complies with the aforesaid directive, the Bank did not make an additional provision in the amount of NIS 125 million in respect of a sectoral excess.

The general and additional provision increased in 2008 by NIS 73 million, compared with a decrease of NIS 149 million in the provision in 2007. The increase in 2008 derives from an increase in the volume of problem loans. On the other hand, the majority of the decrease in 2007 derived from a reduction of the additional provision in respect of the sectoral excess in the real-estate sector, and from a decrease in the volume of the problem loans.

For details about problem loans, see below on page 87.

The following table presents a summary of the provisions for doubtful debts:

	For the year ended 31 December	
	2008	2007
	NIS millions	
Specific provision during the period	**2,780**	1,436
Reduction of a specific provision	**(679)**	(847)
Collection of debts previously written off	**(29)**	(33)
Net addition recorded in the profit and loss statement	**2,072**	556
Net addition recorded in the profit and loss statement re additional and general provision	**73**	(149)
Total provision for doubtful debts	**2,145**	407

The provision for doubtful debts in 2008 was 1.01% of total credit to the public at the end of the year, compared with 0.20% in 2007. The specific provision in 2008 was 0.97%, compared with 0.28% in 2007. It should be noted that in the second half of 2008 the provision in relation to the credit portfolio on an annual basis was 1.49%, compared with 0.56% in the first half of the year (at the Bank, 1.78%, compared with 0.68% in the first half and 1.21% for the whole of 2008).

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 at its consolidated subsidiaries totalled NIS 948 million at the end of 2008 (constituting some 0.30% of total credit risk), compared with NIS 875 million at the end of 2007, (at the Bank, NIS 661 million, compared with NIS 593 million in 2007). Since the general provision and the additional provision are not recognized as expenses for tax purposes, taking into account the statutory tax rate, the balance of the said provision is equivalent to a specific provision of some NIS 1,450 million.

For further details about credit, problem loans and provisions for doubtful debts, see Note 4(C) to the Financial Statements, Exhibit E to the Management Review and page 87 of the Report.
For data on the provisions on a quarterly basis, see page 67.

The Supervisor of Banks intends to adopt the financial accounting standards FAS 114 and 118 regarding the measurement and disclosure of impaired debts, credit risk and provisions for loan losses.

For further details, see Note 1(W)3.

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

Segment	**2008**	2007*	**2008**	2007*
	NIS millions		(percentages)**	
Households	**340**	178	0.55	0.31
Small businesses	**182**	139	1.00	0.76
Corporate banking	**1,070**	(71)	1.40	(0.11)
Commercial banking	**485**	180	1.00	0.35

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

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

	2008	2007
	NIS millions	
The Bank	**1,751**	318
The Arab Israel Bank	**26**	12
Leumi Mortgage Bank	**103**	43
Leumi Card	**26**	16
Bank Leumi USA	**52**	(13)
Bank Leumi (UK)	**155**	21
Leumi Romania	**24**	12
Others	**8**	(2)
Total	**2,145**	407

The following table presents the provision for doubtful debts as a percentage of the balance of credit to the public at the Bank's responsibility, over the last decade:

	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
	%									
The banking system in Israel	**(*)**	0.21	0.52	0.69	0.88	1.13	1.36	0.85	0.51	0.50
The Leumi Group**	**1.01**	0.20	0.51	0.79	0.87	1.09	1.09	0.93	0.44	0.43

(*) Data on the banking system are not known on the date of publication of this Report.
(**) Not including open transactions with credit cards.
For details regarding problem loans, see page 87 below.

Net Interest Income of the Leumi Group in 2008, after a provision for doubtful debts, totalled NIS 4,235 million, compared with NIS 7,241 million in 2007 – a decline of 41.5%. The decline derived from a decrease in net interest income and from an increase in provisions for doubtful debts. At the Bank, net interest income after provision for doubtful debts totalled NIS 3,221 million in 2008, compared with NIS 5,744 million in 2007 – a decline of 43.9%.

Total Operating and Other Income of the Leumi Group in 2008 totalled NIS 2,800 million, compared with NIS 4,222 million in 2007 – a decline of 33.7% (at the Bank – NIS 1,628 million in 2008, compared with NIS 2,756 million in 2007 – a decline of 40.9%). After neutralizing the effect of the losses from investments in shares and funds, the total operating income in the Group decreased by 4.1% and at the Bank by 3.7%. Part of the declines in operating income derives from the impact of the reform on commissions.

The following table presents the principal changes in operating and other income:

	2008	2007	Change	Change
	NIS millions		NIS millions	%
Operating commissions(1)	**3,362**	3,350	12	0.4
Income (losses) from investments in shares (2)	**(912)**	461	(1,373)	–
Other income (3)	**350**	411	(61)	(14.8)
Total operating and other income	**2,800**	4,222	(1,422)	(33.7)

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

1. Operating commissions (increase of NIS 12 million)
   a. An increase in income from credit cards, in the amount of NIS 93 million (13.8%);
   b. An increase in income from the payment system services, in the amount of NIS 71 million (8.6%), primarily from foreign currency conversions and transfers;
   c. A decrease in income from activity in securities, in the amount of NIS 84 million (9.7%);
   d. A reduction in account management fees, in the amount of NIS 16 million (6.3%);
   e. A decrease in income from the handling of credit and the drawing up of contracts, in the amount of NIS 13 million (3.4%).

2. Losses from investments in shares and funds (decline of NIS 1,373 million).
   a. Losses in the value of the investments in securities for trading in the amount of NIS 528 million, including the recording of negative exchange rate differentials in the amount of NIS 145 million in the portfolio of foreign securities for trading, compared with a loss of NIS 2 million during the corresponding period in 2007 from the adjustment of securities to market value;
   b. In 2007, there were net profits totalling NIS 218 million from the sale of available-for-sale shares, while in 2008, the net losses and adjustments to market value totalled NIS 515 million;
   c. The income from dividends totalled NIS 131 million in 2008, compared with NIS 245 million in 2007. The decline is mainly explained by the fact that in 2007, the partial repayment of a particular customer's debt, in the amount of NIS 120 million, was recorded as a dividend, compared with NIS 63 million in 2008. In accordance with the directives of the Supervisor of Banks, the debt is presented as an investment in available-for-sale shares and not under credit to the public.

3. Other income

   The capital market reform came into effect as of the second quarter of 2006, at which time the Bank began collecting distribution commissions in respect of mutual funds that it distributes. As of 2007, the Bank began collecting operating commissions, from companies that manage provident funds, in respect of operating services. As of September 2008, the Bank has been providing pension counseling in a partial format, and has been receiving distribution commissions in respect of the provident funds (including pension funds) that are the subject of such counseling.

The following table presents details of the other income:

	2008	2007	Change	Change
	NIS millions		NIS millions	%
From mutual funds	**123**	165	(42)	(25.5)
From provident funds	**2**	10	(8)	(80.0)
From supplementary training funds	**2**	19	(17)	(89.5)
From operation of provident funds	**49**	43	6	14.0
Profits from a provident fund for severance pay	–	63	(63)	–
Other income	**174**	111	63	56.8
Total	**350**	411	(61)	(14.8)

With regard to the commissions reform and the Bank of Israel's directives in this regard, see pages 39 to 40 above in the Report.
With regard to legal claims and the discussions with the Antitrust Commissioner on topics relating to credit cards, see Note 18 (L)2 to the Financial Statements.
Income received from Visa International, in the amount of NIS 91 million, was recorded under the "other income" item.
With regard to the Antitrust Commissioner's announcement concerning the coordination of commission rates, see page 47.

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 30.5% in 2008, compared with 35.6% in 2007. Operating and other income covered 40.0% of operating and other expenses, and, after neutralizing special expenses as detailed below, 42.3%, compared with cover of 60.9% and 63.3%, respectively, in 2007.

For further details, see Notes 21-23 to the Financial Statements.

Total Operating and Other Expenses of the Leumi Group in 2008 amounted to NIS 7,003 million, compared with NIS 6,937 million in 2007 – an increase of 1.0%. After neutralizing special salary expenses as specified below, there was a decrease of 0.7% (at the Bank – NIS 5,085 million in 2008, compared with NIS 5,059 million in 2007 – an increase of 0.5% and a decline of 1.3% after neutralizing special expenses).

a. Salary expenses totalled NIS 4,118 million in 2008, a 2.4% decline compared with 2007. The decline in salary expenses derives mainly from the non-payment of bonuses to employees in respect of 2008, from a reduction in costs relating to the issue of shares and options to employees, and from salary tax refunds due to losses for tax purposes, which were offset by losses from the pension fund and the severance pay fund, which are also used as a reserve for covering the pension obligations to employees. After neutralizing special salary expenses as specified below, the salary expenses in 2008 decreased by 5.4%.

The following table presents details relating to special salary expenses:

	2008	2007
	NIS millions	
Completing the provisions for severance pay and pension*	**535**	21
Expenses (income) in respect of issue of options to employees	**(16)**	247
Recording of benefit in respect of sale of shares to employees	**(50)**	3
Actuarial adjustments in respect of jubilee grant	**47**	–
Salary tax refunds	**(154)**	–
Other	**22**	–
Total	**384**	271

* Of which, the sum of NIS 254 million was required in respect of the funds' losses in 2008, compared with profits during the corresponding period in 2007.
For further details, see Note 15 to the Financial Statements.

Additional details concerning components of salary expenses:

1. The calculation of the Bank's actuarial liability for pensions and jubilee grant is made on the basis of the capitalization rate determined by the Supervisor of Banks (4%), assuming a real increase in salaries based on past experience and which varies according to the employee's age. The rates of increase range between 0.6% and 8.6%.
2. In 2008, the actuarial parameters related to salary increases were re-examined according to the employee's age, and employee resignations. The net impact of these two items was not material.
3. For details regarding costs related to the privatization of the Bank, see the above table.

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

Salary and salary-related expenses (excluding special expenses) constituted some 56.4% of total operating expenses in 2008, compared with 59.2% in 2007.

b. Operating and other expenses, excluding salary expenses, totalled NIS 2,885 million in 2008, compared with NIS 2,719 million in 2007, an increase of 6.1%. Detailed below are the principal changes in operating expenses due to the following factors:

1. An increase in the expenses of maintenance of buildings and equipment in the amount of NIS 66 million (8.1%);
2. An increase in depreciation expenses in the amount of NIS 57 million (12.3%);
3. An increase in expenses in respect of professional services in the amount of NIS 17 million (6.3%);
4. An increase in computer expenses in the amount of NIS 13 million (5.9%).

The Group's computer expenses, which are presented in Note 25 to the Financial Statements, do not include the Bank's computer expenses, which are included with all its other expenses, since the computer center is a unit within the Bank. These computer expenses mainly include expenses in subsidiaries that purchase computer services and/or are outsourcing costs.

For further details see Notes 24 and 25 to the Financial Statements.

Operating and other expenses in 2008 constitute 76.3% of total income, compared with 58.4% in 2007 and 67.3% in 2006. After neutralizing the special salary expenses detailed in the Report, the operating expenses constitute 72.1% of total income, compared with 56.3% in 2007. The deterioration in the efficiency ratio derives mainly from a significant decline in income due to losses from investment activities in securities.

Total operating and other expenses constitute 2.25% of total assets, compared with 2.30% in 2007, and, after neutralizing the special salary expenses, 2.13% and 2.21%, respectively.

Operating Profit before Taxes of the Leumi Group in 2008 totalled NIS 32 million, compared with NIS 4,526 million in 2007 – a decrease of 99.3% (at the Bank – a loss of NIS 236 million in 2008, compared with a profit of NIS 3,441 million in 2007). After neutralizing special salary expenses, the decrease was at the rate of 91.3%, while at the Bank, it was at the rate of 96.9%.

Provision for Taxes on Operating Profit of the Leumi Group in 2008 totalled NIS 421 million, compared with NIS 1,722 million in 2007. The statutory tax rate for financial institutions in Israel in 2008 was 36.80%, compared with 38.53% in 2007.

The provision for taxes in 2008 was principally affected by the following matters:

1. Losses carried forward for tax purposes, which are not recognized for profit tax, increased tax by some NIS 126 million;
2. The cancellation of deferred tax receivable due to a reduction in the value of the benefit to employees and due to unrecognized expenses arising from options and shares issued to employees, increased tax by some NIS 105 million;

3. Negative exchange rate differentials in respect of the investments abroad which are not included in the basis of the tax calculation increased tax by some NIS 88 million;
4. Unrecognized expenses (including an additional provision for doubtful debts) increased the tax provision by some NIS 65 million;
5. Income tax compensation in respect of the collection of and a reduction in provisions for doubtful debts that were recognized as an expense in previous years increased tax by some NIS 54 million;
6. The amendment to the Value Added Tax Act reduced tax by some NIS 36 million.

For further details on the provision for taxes, see Note 26 to the Financial Statements.
Regarding the amendment to the Income Tax (Adjustments for Inflation) (Amendment) Law, 2007, see pages 220 to 221of the Report.

Operating Profit (Loss) after Taxes of the Leumi Group in 2008 amounted to a loss of NIS 389 million, compared with a profit of NIS 2,804 million in 2007, and, after neutralizing the special salary expenses, a decline of 98.1%.

The Group's share in Operating Profit after Taxes of Companies Included on the Equity Basis in 2008 amounted to a profit of NIS 249 million, compared with NIS 184 million in 2007, an increase of 35.3%.

The majority of the profit under this item derived from the contribution of the following companies:

1. The Israel Corporation Ltd.: profit of NIS 157 million in 2008, compared with NIS 110 million in 2007.
2. Paz Oil Company Ltd.: profit of NIS 82 million in 2008, compared with a profit of NIS 65 million in 2007.

For further details, see pages 142 to 143 of the Report.

Minority Interests in the Profit (Losses) of the Group amounted to a profit of NIS 18 million in 2008, compared with a profit of NIS 4 million in 2007. The increase in profit derives from the minority interest in Leumi Card. (For additional details, see pages 146 to 147 of the Report).

Net Operating Profit (loss) of the Leumi Group amounted to NIS (158) million in 2008, compared with a profit of NIS 2,984 million in 2007. After neutralizing special salary expenses as specified above, the decrease was at the rate of 90.2%.

After-Tax Profit from Extraordinary Items in 2008 amounted to a profit of NIS 250 million, compared with NIS 373 million in 2007. The profit derives from the allotment of 20% of the issued and paid-up share capital of Leumi Card to Kanit-Investment Management and Financing Ltd. The profit in 2007 derived from the sale of a portion of the activities of the provident funds and supplementary training funds that the Group had managed.

For further details, see pages 146 to 147 below and Note 27 to the Financial Statements.

Net Operating Profit (loss) per share reached NIS (0.11) in 2008, compared with NIS 2.11 in 2007 (on a fully diluted basis – NIS (0.11), compared with NIS 2.08).

Net earnings per share reached NIS 0.06 in 2008, compared with NIS 2.37 in 2007 (on a fully diluted basis – NIS 0.06, compared with NIS 2.34).

The following table presents the return on average shareholders' equity for the period (excluding minority interests):

	2008	2007
	%	
Net profit	**0.5**	17.4
Net operating profit (loss)	**(0.8)**	15.4

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

	2008				2007			
	4th Qtr.	**3rd Qtr.**	**2nd Qtr.**	**1st Qtr.**	4th Qtr.	3rd Qtr.	2nd Qtr.	1st Qtr.
	%							
Net profit (loss)	**(22.2)**	**(1.6)**	**19.1**	**9.8**	10.4	21.9**	20.9	22.2**
Net operating profit (loss)	**(22.2)**	**(1.6)**	**13.4**	**9.8**	10.3	19.4	20.9	15.6

The following table presents the return after neutralizing the effect of the special salary expenses*:

	2008	2007
	%	
Net profit	**2.7**	18.2
Net operating profit	**1.4**	16.3

	2008				2007*			
	4th Qtr.	**3rd Qtr.**	**2nd Qtr.**	**1st Qtr.**	4th Qtr.	3rd Qtr.	2nd Qtr.	1st Qtr.
	%							
Net profit	**20.2**	**2.6**	**19.2****	**12.3**	11.6	23.1**	21.5	23.0**
Net operating profit	**20.2**	**2.5**	**13.5**	**12.3**	11.5	20.5	21.5	16.4

*Special salary expenses: expenses relating to the recording of the costs of the options issued, the shares that the State sold to employees and timing differentials relating to reserves for severance pay.

** Assuming that the profit from extraordinary items is nonrecurring, the return on net profit in the second quarter of 2008 is 14.7%, and 14.0% after neutralizing special expenses; in the first quarter of 2007, the return was 17.1% and 18.0% after neutralizing special expenses; in the third quarter of 2007 – 19.9% and 20.6%, respectively.

Development of the Profit over the Last Eight Quarters

A. The following table is a condensed statement of operating profit and loss after taxes for the last eight quarters:

	2008				
	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	**Annual Total**
	NIS millions				
Net interest income (a)	**976**	**1,491**	**1,953**	**1,960**	**6,380**
Provision for doubtful debts	**(1,090)**	**(495)**	**(316)**	**(244)**	**(2,145)**
Operating and other income	**545**	**540**	**864**	**851**	**2,800**
Operating and other expenses (b)	**(1,801)**	**(1,746)**	**(1,662)**	**(1,794)**	**(7,003)**
Operating profit (loss) before taxes	**(1,370)**	**(210)**	**839**	**773**	**32**
Provision for taxes (benefit)	**423**	**(61)**	**(400)**	**(383)**	**(421)**
Operating profit (loss) after taxes	**(947)**	**(271)**	**439**	**390**	**(389)**

	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

B. The following table shows the quarterly development of the principal items in net interest income, before provision for doubtful debts:

	2008				
	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	**Annual Total**
	NIS millions				
Current activities	**1,630**	**1,595**	**1,800**	**1,753**	**6,778**
Collection and reduction of interest in respect of problem loans	**91**	**80**	**87**	**249**	**507**
Provisions for decline in value of available-for-sale debentures	**(810)**	**(425)**	**(82)**	**(11)**	**(1,328)**
Profits (losses) from the sale of available-for-sale debentures and from adjustments to market value of debentures for trading	**128**	**(166)**	**(2)**	**113**	**73**
Adjustments of derivatives to fair value	**(25)**	**250**	**(22)**	**(169)**	**34**
Effect of the known CPI	**(38)**	**157**	**172**	**25**	**316**
Total net interest income	**976**	**1,491**	**1,953**	**1,960**	**6,380**

	2007				
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Annual Total
	NIS millions				
Current activities	1,740	1,878	1,634	1,706	6,958
Collection and reduction of interest in respect of problem loans	121	103	152	85	461
Decline in value of available-for-sale debentures	–	–	–	–	–
Profits (losses) from the sale of available-for-sale debentures and from adjustments to market value of debentures for trading	33	(112)	81	84	86
Adjustments of derivative to fair value	(113)	210	(77)	(67)	(47)
Effect of the known CPI	–	186	19	(15)	190
Total net interest income	1,781	2,265	1,809	1,793	7,648

C. The following table shows the quarterly development of the provisions for doubtful debts:

	2008				
	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	**Annual Total**
	NIS millions				
Specific provision	**992**	**500**	**311**	**269**	**2,072**
Additional provision	**98**	**(5)**	**5**	**(25)**	**73**
Total	**1,090**	**495**	**316**	**244**	**2,145**
Ratio of the provision to total credit to the public (annual basis)	**2.05%**	**0.96%**	**0.63%**	**0.49%**	**1.01%**

			2007		
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Annual Total
	NIS millions				
Specific provision	369	90	66	31	556
Additional provision	(90)	(11)	(28)	(20)	(149)
Total	279	79	38	11	407
Ratio of the provision to total credit to the public (annual basis)	0.57%	0.16%	0.08%	0.02%	0.20%

D. The following table shows the quarterly development of operating and other income:

	2008				
	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	**Annual Total**
	NIS millions				
Operating commissions	**838**	**840**	**832**	**852**	**3,362**
Losses from investments in shares	**(434)**	**(363)**	**(44)**	**(71)**	**(912)**
Other income	**141**	**63**	**76**	**70**	**350**
Total operating and other income	**545**	**540**	**864**	**851**	**2,800**

	2007				
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Annual Total
	NIS millions				
Operating commissions	862	834	827	827	3,350
Profits from investments in shares	227	9	143	82	461
Other income	102	66	162	81	411
Total operating and other income	1,191	909	1,132	990	4,222

E. The following table shows the quarterly development of salary expenses:

	2008				
	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	**Annual Total**
	NIS millions				
Salary expenses, excluding special salary expenses	**981**	**855**	**951**	**947**	**3,734**
Special salary expenses	**(12)**	**188**	**24**	**184**	**384**
Of which: expenses in respect of the issue of options to employees	**(14)**	**(37)**	**6**	**29**	**(16)**
Recording of benefit in respect of the sale of shares to employees	**–**	**(39)**	**11**	**(22)**	**(50)**
Provision for severance pay and pension	**108**	**262**	**2**	**163**	**535**
Salary tax refunds	**(154)**	**–**	**–**	**–**	**(154)**
Actuarial changes in respect of jubilee bonus	**47**	**–**	**–**	**–**	**47**
Miscellaneous	**1**	**2**	**5**	**14**	**22**
Total salary expenses	**969**	**1,043**	**975**	**1,131**	**4,118**

	2007				
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Annual Total
	NIS millions				
Salary expenses, excluding special salary expenses	1,025	1,006	926	990	3,947
Special salary expenses	58	98	78	37	271
Of which: expenses in respect of the issue of options to employees	52	66	76	53	247
Recording of benefit in respect of the sale of shares to employees	5	3	13	(18)	3
Provision for severance pay and pension	1	29	(11)	2	21
Total salary expenses	1,083	1,104	1,004	1,027	4,218

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 due to an increase in the overall interest margin;
- an increase in profits from the sale of available-for-sale debentures and an increase in the market value of debentures and unrealized profits from adjustments to fair value, of debentures for trading compared with the corresponding period in 2007.
- the negative effect of adjustments to fair value of derivative instruments (timing differentials);
- an increase in collections and reduction of interest in respect of problem loans regarding which provisions had been made in the past;

In the second quarter of the year:

- an increase in the volume of financial activity, mostly in the unlinked shekel sector;
- a decline in value of available-for-sale debentures;
- a decrease in value of debentures and unrealized profits from adjustments to fair value of debentures for trading;
- an increase in adjustments to fair value of derivatives, primarily CPI-linked;
- a decrease in collections and reduction of interest in respect of problem loans regarding which provisions had been made in the past;

In the third quarter of the year:

- a decrease in net interest income, mostly due to the decline in value of and/or losses from investments in debentures;
- the effect of the positive known CPI increased income in the third quarter; and there was also an increase in adjustments to fair value of derivatives.

In the fourth quarter of the year:

- most of the decrease in net interest income derived from the decline in value of and/or losses from investments in securities.

2. **Provisions for doubtful debts:**

– During the first three quarters of the year, there was a rise in the provisions for doubtful debts compared with the average quarterly provisions in 2007.

– In the fourth quarter of the year, there was a sharp rise in the provisions for doubtful debts relative to the average quarterly provisions during the first nine months of the year, and also relative to the provision in the fourth quarter of 2007. See further details in the Directors' Report under the section on credit to the public.

3. **Operating and other income:**

– In 2008, the operating and other income steadily diminished relative to the quarterly income in 2007, mainly as a result of losses from and/or declines in value of investments in shares and funds.

– Other income decreased compared to the quarterly average in 2007, mainly as a result of a decrease in distribution commissions from mutual funds, and due to the lack of profits from the provident fund for severance pay.

– Commissions from management fees also diminished as from the third quarter, as a result of the impact of the commissions reform.

4. **Salary expenses and related expenses:**

– In the first quarter the entire severance pay provision was recorded, pursuant to the salary increase at the beginning of the year, compared with the income from the severance pay fund which is spread over the entire year.

– In the second quarter of the year, salary expenses decreased, compared with the first quarter, as a result of an improvement in the income from the provident fund for severance pay.

– In the third quarter of the year, salary expenses increased, following an increase in the liabilities for pension and severance pay, due to the losses of the pension fund and severance pay fund, which also serve as a reserve for covering the liabilities for employees' pension. This also recurred in the fourth quarter refund.

– In the fourth quarter, a salary tax refund was recorded in the amount of some NIS 154 million in respect of losses for tax purposes

– The quarterly average of the annual salary expenses totalled some NIS 1,030 million, and, after deducting special salary expenses, totalled some NIS 934 million.

5. **Other operating expenses:**

- In the fourth quarter of the year, there was an increase in these expenses relative to the average of the previous quarters. The increase amounted to NIS 148 million, some 21.6%. On the other hand, relative to the fourth quarter of 2007, there was an increase of NIS 51 million, some 6.5%.

- Maintenance of buildings and equipment – the increase in the fourth quarter was due to a rise in rental expenses and software maintenance.

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 subsidiaries abroad that are not included in the tax basis.

– In the second quarter of the year, no material change occurred in the rate of the provisions for taxes.

– In the third quarter of the year, the tax rate was high, mainly as a result of the cancellation of deferred taxes in respect of a reduction in the value of the benefit to employees in respect of the issue of options and shares.

– The fourth quarter of the year closed with a pre-tax loss.

7. The profits from extraordinary items:

- In the second quarter of the year, a profit of some NIS 250 million was recorded, of which NIS 234 million was in respect of the allotment of 20% of the issued and paid-up share capital of Leumi Card to Canit- Investment Management and Financing Ltd.

For additional multi-quarter information, see Exhibits G and H in the Management Review.

Structure and Development of Assets and Liabilities

Total Assets of the Leumi Group on 31 December 2008 amounted to NIS 310.8 billion, compared with NIS 302.1 billion at the end of 2007, an increase of 2.9%. The Bank's total assets on 31 December 2008 amounted to NIS 267.7 billion, compared with NIS 254.5 billion at the end of 2007, an increase of 5.2%.

Of the Group's total assets, the value of the assets denominated in or linked to foreign currency was some NIS 110.3 billion, some 35.5% of total assets. In 2008, the shekel appreciated against the US dollar by 1.1% and against the euro by 6.4%.

The change in the exchange rate of the shekel in relation to foreign currencies in general contributed to a decrease of some 1.5% 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 653 billion, compared with NIS 764 billion at the end of 2007 (some US$ 172 billion and US$ 199 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		
	2008	2007	Change	**2008**	2007	Change
	NIS millions		%	NIS millions		%
Total assets	**310,792**	302,151	2.9	**267,706**	254,481	5.2
Deposits of the public	**244,783**	238,045	2.8	**221,409**	208,422	6.2
Debentures, capital notes and subordinated capital notes	**20,636**	19,248	7.2	**4,637**	4,542	2.1
Deposits from banks	**3,742**	6,139	(39.0)	**3,481**	5,457	(36.2)
Cash and deposits with banks	**33,130**	42,329	(21.7)	**58,355**	62,488	(6.6)
Securities	**44,910**	47,169	(4.8)	**37,056**	35,723	3.7
Credit to the public	**213,215**	198,557	7.4	**144,574**	133,729	8.1
Buildings and equipment	**3,445**	3,276	5.2	**3,011**	2,807	7.3

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

	Consolidated			The Bank		
	31 December			31 December		
	2008	2007	Change	**2008**	2007	Change
	NIS millions		%	NIS millions		%
Documentary credits	**1,631**	2,582	(36.8)	**923**	1,784	(48.3)
Credit guarantees	**6,821**	6,993	(2.5)	**6,934**	12,284	(43.6)
Guarantees to purchasers of apartments	**8,117**	7,440	9.1	**7,857**	7,168	9.6
Other guarantees and liabilities	**14,454**	13,822	4.6	**15,453**	15,524	(0.5)
Derivatives*	**235,678**	198,993	18.4	**222,977**	186,725	19.4
Options of all kinds	**125,631**	140,675	(10.7)	**120,030**	131,584	(8.8)

* Including forwards, financial swap contracts, futures, swaps 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		
	2008	2007	Change
	NIS millions		%(1)
Securities portfolios of customers	**297,513**	404,686	(26.5)
of which: in mutual funds(2)	**36,324**	44,235	(17.9)
provident funds(2) (3)	**31,794**	46,747	(32.0)
supplementary training funds(2) (3)	**12,769**	10,497	21.6
Total	**342,076**	461,930	(25.9)

(1) Including increase in market value of securities and the value of securities of mutual and provident funds held in custody, in respect of which operation management and custody services are provided.
(2) On 31 December 2008, 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 operating services, including balances of the funds of customers who receive counseling at Leumi.

The decline in value of assets results primarily from the collapse of the markets in Israel and abroad.

Deposits of the Public

Deposits of the public with the Group amounted to NIS 244.8 billion at the end of 2008, compared with NIS 238.0 billion at the end of 2007, an increase of 2.8%.

The shekel's appreciation against most foreign currencies contributed to a 2.0% 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 20.6 billion as at the end of 2008, compared with NIS 19.2 billion at the end of 2007. Deposits of the public, debentures and subordinated capital notes increased in 2008 by 3.2%, and together constitute 85.4% of total assets.

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

31 December 2008					
	Demand	**Term**	**Savings schemes**	**Ear-marked deposits**	**Total**
	%	**%**	**%**	**%**	**NIS millions**
Israeli currency:					
Unlinked	**47**	**47**	**-**	**40**	**111,976**
CPI-linked	**-**	**11**	**94**	**60**	**27,252**
Foreign currency:					
including foreign currency linked	**53**	**42**	**6**	**-**	**105,225**
Non-monetary	**-**	**-**	**-**	**-**	**60**
Total, as a percentage	**100**	**100**	**100**	**100**	
Total in NIS millions	**42,593**	**196,279**	**5,895**	**16**	**244,783**

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

The increase in the volume of deposits of the public in 2008 was mainly in unlinked shekel deposits, which increased by NIS 15.3 billion, and in CPI-linked shekel deposits which rose by NIS 603 million. On the other hand, foreign currency deposits declined by NIS 8.8 billion, of which NIS 4.7 billion was the result of changes in the shekel's exchange rate. After neutralizing the effect of changes in the exchange rate of the shekel, deposits of the public increased by 4.8%.

Developments in the various kinds of deposits were as follows:

- Unlinked shekel deposits of the public increased by 15.9% compared with 31 December 2007, primarily as a result of the public's preference for minimized exposure and risks.

- Deposits of the public denominated in or linked to foreign currency decreased by 7.7% as compared with 31 December 2007, and after the effect of changes in the exchange rate of the shekel are neutralized, such deposits decreased by 3.5%.

- CPI-linked deposits rose by 2.2% compared with 31 December 2007, primarily in fixed-term deposits.

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 2008, investments in these products declined because of the global financial crisis.

The balance of structured deposits totaled US$ 452 million on 31 December 2008, as compared with US$ 723 million at the end of 2007.

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

	31 December		Accumulated
Segment	**2008**	2007*	Change
	NIS millions		%
Households	**120,846**	115,802	4.4
Small businesses	**14,475**	14,428	0.3
Corporate banking	**23,111**	24,382	(5.2)
Commercial banking	**29,659**	30,317	(2.2)
Private banking	**38,057**	40,916	(7.0)
Financial management, capital markets and other**	**18,635**	12,200	52.7
Total, net	**244,783**	238,045	2.8

* Reclassified.
* * Includes mainly deposits of institutional bodies.

Deposits from Governments amounted to some NIS 0.8 billion at the end of 2008 - 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 2008 there was a decline of some NIS 0.4 billion in deposits from governments, of which some NIS 203 million was a decline at the Bank due to the lending of government debentures. A decline of some NIS 168 million at Leumi USA was 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 0.7 billion.

This item also includes deposits of foreign governments in overseas subsidiaries, which amounted to some NIS 64 million at the end of 2008, compared with NIS 232 million at the end of 2007.

Deposits with Banks and from Banks

A. Deposits with Banks (Central and Commercial):

	31 December 2008		31 December 2007	
	With central banks	**With banks**	With central banks	With banks
	NIS millions			
Israeli Currency:				
Unlinked	**12,959**	**1,119**	5,492	1,590
CPI-linked	**-**	**529**	-	587
Foreign currency including foreign currency-linked	**4,838**	**12,229**	1,299	31,971
Total deposits with banks	**17,797**	**13,877**	6,791	34,148

Total deposits with banks decreased by 22.6%, of which deposits with commercial banks decreased by 59.4%, primarily as a result of a decrease of some NIS 19.6 billion (US$ 5.2 billion) in deposits with foreign banks. The decline results primarily from the diversion of deposits to investments in US and French government bonds and to deposits with central banks in the US and in Western Europe, and from a reduction in the volume of swap transactions initiated by the Bank. On the other hand, there was an increase of 162.1% in deposits with central banks.

B. Deposits from Banks:

	31 December 2008		31 December 2007	
	From central banks	**From banks**	From central banks	From Banks
	NIS millions			
Israeli Currency:				
Unlinked	**-**	**1,581**	-	2,596
CPI-linked	**-**	**800**	-	669
Foreign currency including foreign currency-linked	**-**	**1,361**	10	2,864
Total deposits from banks	**-**	**3,742**	10	6,129

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 against its securities portfolio.

On 31 December 2008, deposits of the Group with the Bank of Israel totaled NIS 13.4 billion, against which there were no loans from the Bank of Israel.

For further details, see pages 100 to 101.

As may be seen from these tables, the liquidity situation of the Group is extremely positive, and the Group has net deposits with banks amounting to NIS 27.9 billion.

Credit to the public

Credit to the public in the Leumi Group at the end of 2008 totaled NIS 213.2 billion, compared with NIS 198.6 billion at the end of 2007, an increase of 7.4% (at the Bank, an increase of 8.1%). Credit to the public comprises 68.6% of total assets (compared with 65.7% at the end of 2007).

The shekel's appreciation against most foreign currencies contributed to a decline of 1.2% in total credit to the public.

As well as granting credit to the public, the Group invests in the securities of companies, in an amount of NIS 8,204 million at the end of 2008, as compared with NIS 12,435 million at the end of 2007. These investments also involve a credit risk.

The following table sets out the quarterly development of credit to the public according to linkage segments:

	1st quarter	2nd quarter	3rd quarter	4th quarter	Total annual
Unlinked in NIS millions	**3,593**	**5,722**	**1,542**	**2,029**	**12,886**
% growth	**4.1**	**6.2**	**1.6**	**2.0**	**14.5**
CPI-linked in NIS millions	**354**	**479**	**1,422**	**(2,112)**	**143**
% growth (reduction)	**0.7**	**0.9**	**2.6**	**(3.8)**	**0.3**
Foreign currency including foreign currency-linked in NIS millions	**(2,330)**	**(4, 658)**	**2,808**	**5,809**	**1,629**
% growth (reduction)	**(4.1)**	**(8.6)**	**5.7**	**11.1**	**2.9**
Total in NIS millions	**1,617**	**1,543**	**5,772**	**5,726**	**14,658**
% increase	**0.8**	**0.8**	**2.9**	**2.8**	**7.4**

The total credit to the public in the Group in Israel amounted to some NIS 189 billion at the end of 2008, compared with NIS 174 billion at the end of 2007, an increase of 8.6%.

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

	31 December 2008		31 December 2007		Change
	NIS millions	**% of mix**	NIS millions	% of mix	%
Unlinked*	**101,569**	**48**	88,683	45	14.5
CPI-linked	**53,457**	**25**	53,314	27	0.3
Foreign currency including foreign currency-linked	**58,189**	**27**	56,560	28	2.9
Total	**213, 215**	**100**	198,557	100	7.4

* Including non-monetary items.

Most of the increase in credit to the public was in unlinked shekel credits amounting to NIS 12,886 million, 14.5%.
Foreign currency and foreign currency-linked credit to the public increased by NIS 1,629 million, and after neutralizing the effect of the changes in the exchange rate of the shekel, such credit increased by 7.1%. CPI-linked credit to the public increased by NIS 143 million, 0.3%.

Total credit to the public that was offset from deposits according to the extent of collection amounted to NIS 9.7 billion in the Group. Some 83.6% 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 2008	31 December 2007
	NIS millions	
US dollar	**39,959**	36,826
Euro	**7,498**	7,315
Other currencies	**10,732**	12,419
Total	**58,189**	56,560

The shekel's appreciation against most foreign currencies contributed to a decline of some 4.2% in foreign currency and foreign-currency linked credit.

The following table sets out the development of indebtedness in the construction and real estate sector:

	31 December		
	2008	2007	Change
	NIS millions		%
Balance sheet credit risk	**40,374**	35,094	15.0
Guarantees to apartment purchasers*	**3,299**	3,315	(0.4)
Other off-balance sheet risk	**17,008**	16,072	5.8
Total	**60,681**	54,481	11.4

* Weighed according to balance sheet value.

The total credit risk of the construction and real estate sector in Israel (according to the sectors of the economy report in Exhibit E to the Management Review) increased in 2008 by 11.4%. Credit risk of the construction and real estate sector in Israel constitutes some 20.4% 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 indebtedness in the sector at the Bank amount to some 22.27% of total indebtedness in Israel, and therefore there is a sectoral excess of credit of some 2.27%, compared with an excess of 0.75% at the end of 2007.

For details regarding the additional provision, see also pages 59 to 60 of the Report.

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

	31 December		Change since
Segment	**2008**	2007*	December
	NIS millions		%
Households (1)	**62,145**	56,812	9.4
Small businesses (2)	**18,161**	18,232	(0.4)
Commercial banking (3)	**48,506**	50,942	(4.8)
Corporate banking (4)	**76,563**	64,129	19.4
Private banking	**6,438**	7,138	(9.8)

* Re-classified.

(1) Credit to households also includes housing loans (mortgages). After neutralizing this credit, credit to households (banking and finance) increased by 6.5%. Housing loans totaled NIS 40.6 billion at the end of 2008, an increase of 11%. (The increase in credit in 2007 was 15.8%.)

(2) After neutralizing the effects of segmentation between the segments, there was an increase was 6.5%.

(3) After neutralizing the effects of segmentation between the segments, there was a decrease was only 0.1%.

(4) There was an increase of some NIS 13 billion in credit activities in Israel of the corporate banking segment, and an overall increase of 19.4% or 15.0% after neutralizing the effects of segmentation.

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 quarterly development of credit to the public according to principal linkage segments:

	1st quarter	2nd quarter	3rd quarter	4th quarter	Total annual
	%				
Households	**1.4**	**3.9**	**3.6**	**0.3**	**9.4**
Small businesses	**0.3**	**(2.0)**	**0.3**	**1.1**	**(0.4)**
Commercial banking	**(1.2)**	**(1.5)**	**(4.5)**	**2.5**	**(4.8)**
Corporate banking	**1.8**	**0.9**	**9.5**	**6.2**	**19.4**
Private banking	**(0.6)**	**(10.5)**	**2.4**	**(1.0)**	**(9.8)**

Pledge in Favor of the Bank of Israel

On 21 May 2008, the Bank signed a debenture pursuant to which it granted a first degree floating charge in favor of the Bank of Israel, on its rights to receive amounts and monetary shekel payments that are due, and that will become due to the Bank from time to time, from customers who are corporations (established according to the laws of the State of Israel), which are not in arrears with their repayments to the Bank of credits received from it, and where the average lifespan of the credit does not exceed three years, that were granted and that will be granted to these customers by the Bank. The charge is in an amount equal to the level of the amounts secured by the debenture, from time to time, up to an amount of NIS 1.1 billion.
This pledge secures funds that are required for the Bank's operations for the purpose of its activities in the CLS clearinghouse.

For further details, see pages 42 to 43 of the Report.

Credit risk according to economic sector

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

	31 December 2008		31 December 2007		
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	**2,501**	**0.8**	2,591	0.8	(3.5)
Industry	**52,212**	**16.3**	47,617	15.6	9.6
Construction and real estate	**60,681**	**18.9**	54,481	17.9	11.4
Electricity and water	**1,851**	**0.6**	2,333	0.8	(20.7)
Trade	**31,009**	**9.7**	32,601	10.7	(4.9)
Hotels, accommodation and food services	**5,275**	**1.6**	5,757	1.9	(8.4)
Transportation and storage	**6,673**	**2.1**	5,959	2.0	12.0
Communications and computer services	**7,084**	**2.2**	6,602	2.2	7.3
Financial services	**42,565**	**13.3**	42,160	13.8	1.0
Other business services	**9,279**	**2.9**	9,161	3.0	1.3
Public and community services	**8,564**	**2.7**	8,326	2.7	2.9
Private persons - housing loans	**43,603**	**13.5**	40,059	13.2	8.8
Private persons – other	**49,197**	**15.4**	46,723	15.4	5.3
Total	**320,494**	**100.0**	304,370	100.0	5.3

* 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 pages 46 to 47 above.

Industry Sector:

The following discussion is according to industry sub-sectors:

Industrial Sectors:

The industrial sectors have been greatly influenced by fluctuations in the prices of raw materials in recent years. Price increases that began in 2007 and intensified during the first half of 2008, as well as concerns regarding further increases, led companies to purchase relatively large inventories compared with previous periods. This process caused large losses for companies during the second half of 2008, when the prices of inputs throughout the world began to drop rapidly. Many companies were left with high levels of inventory of finished products and goods in process which were not purchased because of the slowdown in demand, along with high levels of inventories of raw materials of which no use was made, and were forced to report declines in value in their financial statements.

a. Metals–
In Israel, the metals sector is a combination of the base metal and finished metal fields. Activity in the base metal area is concentrated primarily in the provision of construction, industrial and infrastructure inputs. This industry is therefore influenced by world metal prices, especially prices for iron and steel.

From 2003 and until July 2008, global steel prices rose by 460%, cumulatively (in dollar terms). However, despite the rise in the prices of raw materials, companies in the steel sector have experienced increasing profitability, because the price rises were passed on in full to the industry's customers through sale prices, while in actuality what was sold were inventories that had been purchased in the past at lower prices. Thus, during a period of continual increases in the price of steel, the companies that were active in the steel sector increased their profitability as well.

At the beginning of September 2008, the global "free fall" in the prices of goods began, especially with regard to the prices of raw materials in the metal industry. The first signs of the decline in the prices of raw materials led to an end to trade in steels. Companies active in the steel sector (in Israel and throughout the world) that had purchased relatively large inventories during the first half of 2008, in order to set the price for raw materials with a view to increasing the margins in a market in which prices were rising, found themselves with expensive inventories in a market in which prices were "collapsing".

The global financial crisis, the credit crunch that reduced demand, and the uncertainty regarding the future all led to a re-examination of projects by companies active in this industry, accompanied by a slowdown in imports of raw materials, an end to accumulation of inventories, a contraction of the workforce and more. It is noted that the decline in demand for inputs arose primarily from the construction sector which is one of the largest consumers of metals, and also one of the industries that was most affected by the crisis.

In addition, as a result of the declines in demand and thus in sale prices, the industry made provisions for declines in the value of inventories. Steel manufacturers worldwide also reduced their manufacturing levels in order to decrease the supply.

The assessment for 2009 is that there will be a decline in the scope of activity and erosion in the sector's profitability (as a result of the causes noted above). It should also be noted that the recovery of the metal industry (and of the steel industry in particular) is closely connected to the recovery of the real estate industry in Israel. A first sign of this will be an increase in building starts – and no such increase is currently visible.

b. The High-tech Company Sector
The rapid development which had characterized the high-tech industry in recent years came to a halt at the end of 2007, with the outbreak of the financial crisis in the United States. During 2008, the industrial demand indices indicated a slowdown as a result of the general slowdown in the American economy, which was reflected in the operations of the Israeli companies in the sector. (The main export destinations of the Israeli high-tech industry are the United States and the euro bloc countries). The chip and semiconductors sectors have been affected the most heavily by the crisis.

The recession in this industry has led, *inter alia,* to a postponement of investments in various projects and has even also led to a freeze with respect to some of them, as well as to declining prices and work-force contractions.

The appreciation in of the exchange rate of the shekel against the dollar during the course of 2008 also led to significant erosion of the profitability of the high-tech companies, most of whose income is denominated in dollars, while their expenses are denominated in shekels.

The forward-looking assessment is that the level of risk in the high tech industries will increase in the coming two years, due to the global economic slowdown in general and in the United States in particular, which is expected to lead to a decrease in demand and a slowdown in the rate of technological development.

The Diamond Sector

The global economic crisis and the slowdown in demand, primarily beginning in the second half of 2008, have had a significant impact on the demand for luxury goods and in particular on the activity of the diamond industry.

The decline in global demand led to a decline in the volume of transactions and in sale prices (at rates varying from 15% to 50%), while the large stone field has led the industry-wide slowdown. In order to try to prevent additional price declines, large global companies decided to reduce the quantity of raw diamonds being produced, but it is doubtful that this process will be of any help. This is because diamonds are non-essential products, the consumption of which tends to contract in a crisis, and the downturn in demand is therefore expected to continue.

The Israeli diamond industry, which is characterized by a high level of exposure to exports (primarily to the United States), has suffered, in the past months, as was expected, from declines in the size of transactions due to the global economic crisis. The slowdown in business activity, on an annual basis, was reflected in a decline of some 9% in the industry's level of international trade (imports and exports) during 2008; the decline during the last three months of 2008 was even sharper, and reached a level of some 45%. In the large and precious stones sectors, there has been a total freeze in activity.

Leumi finances the industry's activity, which is concentrated in Ramat Gan and in New York, and focuses primarily on the financing of the industry's large firms. These firms are characterized by a significant presence in a number of diamond centers worldwide, and have the financial and logistical ability to take advantage of 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.

Residential Real Estate

The number of residential units whose construction began during the first nine months of 2008 amounted to 22,640, which represents a decline of 1% as compared to the corresponding period last year. The breakdown of construction starts according to regions indicates an increase in the number of construction starts in the high demand areas in the country's center and a decline in construction starts in the peripheral regions.

The continued contraction in construction starts in recent years has reduced the inventory of new apartments offered for sale. This inventory contracted by 10% during the course of 2008 and it stood at 9,868 units at the end of 2008. The rate of sale of apartments was 1,069 apartments on average each month during 2008. This indicates that at the current rate for sales, the inventory of apartments for sale is sufficient for 9.2 months of supply.

Sales in the traditional high demand areas were characterized by a moderation of demand for low-cost construction and mid-level apartments. During the last quarter of 2008, the slowdown spread to the exclusive residence sector, reaching a level of a total freeze during the last months of the year. The cost of construction inputs had risen in previous years and during the first half of 2008, due to the significant rise in the prices of goods throughout the world. During the second half of 2008 and the beginning of 2009, prices for construction inputs declined and their price environment returned to what it had been in 2007.

Income-producing Property

The income - producing property sector (offices and commercial properties) was characterized during the first half of 2008 by an excess of demand over the supply of offices in the central region of the country. In the commercial construction field, purchases of such properties continued. During the second half, and particularly in the last quarter of 2008, there was a change in direction resulting, as stated, from the economic crisis, and from the preparations for a reduction in demand and in price levels. The change in direction is being reflected in a sharp reduction in the scope of transactions and in an increase in the levels of return required in such transactions.

Infrastructure Projects

Moderate growth in carrying out large volume national infrastructure projects continued during the past years and during the first half of 2008, primarily in PPP (Public Private Partnership) formats (which are based on collaboration between the private and public sectors). The main infrastructure sectors active in this area are water, transportation, energy and electricity. Regarding financing of the projects, the impact of the global economic crisis has had a significant impact, from a number of perspectives. First, there has been a decline in the readiness of foreign financing parties to join in the organization of and participation in the financing of projects. In addition, the risk margins required by institutional investors in Israel, who constitute the most substantial source of long-term financing, have risen significantly.

Trade and Services

Some of the commercial companies have experienced a certain decline in sales during the last quarter of 2008, along with an increase in competition among companies in the industry. The period has been characterized by an expansion of activity primarily through mergers and acquisitions, while taking advantage of opportunities created in the market.

One of the consequences of the impairment of business product which is expected in 2009 is the weakening of the public's purchasing power. The possibility of a gradual impairment in the trade sector should therefore be taken into consideration.

a. Food Marketing Chains:
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.

During the first nine months of 2008, the large chains continued their growth trend, with good financial results. Nevertheless, as with the other branches of the economy, this sector is expected to be affected by the global slowdown, although the damage is expected to be lower than the average. The impact is expected to be felt primarily in terms of the composition of the consumption, which is expected to change as a transition is made to lower cost items at the expense of premium products. Consequently, the large chains have chosen to deal with the slowdown by expanding the platforms of the heavy discount stores.

b. Hotels:
The year 2008 was a record year for tourist visits to Israel. More than 3 million visitors came to Israel during 2008 – a statistic which reflects a jump of 32% as compared to 2007 and even an increase of 13% when compared to the previous record year (2000). The total of all overnight stays in 2008 amounted to 21.6 million – an increase of 5% compared with the total of overnight stays in 2007. This increase was primarily due to an increase in overnight stays by tourists, which rose by 21%, and which amounted to some 10 million overnight stays. This amount represents a decline of some 5.5% in overnight stays by Israelis, which dropped to some 11.4 million overnight stays. The average national room occupancy rate for 2008 amounted to some 67%, as compared to 62%, in 2007, and 58% in 2006. The 2008 national hotel occupancy rate was the highest in the last decade, but was lower than the occupancy rate of 1995, which was 68.1%.

Part of the improvement in profitability, due to the parameters listed above, was offset by the erosion in the dollar exchange rate, at a rate of some 12% - the average exchange rate in 2008 was NIS 3.6 to the dollar, as compared NIS 4.1 to the dollar in 2007 - and by the increase in the price of energy and food inputs during the first half of 2008.

The incoming tourist data indicate an overall upward trend which has been continuing for a number of years (other than a temporary decline in 2006 as a result of the Second Lebanon War). This point emphasizes the sector's high degree of sensitivity to security and geopolitical events, which increases its risk level. Additionally, the international economic recession, which is being felt to a significant degree in the countries that weigh heavily in terms of providing incoming tourists to Israel, is expected to have an adverse impact on receipts in the Israeli tourist industry in the coming years.

c. Communications Service:

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

The key issues to be noted in this sector in 2008 are:

- On 13 August 2008, the Ministry of Communications announced the adoption of most of the recommendations of the Gronau Commission (which had been published in March 2008) regarding the implementation of a policy and rules for competition in Israeli communications, out of a desire to increase competition in the industry. The Ministry of Communications' objective is to bring about the development of technological innovation and to increase the supply of services, while improving consumer welfare in Israel and creating a balanced playing field.

- The Telephone Number Mobility Law came into effect 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.

- The introduction of DTT (digital terrestrial television), the implementation of which is being planned for the third quarter of 2009. The State will enable reception of five channels which will be broadcast digitally, through a converter that will be sold to all interested parties for a one-time payment.

- At the end of 2008, cooperation began between companies belonging to the same communications group, who combine cellular phone minutes with the provision of internet services.

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

1. Fixed line communications - In the domestic fixed line communications field, a commercial license were granted in 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. Further, additional companies in the communications sphere (particularly in the international and cellular telephone field) received IO licenses and other companies have filed applications for a similar license. Currently, the cellular companies' IO licenses are primarily directed at the business sector, although some of them began to market these services to private customers at the end of 2008.

The principal Ministry of Communications decisions in the wake of the desire to work towards implementation of the Gronau Commission's recommendations regarding fixed line communications have involved the making of structural changes for the establishment of a wholesale market which will be based on the Bezeq infrastructure which will be divided into segments. If this process reaches the implementation stage, it can contribute to a greater degree of flexibility regarding the rates for baskets of alternate services.

2. Cellular communications - The cellular companies continue to present good levels of profitability and cash generation in 2008. 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 Ministry of Communications has adopted the recommendations of the Gronau Commission regarding cellular communications and is planning to give additional operators the opportunity to establish national broadband infrastructures with WiMax technology (a wireless technology for the provision of cellular line communications which enables high broad band communication). In addition, the Ministry of Communications will allow operators to enter this field as virtual operators (MVNOs), to provide service by using the existing infrastructure of the companies that are currently operating in the sector. Looking forward, this sector is expected to continue to present good results, due to the stable demand for its services.

3. Multi-channel television – There are two companies operating in this sector, and they are engaged in lively competition. In 2008, both companies showed improved business results. Regarding the Gronau

Commission conclusions regarding multi-channel television, it has been resolved to establish a designated commission which will examine possible solutions for compensating the companies for reduced income following the commencement of the use of DTT – digital terrestrial television. *Inter alia,* the possibility of allowing for advertising on cable and satellite television was raised. This sector is also not expected to suffer significantly because of the slowdown, as its product is a cheaper, alternative form of family entertainment.

4. 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). In 2007, the sector was characterized by consolidation. No further mergers took place in 2008, and three large companies continue to 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 will therefore have trouble sustaining high levels of growth in the coming years. The companies in the sector are therefore currently focusing on increasing the average income per subscriber and less on increasing the number of subscribers.

Households and Private Consumption

The upward trend in GDP per capita in recent years reversed itself during the second half of 2008. During the last quarter of 2008, there was a moderate increase of 0.3% in per capita private consumption of perishable goods, compared with the corresponding period in 2007. Per capita consumption of non-perishable goods dropped sharply at the rate of 18.4% compared to the corresponding period last year. As a result, per capita consumption declined during the second half of 2008. Looking forward, private consumption is expected to weaken in the coming year as a result of the consumers' lack of employment confidence and of declines in the value of the portfolio of financial assets held by the public.

Mortgages - housing loans

The drop in the unemployment rate and the improvement in the standard of living in recent years, along with declines in interest rates, had led to increased demand for mortgages. The halt in growth during the second half of 2008 unsettled the sense of employment confidence of apartment purchasers, and led to a significant drop in the demand for new mortgages. In addition, credit providers have toughened their credit policy and raised the requirements for own funds in relation to the size of loans. The combination of these two factors is expected to lead to a decline in new credit for housing in 2009.

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 2008		
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**	**5.8**	**16.5**
80	600	**14.6**	**18.8**	**12**
600	1,200	**1.1**	**6.4**	**2.6**
1,200	2,000	**0.3**	**3.1**	**1.5**
2,000	8,000	**0.4**	**9.0**	**5.7**
8,000	20,000	**0.1**	**8.3**	**6.4**
20,000	40,000	**0.05**	**8.1**	**4.8**
40,000	200,000	**0.04**	**17.1**	**22.7**
200,000	800,000	**0.01****	**15.3**	**15.7**
Above 800,000		**0.0****	**8.1**	**12.1**
Total		**100**	**100**	**100**

		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	16.6
80	600	12.8	19.6	11.1
600	1,200	0.9	5.8	2.4
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	6.9
20,000	40,000	0.05	8.3	7.4
40,000	200,000	0.04	19.2	21.4
200,000	800,000	0.01**	14.1	16.6
Above 800,000		0.0***	5.2	10.4
Total		100.0	100.0	100.0

* After deducting the specific provisions for doubtful debts.
** In 2008 – 131 borrowers and in 2007 - 121 borrowers
*** In 2008 – 20 borrowers and in 2007 - 14 borrowers.
See Note 4 (F) to the Financial Statements for further details about the spread of credit according to size.

The following are details of the balances of credit to the public and of the off-balance sheet credit risk which exceed NIS 800 million per individual borrower based on a more detailed breakdown of credit areas and based on a breakdown of economic sectors, as of 31 December 2008:

1. Credit risk according to size of credit to the borrower

		Number of borrowers		**Balance sheet credit**		**Off-balance sheet credit**	
Credit ceiling in NIS millions		Total	Of this, related parties	Total	Of this, related parties	Total	Of this, related parties
From	To			In NIS millions			
800	1,200	**8**	**1**	**5,051**	**657**	**2,666**	**266**
1,200	1,600	**5**	**-**	**4,096**	**-**	**2,246**	**-**
1,600	2,000	**4**	**1**	**3,789**	**1,340**	**3,271**	**341**
2,000	2,400	**1**	**1**	**1,876**	**1,876**	**436**	**436**
2,400	2,800	**1**	**-**	**1**	**-**	**2,677**	-
2,800	3,200	**1**	**-**	**2,857**	**-**	**-**	**-**
Total		**20**	**3**	**17,670**	**3,873**	**11,296**	**1,043**

2. Credit risk according to economic sectors

	Total number of borrowers	Balance sheet credit	Off-balance sheet credit
	Total	Total	Total
		In NIS millions	
Industry	**7**	**5,723**	**6,265**
Construction and real estate	**4**	**2,883**	**995**
Trade	**1**	**1,876**	**436**
Communications and computer services	**2**	**2,645**	**341**
Financial services	**5**	**4,503**	**2,371**
Public and community services	**1**	**40**	**888**
Total	**20**	**17,670**	**11,296**

The indebtedness of the six largest groups of borrowers represented 10.1% of total credit risk at 31 December 2008 and 109.2% of the capital calculated for the limitation on the six largest groups of borrowers.

For additional details, see pages 189 to 190 of the Report.

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:

	2008	2007
	(NIS millions)	
Problem Loans[(1)]		
Non-performing	**2,012**	1,604
Restructured [(2)]	**405**	929
To be restructured [(3)]	**558**	85
In temporary arrears	**562**	764
Under special supervision*	**14,545**	9,618
Total balance sheet credit to problem borrowers [(1)]	**18,082**	13,000
Off-balance sheet credit risk to problem borrowers [(1) (5)]	**3,482**	2,438
Debentures of problem borrowers (members of the public and banks)	**614**	4
Other assets in respect of derivatives of problem borrowers	**612**	32
Total overall credit risk in respect of problem borrowers[(1)]	**22,790**	15,474
Assets received in respect of repaid credit	**302**	839
*of which: debts for which there is a specific provision [(4)]	**7,373**	4,672
*of which: credit for housing for which there is a provision according to the extent of the arrears	**505**	523

(1) Not including problem loans that are covered by collateral that is permitted to be deducted for the purpose of restrictions on the indebtedness 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 indebtedness 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, including debentures that are defined as problematic.

The increase in the volume of problem loans is the result of the global economic crisis, the deterioration of the condition of the economy, the negative impact on borrowers' repayment ability and the erosion in the value of collateral.

There was an increase of 51.2% 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 indebtedness of a borrower, another part of which has been defined as a problem loan under another classification ("resultant"). The sum of some NIS 3.6 billion out of the debts under special supervision is resultant and some NIS 10.9 billion is in accordance with decisions of Management.

Since 2006, Proper Banking Management Directive No. 325 "Management of Current Account Credit Lines" has been 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. On 5 January 2009, the Supervisor of Banks announced that the directive would not apply to excesses of up to NIS 5,000 for customers of branches located in the South of the country, in the region that was declared to be under special home front status until 30 June 2009. 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 100 million, and loans under special supervision by NIS 1,948 million. As a result, an additional provision, as defined in the Supervisor of Banks' directives, was made in the amount of NIS 8 million. In 2007, the volume of non-performing loans was NIS 87 million, the volume of loans under special supervision was NIS 1,830 million, and the additional provision was in the amount of NIS 7 million.

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 948 million at the end of 2008 (constituting some 0.30% of total credit risks), compared with NIS 875 million at the end of 2007 (some 0.29% 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 2008 totaled NIS 520 million, a decrease of NIS 122 million (19%) as compared with 31 December 2007.

Securities

The Group's investments in securities as at 31 December 2008 amounted to NIS 44,910 million, a decrease of NIS 2,259 million, a decline of 4.8%, compared with 31 December 2007; this was mainly as a result of the decrease in value of investments in securities.

Securities are classified into three categories: securities for trading, available-for-sale securities 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. 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 in "other overall profit", called "adjustments for presentation of available-for-sale securities at fair value" ("shareholders' equity") less the related tax, but whenever the decrease in value is of a non-temporary nature the difference is charged to the profit and loss statement. 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).

For details of accounting policy and the manner of valuing the securities portfolio and the difference between a temporary reduction in value and that of a non-temporary nature, see the Section "Accounting Policy on Critical Subjects" on pages 50 to 51 and Note 1(F) to the Financial Statements.

The following table sets out the classification of the securities item in the consolidated balance sheet as at 31 December 2008 in accordance with the above-mentioned rules:

	31 December 2008				
	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	**1,446**	**30**	**(1)**	**1,475**	**1,446**
Available-for-sale	**30,811**	**502**	**(1,923)**	**29,390**	**29,390**
For trading	**10,778**	**168**	**(196)**	**10,750**	**10,750**
	43,035	**700**	**(2,120)**	**41,615**	**41,586**
Shares and funds					
Available-for-sale	**2,790**	**430**	**(1)**	**3,219**	**3,219**
For trading	**457**	**-**	**(352)**	**105**	**105**
	3,247	**430**	**(353)**	**3,324**	**3,324**
Total securities	**46,282**	**1,130**	**(2,473)**	**44,939**	**44,910**

	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
	42,149	232	(549)	41,832	41,814
Shares and funds					
Available-for-sale	3,275	1,195	(34)	4,436	4,436
For trading	918	28	(27)	919	919
	4,193	1,223	(61)	5,355	5,355
Total securities	46,342	1,455	(610)	47,187	47,169

As at 31 December 2008, some 72.6% of the Group’s nostro portfolio was classified as available-for-sale securities and some 24.2% as securities for trading. This classification allows for flexibility in the management of the securities portfolio. Some 7.4% 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 which are traded on the stock exchange.

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

	2008	2007
	NIS millions	
Debentures redeemed and/or sold (held to redemption and available-for-sale)	**46,987**	36,362
Purchases of debentures held to redemption and available-for-sale	**45,615**	35,880
Net profit from investments in debentures:		
- financing income on accumulated basis	**914**	667
- profit (loss) from sale and from decrease in value of available-for-sale debentures	**(1,337)**	108
- profit (loss) realized and/or unrealized from adjustments to fair value of debentures for trading	**82**	(22)

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

	31 December 2008			31 December 2007		
	Govt. of Israel	**Foreign govts.**	**Other companies**	Govt. of Israel	Foreign govts.	Other Companies
	NIS millions					
Israeli currency:						
Unlinked	**9,422**	**-**	**42**	8,040	-	41
CPI-linked	**4,948**	**-**	**1,046**	4,993	-	1,462
Foreign currency including foreign currency-linked	**2,127**	**4,601**	**19,400**	1,760	1,973	23,545
Total debentures*	**16,497**	**4,601**	**20,488**	14,793	1,973	25,048

* of which NIS 2,546 million subordinated debentures.

In 2008 there was a decrease of some NIS 4.6 billion, some 18.2% in the Group's investments in corporate debentures, mainly in foreign currency debentures abroad. Some 50.7% of the debentures is invested in government debentures, mainly of the Israeli government.

See Note 3 to the Financial Statements for further details.

The following table sets out the value of securities according to the method of calculation in NIS millions:

	31 December 2008
Securities traded on an active market	**38,594**
Securities according to prices determined according to external models	**3,540**
Securities according to quotation from counterparty or to cost	**2,776**
Total	**44,910**

The available-for-sale portfolio

The following table shows the available-for-sale portfolio as at 31 December:

	2008		2007		Change	
	NIS millions					
	Abroad	In Israel	Abroad	In Israel	Abroad	In Israel
Debentures	**20,246**	**9,144**	24,451	8,641	(4,205)	503
Shares and funds	**1,260**	**1,959**	1,174	3,262	(86)	(1,303)
Total	**21,506**	**11,103**	25,625	11,903	(4,119)	(800)

a. In 2008, NIS 1,784 million was charged to shareholders' equity in respect of the available-for-sale portfolio, due to a decrease in value, compared with NIS 210 million in 2007.

b. In addition, NIS 1,337 million was charged to profit and loss in respect of losses from the sale of debentures and provisions defined as decreases in value of securities of a non-temporary nature, compared with NIS 108 million in 2007.

c. Further, losses of NIS 515 million were charged to profit and loss in respect of the sale and decrease in value of shares and funds, compared with profits of NIS 218 million in 2007.

d. The following table shows a summary of the above results in respect of the available-for-sale portfolio (including financing income).

	2008	2007
	NIS millions	
Profits (losses) in respect of securities which were charged to profit and loss	**(772)**	355
Adjustments for decrease in value of securities in shareholders' equity	**(1,784)**	(210)

e. The following table shows net balances in shareholders' equity (net adjustments in respect of available-for-sale securities before tax):

	31 December 2008	**30 September 2008**	31 December 2007	**Movement 4th Quarter**	**Year 2008**
	NIS millions				
Shares	**429**	243	1,161	**186**	**(732)**
Israel government debentures	**434**	14	20	**420**	**414**
Foreign government debentures	**9**	3	1	**6**	**8**
Other debentures	**(1,864)***	(1,522)	(387)	**(342)**	**(1,477)**
Other credit instruments	**(27)**	(35)	(30)	**8**	**3**
Total	**(1,019)**	(1,297)	765	**278**	**(1,784)**
Related tax	**371**	471	(263)	**(100)**	**634**
Net total	**(648)**	(826)	502	**178**	**(1,150)**

* of which as at 31 December 2008, NIS (69) million in mortgage-backed securities, compared with NIS (61) million as at 30 September 2008 and NIS (47) million at the end of 2007.

The accumulated net balance of adjustments to fair value of securities held in the available-for-sale portfolio, as at 31 December 2008, totaled the negative amount of NIS 648 million (after the effect of taxes) compared with the positive amount of NIS 502 million at the end of 2007. These amounts represent losses/profits which had not been realized at the dates of the Financial Statements.

According to the rules for calculating capital adequacy, the balance in respect of adjustment of securities to fair value does not affect the calculation of the capital for the purpose of the minimum capital ratio, except for net unrealized losses from adjustments to fair value of available-for-sale shares, less the effect of taxes.

The large decline in value in the debentures item relates mainly to the decrease in value of debentures issued by foreign banks, a total of NIS 1,281 million, and NIS 104 million in respect of Israeli debentures, compared with NIS 208 million and a positive capital fund in the amount of NIS 6 million respectively in 2007.

Declines in value of available-for-sale securities which were charged to shareholders' equity:

		Duration of decline in value since commencement of the decline				
		Up to 6 months	6-9 months	9-12 months	More than 12 months	Total amount
		NIS millions				
Rate of decline						
Up to 10%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**6**	**4**	**4**	**69**	**83**
	Other debentures	**45**	**40**	**51**	**203**	**339**
	Total	**51**	**44**	**55**	**272**	**422**
10%-20%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**11**	**-**	**-**	**43**	**54**
	Other debentures	**87**	**9**	**135**	**428**	**659**
	Total	**98**	**9**	**135**	**471**	**713**
20%-30%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**-**	**-**	**-**	**63**	**63**
	Other debentures	**35**	**18**	**99**	**382**	**534**
	Total	**35**	**18**	**99**	**445**	**597**
30%-40%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**-**	**-**	**-**	**-**	**-**
	Other debentures	**42**	**-**	**77**	**50**	**169**
	Total	**42**	**-**	**77**	**50**	**169**
Above 40%	Shares	**-**	**-**	**-**	**1**	**1**
	Asset-backed debentures	**-**	**-**	**-**	**1**	**1**
	Other debentures	**2**	**5**	**4**	**10**	**21**
	Total	**2**	**5**	**4**	**12**	**23**
Total amount	Shares	**-**	**-**	**-**	**1**	**1**
	Asset-backed debentures	**17**	**4**	**4**	**176**	**201**
	Other debentures	**211**	**72**	**366**	**1,073**	**1,722**
Overall total		**228**	**76**	**370**	**1,250**	**1,924**

For the treatment of the evaluation of securities and the distinction between a decline in value of a temporary nature and that of a non-temporary nature, see pages 50 to 51above.

With regard to the available-for-sale portfolio, during the period from the end of December 2008 until the end of February 2009, there was an increase in the negative amount in the capital fund of some NIS 476 million.

The trading portfolio

The following table shows the composition of the trading portfolio as at 31 December:

	2008		2007		Change	
	NIS millions					
	Abroad	In Israel	Abroad	In Israel	Abroad	In Israel
Debentures	**4,869**	**5,881**	1,802	5,339	3,067	542
Shares and funds	**105**	**-**	919	-	(814)	-
Total	**4,974**	**5,881**	2,721	5,339	2,253	542

In respect of trading debentures, realized and unrealized profits in the amount of NIS 82 million were recorded in the profit and loss statement, compared with losses in the amount of NIS 22 million in 2007, and in respect of shares and funds, realized and unrealized losses were recorded in the amount of NIS 528 million, compared with NIS 2 million in 2007.
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1. Investments in Securities Issued Abroad

The Group's securities portfolio includes some NIS 26.5 billion (some US$ 7.0 billion) of such securities, all of which (but for 3.1%) are investment grade securities, of which some 95% are rated 'A-' and above, of which some 30% are rated 'AAA', of which NIS 2,546 million is subordinated debentures. Of the said portfolio, some NIS 21.5 billion (some US$ 5.7 billion) is classified in the available-for-sale securities portfolio, and the balance in the securities for trading portfolio.

The following table shows the composition of investments in securities issued abroad:

	2008		2007	
	Available-for-sale portfolio	Trading portfolio	Available-for-sale portfolio	Trading portfolio
	NIS millions			
Government debentures	**2,175**	**3,707**	2,682	194
Debentures of banks and financial institutions	**11,240**	**472**	9,725	812
Asset-backed debentures	**4,211**	**207**	6,270	390
Other debentures	**2,620**	**483**	5,774	406
Shares and funds	**1,260**	**105**	1,174	919
Total	**21,506**	**4,974**	25,625	2,721

The fair value is based on prices received from external sources. The value of most of the portfolio is calculated each month by a recognized international institution ("The Financial Times"), which carries on the business of calculating the fair value of financial assets for the purpose of disclosure in financial statements. This institution is independent of both the issuing entities and the marketing entities. The calculation is based mainly on the prices of transactions on active markets. The CLO portfolio, which constitutes a comparatively small part of the securities portfolio, is valued by a professional external entity, whose business is the valuation of this type of instrument. Since there is no active market in these instruments, the evaluation is based on a model. The Bank validated the model and ensured, to a reasonable degree of certainty, the accuracy of the fair value. The validation includes, *inter alia*, an examination of the systemic-logical connection between the data and the evaluation, with reference to factors material to the evaluation and the validity of the data and the parameters on which the evaluation was based. Internal models were not used for the purpose of evaluating securities.

According to generally accepted accounting principles, a temporary decline in value in the available-for-sale securities portfolio is charged to shareholders' equity, while a decline in value which is of a non-temporary nature is charged to the profit and loss statement.

For details of the accounting policies see pages 50 to 51.

The Management of the Bank estimates that the decline in the value of the available-for-sale portfolio is mostly temporary in nature. From the time the investments were made, the Bank's intention was to hold them until maturity. The Bank intends, and is able, to continue to hold the investments until the expected return of the full cost of the assets or until maturity. Therefore, the decline in value is charged against shareholders' equity. The total decline charged to shareholders' equity in respect of securities issued abroad, from the date of purchase until 31 December 2008, amounts to some NIS 1,341 million (some NIS 847 million after taxes).

In addition to the temporary decline in value which was charged to shareholders' equity, an amount of some NIS 1,293 million was charged to the profit and loss account in 2008, of which NIS 712 million was in the fourth quarter.

The following table shows the fair value of debentures of banks and financial institutions abroad (excluding asset-backed securities):

	AAA to AA-	A+ to A-	BBB+ to BBB	BB+ to B-	Below B-	Unrated	Total
	NIS millions						
Euro bloc*	662	2,983	133	-	-	5	3,783
United Kingdom	823	531	36	-	-	-	1,390
Germany	-	738	42	-	-	-	780
USA	1,291	4,307	65	-	107	4	5,774
Other	1,125	878	32	-	4	-	2,039
Total	3,901	9,437	308	-	111	9	13,766

*excluding Germany

1.1 Investments in foreign asset-backed securities

The Group's securities portfolio includes some NIS 4.4 billion (some US$ 1.2 billion) of asset-backed securities (both mortgage-backed and non-mortgage-backed), all of which (save for 2.5%) are rated 'A-' and above, of which some 97% are rated 'AAA'. Of the said portfolio, some NIS 4.2 billion (some US$ 1.1 billion) is classified in the available-for-sale portfolio, and the balance in the securities for trading portfolio.

The following table shows a summary of investments in asset-backed securities in the available-for-sale portfolio as at 31 December 2008:

	Cost	Unrealized profits	Unrealized losses	Balance sheet value (fair value)
	NIS millions			
MBS - mortgage-backed securities	**3,377**	**15**	**(84)**	**3,308**
ABS-asset-backed securities (other than mortgage-backed)	**1,020**	**-**	**(117)**	**903**
Of which: CLO	**790**	**-**	**(100)**	**690**
SCDO	**122**	**-**	**(10)**	**112**
Other	**108**	**-**	**(7)**	**101**
Total	**4,397**	**15**	**(201)**	**4,211**

For the definition of asset-backed securities see Note 3 to the Financial Statements.

The Group's available-for-sale securities portfolio of foreign asset-backed securities as at 31 December 2008 includes investments in mortgage-backed securities in the total amount of some NIS 3.3 billion. 97.8% of the mortgage-backed securities in the available-for-sale portfolio are guaranteed or directly issued by United States federal agencies, (FNMA, FHLMC). These agencies have come under governmental protection under the U.S. administration's rescue plan. This portfolio includes sub-prime mortgage-backed securities in the amount of NIS 3.8 million (US$ 1.0 million).

As at 31 December 2008, the accumulated net decline in value charged to shareholders' equity resulting from the mortgage-backed securities portfolio was some NIS 69 million.

The total of the mortgage-backed securities that are not (U.S.) government guaranteed and are not backed by American federal entities in both the available-for-sale and trading portfolios, amounts to some NIS 185 million.

The projected term to maturity for all the mortgage-backed securities portfolio is 4.5 years, on average.

In addition to the mortgage-backed securities, the Group's available-for-sale portfolio also includes other securities that are backed by assets other than mortgages (car financing credit and other types of credit), in the amount of some NIS 0.9 billion. All these securities, save for 6.9%, are rated 'A-' and above, of which 56% are rated 'AAA'. This portfolio includes, *inter alia,* SCDOs in the amount of some NIS 112 million, CDOs in the amount of some NIS 26 million and CLOs in the amount of some NIS 690 million. The projected term to maturity of the portfolio of securities that are backed by assets other than mortgages is some 6 years on average.

The Management of the Bank estimates, and on the basis of examination according to the criteria detailed on pages 50 to 51, that the decline in the value of the portfolio of securities that are backed by assets other than mortgages is partly of a temporary nature. This part was charged to shareholders' equity. As at 31 December 2008, the decline in value charged to shareholders' equity attributed to the portfolio of securities backed by assets other than mortgages totaled some NIS 117 million (some NIS 74 million after tax).

The total of asset-backed securities of the SDCO type amounted to NIS 112 million. The amount in respect of a decrease in value of NIS 341 million was charged to the profit and loss statement in respect of this portfolio.

The total of asset-backed securities of the CLO type amounted to NIS 690 million. The amount of NIS 100 million was charged to shareholders' equity in respect of these securities, and a decrease in value in the amount of NIS 435 million was charged to the profit and loss statement.

The charge to profit and loss in respect of these two portfolios was made on the basis of the policy detailed in the principal accounting policies section on pages 50 to 51, although as at the date of publication of this Report, there has been no credit failure, neither in the SCDO-type asset-backed securities nor in the CLO-type asset-backed securities.

The securities for trading portfolio includes investments in asset-backed securities through portfolio managers in the amount of some NIS 207 million (US$ 54 million), of which some NIS 169 million is invested in mortgage-backed securities and some NIS 38 million is invested in other asset-backed securities. This portfolio includes securities that are backed by sub-prime mortgages in the amount of NIS 16.7 million (US$ 4.4 million) 74% of which are rated 'AAA' and the balance 'AA'. Any difference which may arise between fair value and the adjusted cost is charged to the profit and loss statement.

During the second quarter of 2008, the Bank reduced most of its holdings (some two-thirds of this portfolio) in off-balance-sheet corporate CDS derivatives at an immaterial loss. The balance of corporate CDS held at 31 December 2008 was the amount of NIS 209 million. An evaluation of these instruments on the basis of fair value was recorded directly in profit and loss.

With respect to the investment in CDS, declines in value in the amount of some NIS 109 million were recorded in the profit and loss statement during the 2008. In the fourth quarter of the year, income of NIS 25 million was recorded.

For the definition of asset-backed securities see Note 3 to the Financial Statements.

1.2 Investments in other (non asset-backed) foreign securities

The Group's securities portfolio as at 31 December 2008 includes some NIS 22.6 billion (some US$ 5.9 billion) of non-asset-backed securities, which include mainly securities issued by banks and financial institutions, the balance being securities issued by the governments of the USA, France and Israel, and securities of Israeli companies that were issued abroad. Of these securities, NIS 17.3 billion (US$ 4.5 billion) are classified in the available-for-sale portfolio, and some NIS 4.7 billion in the securities for trading portfolio. Of these securities, 96% are rated 'A-' or above, of which 17% are rated 'AAA'.

The distribution of these securities among the various countries in which they were issued is as follows: United States, European Union countries of the Euro Bloc (Germany, France, Spain, Italy, and the Benelux states), the United Kingdom and other countries. The projected term to maturity of these securities is some 3.2 years, on average.

For further details regarding exposure to overseas banks and financial institutions see page 205.

The Bank estimates that the decline in the prices of these securities is mostly of a temporary nature, and most of the decline in value was therefore charged to shareholders' equity. This is based on the criteria described on pages 50 to 51 under principal accounting policies and takes into consideration additional parameters such as the involvement and backing – including direct capital investment – of governments for insuring the strength of these and other banks in their countries, and market expectations regarding the risk of bank failures, as expressed in the prices of the credit derivatives (CDS).

As at 31 December 2008, the decrease in value charged to shareholders' equity in respect of non-asset-backed securities issued abroad in the available-for-sale portfolio totaled NIS 1,272 million (NIS 804 million after tax).

For further details of shareholders' equity see page 91.

In addition to the temporary decline in value which was charged to the shareholders' equity, NIS 552 million (NIS 349 million after tax) was charged to the profit and loss statement with respect to these securities in the available-for-sale portfolio. These amounts include the provisions made in respect of the Leumi Group's exposure to Lehman Brothers and to the Washington Mutual Group. In September 2008, the Bank reported on its exposure to Lehman Brothers in the amount of US$ 88 million and on the non-receipt of an additional amount of some US$ 100 million, in respect of a redeemed certificate, and on its exposure in the amount of some US$ 50 million to Washington Mutual. The Bank has taken legal steps to attach assets of companies in the Lehman Group in Israel.

In addition to those in the available-for-sale portfolio, there are also non-asset backed securities in the trading portfolio. The trading portfolio includes mainly securities of banks and financial institutions, and securities portfolios that are managed by external investment managers, and securities funds. All the securities in the trading portfolio are investment grade securities, and some 2.5% of them are rated 'A' and above. The value of the trading portfolio as at 31 December 2008 amounted to NIS 4.8 billion (US$ 1.3 billion). The difference between the fair value and the adjusted cost, to the extent there is such, is charged to the profit and lost statement. The activity in this portfolio in the first months of 2009 did not produce a substantial profit or loss.

2. Investments in corporate debentures issued in Israel

Investments in debentures issued in Israel amounted to NIS 15.9 billion on 31 December 2008, of which NIS 14.6 billion was in debentures issued by the government of Israel, and the balance of NIS 1.3 billion was in corporate debentures. Of the corporate debentures, 9.1% are rated 'A-' and above, of which 63% are rated 'AA' and above. The investments in the corporate debenture portfolio are spread among various branches of the economy. The largest investment, some 18%, is in the real estate sector. On 31 December 2008, investments in corporate debentures amounted to NIS 0.9 billion in the available-for-sale portfolio, and the balance was in the trading portfolio.

All the corporate debentures in the trading portfolio and part of those in the available–for-sale portfolio are listed and traded on the Stock Exchange. Some 60% of the corporate debentures in the available-for-sale portfolio are not listed. The evaluation of the listed corporate debentures is based on market prices on the stock exchange, and the non-listed corporate debentures are valued by a professional entity which carries on business as a valuer. Since there is no active market in these debentures, the evaluation is based on a model. The Bank validated the model and ensured, to a reasonable degree of certainty, the accuracy of the fair value. The validation includes, *inter alia*, an examination of the systemic-logical connection between the data and the evaluation, with reference to factors material to the evaluation and the validity of the data and the parameters on which the evaluation was based, including specific reference to the results of the model of the “Sha’arei Ribit” company, which values these assets for use in the financial statements of financial institutions.

The test for determining whether a decline in value of a debenture in the available-for-sale portfolio is of a non-temporary nature is based primarily on the criteria set out in accounting policy in Note 1 (F) to the Financial Statements and on pages to 50 to 51of the Directors Report.

Out of the total amount of NIS 927 million in the corporate debenture portfolio in the available-for-sale portfolio, some 18.6% of the portfolio had decreased in value by over 20% as at 31 December 2008. The total decrease in value amounted to NIS 195 million, of which a decrease in value of a temporary nature in the amount of NIS 110 million was charged to shareholders' equity and the balance of NIS 117 million was charged to profit and loss. The Bank estimates that the decline in the value of the corporate debentures portfolio is mainly of a temporary nature, on the basis of an individual examination of each debenture. The assessment of the companies' repayment ability was found to be satisfactory, all have relatively high investment ratings, and the declines in value have mostly developed in recent months, due to the global financial crisis. The Bank intends, and is able, to continue to hold the debentures until the restoration of their value and even until maturity.

3. Investments in shares and funds

Total investments in shares and funds amounted to some NIS 3,324 million on 31 December 2008, of which NIS 2,061 million was in listed shares and NIS 1,263 million was in non-listed shares. Of the total investment, NIS 3,219 million is classified as available-for-sale and NIS 105 million is classified in the trading portfolio.

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

	The Bank's share on a consolidated basis in the paid up capital giving the right to receive profits		Value of the investment in the consolidated balance sheet	
	31 December 2008	31 December 2007	**31 December 2008**	31 December 2007
	%		NIS millions	
Migdal Insurance and Financial Holdings Ltd. [(2)]	**9.85**	9.89	**411**	619
Gibor Sport Ltd.	**-**	4.3	**-**	3
Africa Israel Properties Ltd.	**4.3**	4.3	**15**	120
Cellcom Israel Ltd [(3)]	**-**	2.23	**-**	267
Super-Pharm (Israel) Ltd. [(4) *]	**18.0**	18.0	**182**	182
Hot – Cable Communications Systems Ltd. [(5)]	**14.96**	14.96	**239**	637
Otzar Hityashvuth Hayehudim B.M.	**8.62**	8.64	**29**	95
Bezeq – Israel Communications Company Ltd. [(6)]	**4.23**	4.23	**683**	754
Union Bank of Israel Ltd. [(7)]	**6.46**	6.46	**101**	99
Tower Semiconductor capital notes [(8)]	**-**	-	**49**	164
Visa International	**-**	-	**27**	-
CLS Bank	**-**	-	**21**	-
Funds[(9)]	**-**	-	**991**	907
Apax	**-**	-	**56**	54

* not listed

(1) See pages 142 to 143 for details of non-banking investments presented on the equity basis.

The following table shows investments (positions) in shares and funds in the securities item (available-for-sale portfolio and trading portfolio) (in NIS millions):

	Balance sheet amount	
	2008	2007
Listed shares	**1,718**	3,765
Funds according to quote by counterparty	**988**	907
Unlisted shares	**618**	683
Total	**3,324**	5,355

(2) For additional details see pages 143 to 144.

(3) In September 2008, Leumi Partners Ltd., (a wholly owned subsidiary of the Bank) sold the balance of its holdings in Cellcom Israel Ltd., for total consideration of NIS 237 million.

(4) **Super-Pharm**

On 17 July 2007, the allotment of 18% of the shares of Super-Pharm (Israel) Ltd. ("Super-Pharm") to Leumi Partners Ltd. was completed, pursuant to an agreement signed on 1 May 2007 between Leumi Partners Ltd. 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 Partners Ltd. for a consideration of some NIS 180 million, subject to adjustments laid down in the agreement. In addition, Leumi Partners Ltd. was granted an option for the allotment of a further 2% of the share capital of Super-Pharm. Leumi Partners Ltd. was granted standard minority protection rights.

(5) **Hot - Cable Communications Systems Ltd.**

In the framework of the completion of the merger in 2006 of the activities of the cable television companies, the Bank and additional banks received shares in the merged company, Hot-Cable Communications Systems Ltd ("Hot"). The Bank holds 14.96% of the merged company.

On 4 May 2008, the Bank signed an agreement with Netvision Ltd. ("Netvision") for the sale of the Bank's parcel of shares in Hot for a consideration of some NIS 480 million.

Completion of the transaction was postponed until 30 September 2008, and was dependent on the fulfillment of conditions precedent. On 30 October 2008, Netvision gave notice of the cancellation of the above-mentioned agreement, because the permits required by law for the completion of the transaction had not been received.

(6) 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. Adjustments to market value in the sum of NIS (70) million were recorded in shareholders' equity in 2008 in respect of these shares and the aggregate balance as at the end of 2008 amounted to NIS 181 million. Total dividends received in 2008 in reduction of the debt amounted to NIS 63 million, and in 2007, to NIS 120 million.

(7) **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 2008, the Bank held 6.46% of Union Bank's shares.

For further details in respect of the above-mentioned agreement see Note 18 K to the Financial Statements.

(8) For further details, see page 123.

(9) Most investments in funds were realized in 2008, and the consideration was received in 2009.

Securities Pledge

The Bank is a member of the Stock Exchange Clearing House Ltd. and of 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 2008, the Bank had pledged debentures having a value of NIS 1.5 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 2008 was NIS 151 million.

On 23 July 2007, the Bank signed a debenture in favor of the Bank of Israel as security for amounts due or that will be due to the Bank of Israel from the Bank. As collateral for the above, the Bank created a floating charge in favor of the Bank of Israel, unlimited in amount, over debentures deposited in a specific account maintained at the Tel Aviv Stock Exchange Clearing House in the name of the Bank of Israel. The balance of the account as at 31 December 2008 was NIS 2.4 billion.

As at 31 December 2008, the Bank had no outstanding credits from the Bank of Israel while the balance of the Bank's deposits with the Bank of Israel amounted to NIS 13.3 billion.

Other assets

At the end of 2008, other assets amounted to NIS 13.5 billion, compared with NIS 7.7 billion at the end of 2007, an increase of some 76.8%. (At the Bank, the increase was 86.9%.) The increase in this item resulted from an increase in the balance of the fair value of derivative instruments of some NIS 5.1 billion, from an increase in receivable deferred taxes of some NIS 480 million, and a surplus of pre-payments of income tax in the amount of some NIS 639 million.

Fixed Assets and Installations

Buildings and Equipment - the cost after depreciation of buildings and equipment as at 31 December 2008 amounted to NIS 3,445 million, compared with NIS 3,276 million as at 31 December 2007.

The investments in buildings and equipment as at 31 December 2008 are as follows:

	Cost	Accumulated Depreciation	Balance for Depreciation	
			31 December 2008	31 December 2007
	NIS millions			
Buildings and land	**3,163**	**1,566**	**1,597**	1,577
Equipment, furniture and vehicles	**5,680**	**3,832**	**1,848**	1,699
Total	**8,843**	**5,400**	**3,445**	3,276

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 as at 31 December 2008 amounted to NIS 29 million.

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 256,500 sq.m., is divided into branches - some 82,945 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 5,300 sq.m. as of 31 December 2008, and are presented according to the lower of depreciated cost or realization value.

Investment in buildings in 2008 totaled NIS 135 million (including property purchases in the amount of NIS 13.6 million) compared with NIS 109 million in 2007 (including property purchases of NIS 12 million). In addition to property owned by the Bank, the Bank leases 187 properties under unprotected leases and 10 properties under protected leases. Total property leased constitutes some 64,000 sq.m.

"Keshev" – "The Yitzhak Rabin Bank Leumi Service Center". "Matam" – the computer, operations 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 1.96 million including VAT (as at 31 December 2008).

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 7,103 mips and a second computer with an operating power of some 471 mips. The secondary production computer is expandable to a capacity of some 7,103 mips for internal back-up purposes in the Keshev facility.

One computer, with an operating power of some 2,633 mips, operates at the Tel Aviv facility, and serves as the development and testing environment. This computer is expandable to a capacity of some 6,567 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 416 TB (terra-bytes, a measurement of storage capacity). The storage volume of the mainframe computer environment is some 54 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 and includes some 1,850 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. Some 4% of the WIN servers use virtualization technology.

The Bank has a database of historical data stored on disks and tapes manufactured by XIV and IBM, 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 313 servers and some 7,200 work-stations, mostly PC-based, have been installed in the branches. There are 311 innovative automatic teller machines and some 545 self-service "Leumi Information" stations (333 stations in the branches and 212 external information stations in the walls of branches). 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. During the years 2008-2009, the Bank will be upgrading the network of "Leumi Information" customer stations with new and advanced equipment.

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 219 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 together with the overseas subsidiaries, the Bank is improving and 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 communication 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 2008-2009, involving the upgrading of the Bank's international communications network for the Bank's US and 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 2008, the Group invested some NIS 601 million in equipment, as compared with NIS 591 million in 2007. 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 2008 were designed for the benefit of the customers, to increase their satisfaction, reinforce their loyalty and to prevent their leaving. The major investment in 2008 (as in 2007) 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.)

The Bank has also issued a tender for the establishment of an internet-based sub-custody system for customers. A supplier has been chosen and the customization of the system has begun. Development will continue in 2009.

In 2008, a new direct internet banking system for retail customers was put into place as part of the infrastructure for all segments of the Bank.

During the course of 2008, a new content management system for the Bank's overseas subsidiaries was put into place, as part of the infrastructure for all Bank websites. The system is used for the establishment of marketing websites for the Group on the internet.

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 121 million in 2008 (some NIS 109 million in 2007). The principal issues were tax reform, implementation of the Commissions Law, payments and clearing systems and the information technology directives. In 2008, 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 (activity in foreign currency began in February 2008, and in shekels in May 2008) (see above on pages 41 to 42 of the Report), the 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, and the pension and financial counseling system was put into operation in 2008.

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 Israel Standards Institute, 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 estate and procurement department.

The Real Estate and Procurement Department 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 Estate and Procurement Department with a "gold label" which was presented in a festive ceremony of the Standards Institute during the fourth quarter of 2008.

The Data Management and Security Section has been certified as being in compliance with ISO 27001 (the data security standard) by the Israel Standards Institute.

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.

Operational Segments in the Group

This chapter describes the business development according to operational segments.

For a description of the methodology of the operational segments, see above pages 17 to 20.

Up until 2007, the construction and real-estate segment was presented as a separate segment. Beginning from 2008, the sector was reclassified under other segments and is now presented as a product in each of the segments where such activity takes place. In addition, the activities of Leumi USA were transferred from the corporate banking segment to the commercial banking segment. The comparative data for 2007 were adjusted accordingly.

Following are principal data according to operational segments of the principal balance sheet items as at 31 December:

	Credit to the Public			Deposits of the Public			Total Assets		
	2008	2007*	Change	**2008**	2007*	Change	**2008**	2007*	Change
Segments	NIS millions		%	NIS millions		%	NIS millions		%
Households(1)	**62,145**	56,812	9.4	**120,846**	115,802	4.4	**62,775**	57,476	9.2
Small businesses(2)	**18,161**	18,232	(0.4)	**14,475**	14,428	0.3	**18,183**	19,093	(4.8)
Corporate banking(3)	**76,563**	64,129	19.4	**23,111**	24,382	(5.2)	**79,962**	67,548	18.4
Commercial banking(4)	**48,506**	50,942	(4.8)	**29,659**	30,317	(2.2)	**49,989**	52,321	(4.5)
Private banking	**6,438**	7,138	(9.8)	**38,057**	40,916	(7.0)	**10,708**	10,791	(0.8)
Financial management – capital markets and others	**1,402**	1,304	7.5	**18,635**	12,200	52.7	**89,175**	94,922	(6.1)
Total	**213,215**	198,557	7.4	**244,783**	238,045	2.8	**310,792**	302,151	2.9

* Reclassified.

(1) Credit to households also includes housing loans (mortgages). After neutralizing this credit, credit (banking and financial) to households increased by 6.5%. Housing loans amounted to NIS 40.6 billion at the end of 2008, having increased by 11%. (The rate of increase in 2007 was 15.8%.)

(2) After neutralizing the effect of segmentation between the segments, there was an increase of 6.5%.

(3) There was an increase of some NIS 13 billion in credit in the corporate banking segment in activities in Israel, and an increase of 19.4% overall, or 15.0% after neutralizing the effect of segmentation.

(4) After neutralizing the effect of segmentation between the segments, there was a decrease of 0.1% only.

Following are principal data according to operational segments of off-balance sheet items and data on customers' balances in the capital market:

	Guarantees and Documentary Credit			Securities Portfolios, including Mutual Funds		
	2008	2007*	Change	**2008**	2007*	Change
Segments	NIS millions		%	NIS millions		%
Households	**568**	563	0.9	**66,648**	79,448	(16.1)
Small businesses	**1,219**	1,172	4.0	**3,562**	6,669	(46.6)
Corporate banking	**21,319**	20,153	5.8	**52,090**	84,377	(38.3)
Commercial banking	**7,136**	7,317	(2.5)	**35,659**	48,084	(25.8)
Private banking	**391**	962	(59.4)	**60,504**	73,048	(17.2)
Financial management – capital markets and others	**390**	670	(41.8)	**79,050**	113,060	(30.1)
Total	**31,023**	30,837	0.6	**297,513**	404,686	(26.5)

* Reclassified

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(1)		
	2008	2007(2)	Change	**2008**	2007(2)	Change
Segment	NIS millions		%	NIS millions		%
Households (3)	**852**	935	(8.9)	**650**	657	(1.1)
Small businesses	**260**	197	32.0	**242**	168	44.0
Corporate banking	**303**	1,049	(71.1)	**301**	1,031	(70.8)
Commercial banking	**281**	520	(46.0)	**255**	504	(49.4)
Private banking	**116**	199	(41.7)	**113**	193	(41.5)
Financial management – capital markets and others	**(1,275)**	622	–	**(1,274)**	596	–
Total	**537**	3,522	(84.8)	**287**	3,149	(90.9)

(1) After neutralizing special salary expenses, as detailed above on page 62.
(2) Reclassified.
(3) The profit from extraordinary items in 2008, which derived from the allotment of share capital of Leumi Card, and, in 2007, from the sale of the provident fund operations, was attributed to each operational segment according to the segment's share. In 2008, some NIS 202 million, and in 2007, some NIS 278 million.

For further details, see Note 28 to the Financial Statements.

Return on Equity According to Operational Segments

Bank of Israel directives require calculation of the return on equity that is to be allocated to each operational segment.

Tier I capital was allocated among the segments according to each segment's relative share of the Group's total risk assets.

The operational segments were 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 I 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			
	2008	2007	**2008***	2007*	**2008**	2007	**2008***	2007*
Segment								
Households	**19.7**	22.1	**20.6**	24.5	**14.9**	14.9	**15.7**	17.2
Small businesses	**20.7**	15.4	**21.3**	17.3	**19.2**	12.8	**19.9**	14.8
Corporate banking	**4.5**	16.5	**4.6**	16.7	**4.4**	16.2	**4.6**	16.4
Commercial banking	**6.9**	12.2	**7.2**	12.7	**6.3**	11.8	**6.5**	12.3
Private banking	**19.0**	33.4	**19.5**	34.7	**18.5**	32.4	**19.0**	33.6
Financial management – capital markets	**(47.6)**	14.0	**(35.2)**	14.6	**(47.6)**	14.0	**(35.2)**	14.6
Others	**(44.3)**	41.9	**(44.3)**	41.7	**(44.0)**	36.3	**(44.0)**	36.0

The data for 2007 was reclassified.
* After neutralizing special salary expenses.

The following table presents the quarterly development of the net operating profit according to operational segments, after neutralizing special salary expenses:

	2008				2007*			
	4th quarter	**3rd quarter**	**2nd quarter**	**1st quarter**	4th quarter	3rd quarter	2nd quarter	1st quarter
	NIS millions							
Households	**134**	**206**	**154**	**156**	106	253	127	171
Small businesses	**(24)**	**82**	**85**	**99**	2	34	64	68
Corporate banking	**(146)**	**63**	**178**	**206**	197	255	311	268
Commercial banking	**(131)**	**119**	**84**	**183**	159	105	139	101
Private banking	**71**	**(19)**	**24**	**37**	69	50	32	42
Financial management – capital markets and others	**(974)**	**(322)**	**119**	**(97)**	38	255	263	40
Total	**(1,070)**	**129**	**644**	**584**	571	952	936	690

* Reclassified

The principal characteristics of the operational segments and their business activities as specified above are as follows:

(For the criteria for classifying customers according to operational segments, see page 18.)
For further details regarding activities of the principal subsidiaries and affiliates, see page 155 below.
A breakdown of the results of the operational segments is presented in Note 28 to the Financial Statements.

1. The Household Segment

General

Banking in the household segment provides a range of financial services and products to individual customers 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 pages 46 to 47.
The strategic objectives for banking in the household segment are to increase profitability by broadening the customer base and by 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:

– a systematic and constant focus on improving the **level of service** to the customer by upgrading employees' skills, and measuring and controlling the work procedures and customer interface;
– **broadening the availability of service to customers** by increasing the number of branches and adapting them to future banking needs, while integrating advanced automated instruments, and adapting them to the customers' various needs;
– **expanding the direct marketing channels**: advanced telephone and internet response services and instruments for self-service performance of financial operations;
– **developing financial products and services** by providing professional and objective counseling in relation to financial investment products and pension products that correspond to the needs of customers, while using data mining (CRM, DWH) and analytical models to analyze and forecast the customers' financial activities and needs;
– systematic, information-based **initiative** *vis-à-vis* customers in all operational segments: investments, pension counseling, consumer and commercial credit and current account services; improving the level of service in order to increase customer satisfaction and loyalty by creating advantages for groups of customers through differential service**;**
– **cooperation with companies in the Group,** such as Leumi Mortgage Bank and Leumi Card, in order to exploit the Group's abilities in providing comprehensive banking solutions to customers.

Pension Counseling

In August 2008, the Bank received a license to engage in pension counseling. The Bank began its counseling activities in September 2008, initially at a number of pilot branches. Upon completing the pilot, the Bank began offering this service in additional branches throughout Israel. Counseling is provided in accordance with the conditions laid down in its license. Counseling is provided by licensed pension counselors, who have been trained by the Bank (the majority of whom are licensed investment counselors), and who use counseling support systems developed by the Bank, with the assistance and validation of experts in the field. The Bank also defined work procedures tailored for pension counseling.
For further details, see page 36.

Structure of the Segment

Household banking segments its customers 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 the various distribution channels: 216 branches (including 12 counters and branches of the Arab Israel Bank Ltd.), located throughout the country and organized into eight districts on a geographical basis, and by means of direct/technological 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. All aspects of customer service are concentrated with these teams, who specialize in providing service according to the customer's characteristics and needs.
Service to these customers is multi-channel and is provided both by means of the broad distribution of branches, the Leumi Call center and via 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 Commissioner 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 and pension products to specific customers.
  These changes required 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 in new work procedures at the branches and headquarters.
  Additional legislative amendments enacted in 2008 in the field of pension savings oblige the Bank to modify and update the systems that support the pension counseling process.
– The Bank has been implementing the principles of the package deal for households since December 2005; additional changes came into effect in 2008 as a result of the enactment of an amendment to the Banking (Service to Customers) Law that is relevant mainly to this segment. For details regarding the amendment to the said law, see pages 39 to 40 above.

For further details, see pages 35 to 48.

Changes in the Markets of the Household Segment or in Customer Characteristics

The household segment is affected by changes in the demographic and economic data for the population of the State, by changes in private consumption and by customers' saving characteristics. In the second half of 2008, the growth rate began to slow, which was expressed, *inter alia*, by declines in the growth rates of per capita GDP and in expenditure for private consumption, compared with 2007.

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 automated-direct channels is expected to continue in 2009, with an emphasis on the telephone, cellular phones and the internet, and adaptation of these 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 are connected, and who perform most of their day-to-day activities in their accounts via the center.
An increase in activity is also expected in internet activity, through which thousands of operations are performed every day, as a result of technological improvements and adaptations of Leumi's websites to the different customer segments. Developments in computerization enable information on customer activity to be managed intelligently and efficiently. Advanced tools enable data mining and analysis for the purpose of developing products and services, and for tailoring services to customers.

Critical Success Factors in the Household Banking Segment

Critical success factors for banking in the segment are:

1. Maintaining pro-active service pursuant to the needs and wishes of the customers;
2. Efficiency: constant examination of retail operating costs against the benefits derived from them, and reduction of the cross subsidization between the various activities and populations;
3. Quality: abiding by the rules of consistent and methodical documentation, while strictly adhering to rules of compliance with consumer laws and regulations;
4. Provision of investment counseling and pension counseling services by making available suitable manpower and technological support;
5 Distribution and availability of points of sale and service: expanding the distribution of the branches and adapting operating hours to the region and type of population;

6. Broadening the exposure and availability of direct technological channels (internet and telephone) to customers and broadening the geographical distribution (ATMs).

Entry and Exit Barriers in the Household Banking 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 to competitors. The importance of the infrastructure increases as the regulatory requirements increase.
- The investment required in physical and technological infrastructure constitutes a barrier to both entry and exit.
- The development of analytical capabilities to effectively adapt solutions for customers based on historical data on customer activity and market behavior.
- The training of skilled human resources in the light of increasingly strict and frequently changing regulations.

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 may be purchased outside of the banks as well. The following are the main alternatives:

Consumer credit	–	credit card companies, retail food chains, insurance companies
Pension savings	–	pension marketers (insurance companies, companies managing provident funds, supplementary training funds, pension funds and insurance agents, private pension consultants)
Capital market	–	brokers, insurance companies, fund managers
Mortgages	–	contractors, construction companies, insurance companies.

Structure of the Competition

The competition is over the fundamental principles of success: the availability and correct usage of distribution channels, segmentation and understanding of customer needs, and efficiency.

Some of the banks take 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 the potential customer base for mortgages and for the opening of current accounts as well.

In addition, competition in retail banking has been developing in recent years from financial and other entities, primarily from credit card companies – while in the field of consumer credit, competition is developing from mortgage banks, insurance companies and retail marketing chains. The competition is created by entities that are not subject to supervision by the Bank of Israel (or that are not supervised at all) and that 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 banks in this segment.

In the field of pension counseling, the competition over customers is intense; competitors include insurance agents, pension arrangement managers and companies that manage their own pension funds.

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 multi-channel availability: via telephone, the internet and branches, in order to provide customers with an interface with the Bank for executing transactions and receiving information.

In the credit field, Leumi offers, *inter alia*, a product that enables customers to enjoy pre-approved loans via all of the self-service channels, including ATMs, according to their characteristics and needs. Customers are also 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 and savings schemes. The Bank also offers investment counseling and pension counseling services.

Customers

Leumi is able to offer its services with segmental adaptations 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 are in the field of investments.

For further details, see page 18.

Marketing and Distribution

The following information is "forward-looking information." For the meaning of this term, see pages 46 to 47.
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 for the Management. Leumi sees strategic importance in a broad distribution network. Nine new branches were opened during 2008 (including a counter), and six new branches are planned to be opened during the course of 2009 to serve customers of this segment.
In addition, emphasis is placed on offering service *via* a multitude of channels, while maintaining a uniform customer experience and level of service. The principal distribution channels of the household segment are the branch channel, while the direct channels (internet, Leumi Call and ATMs) are in a continuing growth trend, both for execution of transactions and for informational needs. The Bank also makes use of direct mailings, advertising on websites in general and on the Bank's websites in particular, and 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 of banking groups with external entities, and affect 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 capability, all of which enable Leumi to initiate and offer customers high-quality products and services.

Human Capital

In 2008, the average number of positions assigned to the household segment totalled 6,953, of which 1,555 were management staff, compared with 6,754 positions in 2007, of which 1,520 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 page146 below.

Housing Loans – Mortgages -– is a supplementary product to the package of services being provided to Leumi's customers, and to customers of other banks. These loans are provided by Leumi Mortgage Bank Ltd. ("Leumi Mortgage Bank"). Leumi Mortgage Bank has 81 representative offices operating in Leumi branches and 11 independent offices.

The majority of Leumi Mortgage Bank's activity is in mortgage loans for the purchase of residential apartments. Leumi Mortgage Bank offers a number of services, the purpose of which is to turn the process of taking out a mortgage into a simple process for the customer, such as "Running for You" and "Time Out from the Mortgage."

The policy of Leumi Mortgage Bank's Management is to continue focusing its activity in the loan segment for residential apartment purchases and in the loan segment using residential apartments as collateral.

During 2008, Leumi Mortgage Bank granted new loans (excluding refinancing) totalling some NIS 8.4 billion, compared with NIS 7.3 billion in 2007, a growth rate of some 15%.

The volume of refinancing at Leumi Mortgage Bank declined in 2008 to NIS 1,087 million (11.4% of the Bank's performance), compared with NIS 1,361 million in 2007.

In addition, these sums include NIS 303 million in credit granted from designated deposits, the payment of which is contingent upon the extent of collections, compared with NIS 349 million last year.

Leumi Mortgage Bank's aggregate share of the credit portfolio in the system as on 31 December 2008, according to the Bank of Israel's activity report, was 25.6%, compared with 25.9% in 2007.

The net profit in the mortgage sector totalled NIS 162 million in 2008, compared with NIS 248 million in 2007, a decrease of NIS 86 million.

The net interest income and the operating income decreased by NIS 25 million, from NIS 624 million in 2007, to NIS 599 million in 2008.

The provision for doubtful debts increased from NIS 39 million in 2007 to NIS 98 million in 2008.

Operating expenses amounted to NIS 238 million in 2008, similar to 2007.

For additional details on Leumi Mortgage Bank, see page 158 of the Report.

The following table presents data on performance of new loans provided and loans refinanced for the purchase of residential apartments, and of collateralization of residential apartments in the household segment:

	2008	2007	
	Annual Total	Annual Total	Change
	NIS millions		%
From bank funds	**9,250**	8,126	13.8
From Ministry of Finance funds:			
Directed loans	**221**	349	(36.7)
Non-recourse loans	**7**	8	(12.5)
Total new loans	**9,478**	8,483	11.7
Refinanced loans	**1,113**	1,541	(27.8)
Total performance	**10,591**	10,024	5.7

Following are condensed operating results of the household segment:

	Banking and finance	Credit cards	Capital market	Mortgages	Activity abroad	Total
	2008					
	NIS millions					
Net interest income (loss):						
From external sources	**(1,940)**	**161**	**4**	**2,093**	**(18)**	**300**
Intersegmental	**3,972**	**(43)**	**(3)**	**(1,630)**	**41**	**2,337**
Operating and other income:						
From external sources	**662**	**446**	**451**	**122**	**8**	**1,689**
Intersegmental	**1**	**222**	**–**	**14**	**–**	**237**
Total income	**2,695**	**786**	**452**	**599**	**31**	**4,563**
Provisions for doubtful debts	**214**	**18**	**–**	**98**	**10**	**340**
Operating and other expenses:						
To external sources	**2,167**	**469**	**265**	**221**	**29**	**3,151**
Intersegmental	**3**	**(13)**	**–**	**17**	**–**	**7**
Operating profit (loss) before taxes	**311**	**312**	**187**	**263**	**(8)**	**1,065**
Provision for taxes	**167**	**99**	**69**	**101**	**–**	**436**
Operating profit (loss) after taxes	**144**	**213**	**118**	**162**	**(8)**	**629**
Minority interests' share in profits of consolidated companies	**–**	**(13)**	**–**	**–**	**–**	**(13)**
Net operating profit (loss)	**144**	**200**	**118**	**162**	**(8)**	**616**
Profit from extraordinary items after taxes	**–**	**202**	**–**	**–**	**–**	**202**
Net profit (loss)	**144**	**402**	**118**	**162**	**(8)**	**818**
% Return on equity						**19.7%**
Average balance of assets	**15,313**	**5,984**	**81**	**38,639**	**302**	**60,319**
of which: investments in companies included on the equity basis	**-**	**8**	**-**	**-**	**-**	**-**
Average balance of liabilities	**108,455**	**439**	**–**	**12,000**	**1,023**	**121,918**
Average balance of risk assets	**13,409**	**5,899**	**78**	**32,507**	**309**	**52,202**
Average balance of mutual fund and supplementary training fund assets	**–**	**–**	**32,689**	**–**	**–**	**32,689**
Average balance of securities	**–**	**–**	**42,381**	**–**	**142**	**42,523**
Average balance of other assets under management	**204**	**–**	**–**	**7,873**	**–**	**8,077**
Margin from credit-granting activities*	**651**	**117**	**1**	**277**	**5**	**1,051**
Margin from accepting deposits*	**1,266**	**1**	**–**	**69**	**17**	**1,353**
Other	**115**	**–**	**–**	**117**	**1**	**233**
Total net interest income	**2,032**	**118**	**1**	**463**	**23**	**2,637**
Balance of credit to the public	**15,064**	**6,050**	**92**	**40,603**	**336**	**62,145**
Balance of deposits of the public	**112,883**	**18**	**–**	**6,917**	**1,028**	**120,846**

* The margin is, in effect, the interest gap between the interest received from the granting of credit and the interest paid on raising deposits, 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 9.4%, with the growth in banking credit and financing being some NIS 0.5 billion, 3.6%, while in mortgages, some NIS 4.0 billion, 11.0%.
Total deposits of the public rose by 4.4%, primarily in banking and finance, which rose by NIS 5.2 billion. With regard to the segment's securities portfolios, there was a decline of some NIS 12.8 billion (16.1%).

Household segment (continued)

	Banking and finance	Credit cards	Capital market	Mortgages	Overseas activity	Total
	2007					
	NIS millions					
Net interest income (loss):						
From external sources	(2,394)	103	3	1,642	(28)	(674)
Intersegmental	4,391	(28)	(3)	(1,156)	39	3,243
Operating and other income:						
From external sources	662	381	505	126	2	1,676
Intersegmental	1	213	–	12	–	226
Total income	2,660	669	505	624	13	4,471
Provisions for doubtful debts	125	13	–	39	1	178
Operating and other expenses:						
To external sources	2,354	461	392	225	6	3,438
Intersegmental	1	3	–	14	–	18
Operating profit before taxes	180	192	113	346	6	837
Provision for taxes	71	56	43	98	1	269
Operating profit after taxes	109	136	70	248	5	568
Profit from extraordinary items after taxes	–	–	278	–	–	278
Net profit	109	136	348	248	5	846
% Return on equity						22.1%
Average balance of assets	13,671	5,461	70	34,915	45	54,162
of which: investments in companies included on the equity basis	–	4	–	–	–	4
Average balance of liabilities	108,333	257	–	12,696	575	121,861
Average balance of risk assets	11,799	5,373	69	29,028	38	46,307
Average balance of mutual fund and supplementary training fund assets	–	–	34,899	–	–	34,899
Average balance of securities	–	–	42,895	–	64	42,959
Average balance of other assets under management	279	–	–	8,102	–	8,381
Margin from credit-granting activities	573	84	–	274	1	932
Margin from accepting deposits	1,277	–	–	80	10	1,367
Other	147	(9)	–	132	–	270
Total net interest income	1,997	75	–	486	11	2,569
Balance of credit to the public	14,544	5,558	75	36,590	45	56,812
Balance of deposits of the public	107,631	11	–	7,576	584	115,802

Main Changes in the Net Profit

Net profit from the household segment totaled NIS 818 million in 2008, compared with NIS 846 million in the corresponding period in 2007, a decline of 3.3%. The decline in net profit derived from the segment's share of profits from extraordinary items amounting to some NIS 202 million in 2008, compared with profit from extraordinary items totaling NIS 278 million in 2007. Operating profit after taxes totalled NIS 616 million, compared with NIS 568 million. The increase in operating profit after taxes derived from an increase in total income of NIS 92 million, and from a decrease in expenses of NIS 298 million, arising from the non-payment of bonuses to employees in respect of 2008. The increase was partially offset by an increase in the provisions for doubtful debts, mainly in banking and finance, by some NIS 89 million, and by an increase of some NIS 59 million in mortgages.

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 37 branches and offices.
The Bank also handles the personal accounts of the proprietors of the businesses in the segment, such 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 46 to 47.

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 employees' skills, and measuring and controlling the work procedures and customer interface;
– **expanding the direct marketing channels**: advanced telephone, fax and internet response services;
– developing financial products and services adapted to the needs of customers, and data and analytical models to analyze and forecast the customers' financial activities and needs;
– systematic, information-based **initiative** *vis-à-vis* customers in all operational segments: 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 through differential service**;**
– **cooperation with companies in the Group,** such as Leumi Mortgage Bank and Leumi Card, in order to exploit the Group's abilities in providing comprehensive banking solutions to customers.

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 counseling in relation to routine business activities, while determining sub-segments according to levels of activity and risk.
The main products supplied to the small business segment 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, imposed on the banks by the Banking Supervision Department, the Israel Securities Authority, the Commissioner 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 39 to 40 above.

Developments in the Markets of the Segment, or Changes in the Characteristics of its Customers

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:

– 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, and strictly abiding by rules of compliance with consumer laws and regulations;
– the distribution and availability of points of sale and service: expanding the distribution of the branches and adapting operating hours to the region and types of businesses;
– increasing the exposure and availability of direct channels (internet and fax) to customers;
– focusing on the provision of pro-active service and initiatives according to the needs and wishes of the customers.

Main Entry and Exit Barriers in the Segment

– The technological and physical infrastructure (branch distribution) and the quality of the manpower are relative advantages of banking in the small business segment, and constitute entry barriers to competitors. The importance of the 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 high-quality human resources possessing 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 insurance companies.

Business credit	– insurance companies, credit card companies, suppliers
The capital market	– 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 tactics and the use of price strategy.

In addition, competition has been developing recently from financial and other entities, primarily from credit card companies by means of supplier cards, and from insurance companies, which are showing 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 banks in this segment.

The Segment's Products and Services

The services provided include, *inter alia*, ongoing financing according to customers' needs, financing of investments to maintain and expand activity, the provision of 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 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.
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.

Customers

The customers attributed to this segment are characterized by diverse business activities (small to medium sized) and a great number and variety of sectors and fields.

For further details, see page 18 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 are established in most of the branches in the Banking Division for handling business customers, with the emphasis on deepening the familiarity with these 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 with existing customers and with potential customers.

Competition

The competition that the Bank has been facing in the small to medium-sized business segment has been intensifying in recent years. The competitors that the Bank faces include all commercial banks in Israel, and recently, also credit card companies and insurance companies.
The Bank competes by exploiting its expansive distribution advantages, professional and skilled manpower in the various banking fields and its data processing ability, all of which enable Leumi to be proactive and offer customers high-quality products and services.

Human Capital

In 2008, the average number of positions assigned to the small business segment totalled 1,695, of which, 402 were management staff, compared with 1,668 positions, of which, 389 were management staff.
The employees engaged 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 at the Bank.

Following are condensed operating results of the small business segment:

	Banking and finance in Israel	Credit cards	Capital market	Mortgages	Real estate	Overseas activity: Banking and finance	Overseas activity: Real estate	Total
	2008							
	NIS millions							
Net interest income:								
From external sources	**789**	**16**	**4**	**9**	**323**	**66**	**1**	**1,208**
Intersegmental	**(111)**	**(5)**	**(3)**	**(7)**	**(140)**	**(36)**	**–**	**(302)**
Operating and other income:								
From external sources	**299**	**51**	**20**	**–**	**47**	**17**	**–**	**434**
Intersegmental	**–**	**(26)**	**–**	**–**	**–**	**–**	**–**	**(26)**
Total income	**977**	**36**	**21**	**2**	**230**	**47**	**1**	**1,314**
Provisions for doubtful debts	**120**	**1**	**–**	**–**	**24**	**37**	**–**	**182**
Operating and other expenses:								
To external sources	**510**	**22**	**7**	**–**	**77**	**87**	**–**	**703**
Intersegmental	**1**	**4**	**–**	**–**	**–**	**–**	**–**	**5**
Operating profit (loss) before taxes	**346**	**9**	**14**	**2**	**129**	**(77)**	**1**	**424**
Provision for taxes (benefit)	**141**	**4**	**5**	**1**	**47**	**(8)**	**–**	**190**
Operating profit (loss) after taxes	**205**	**5**	**9**	**1**	**82**	**(69)**	**1**	**234**
Profit from extraordinary items after taxes	**–**	**18**	**–**	**–**	**–**	**–**	**–**	**18**
Net profit (loss)	**205**	**23**	**9**	**1**	**82**	**(69)**	**1**	**252**
% return on equity								**20.7%**
Average balance of assets	**11,694**	**579**	**92**	**145**	**4,758**	**673**	**86**	**18,027**
Average balance of liabilities	**11,261**	**791**	**–**	**–**	**1,796**	**496**	**77**	**14,421**
Average balance of risk assets	**9,048**	**564**	**106**	**144**	**4,735**	**668**	**83**	**15,348**
Average balance of mutual fund and supplementary training fund assets	**–**	**–**	**1,346**	**–**	**–**	**–**	**–**	**1,346**
Average balance of securities	**–**	**–**	**3,327**	**–**	**–**	**18**	**–**	**3,345**
Average balance of other assets under management	**464**	**–**	**–**	**–**	**–**	**–**	**–**	**464**
Margin from credit-granting activities	**469**	**9**	**1**	**2**	**141**	**12**	**1**	**635**
Margin from accepting deposits	**133**	**–**	**–**	**–**	**18**	**15**	**–**	**166**
Other	**76**	**2**	**–**	**–**	**24**	**3**	**–**	**105**
Total net interest income	**678**	**11**	**1**	**2**	**183**	**30**	**1**	**906**
Balance of credit to the public	**11,665**	**594**	**35**	**149**	**4,852**	**780**	**86**	**18,161**
Balance of deposits of the public	**11,923**	**–**	**–**	**–**	**1,928**	**547**	**77**	**14,475**

Main Changes in the Volume of Activity

In the small business segment there was no change in the total credit, while total deposits of the public in Israel increased by NIS 0.6 billion, while in relation to overseas activities, there was a decline of NIS 0.7 billion.
The securities portfolios recorded a decline at the rate of some 46.6% (NIS 3.1 billion).

Small Business Segment (continued)

	Banking and finance in Israel	Credit cards	Capital market	Mortgages	Real estate	Overseas activities	Total
	2007						
	NIS millions						
Net interest income:							
From external sources	660	12	6	8	278	76	1,040
Intersegmental	(27)	(4)	(4)	(6)	(110)	(21)	(172)
Operating and other income:							
From external sources	301	46	21	–	46	28	442
Intersegmental	1	(28)	–	–	–	–	(27)
Total income	935	26	23	2	214	83	1,283
Provisions for doubtful debts	74	–	–	–	31	34	139
Operating and other expenses:							
To external sources	645	20	11	–	99	118	893
Intersegmental	–	–	–	–	–	–	–
Operating profit (loss) before taxes	216	6	12	2	84	(69)	251
Provision for taxes	82	2	4	1	32	(16)	105
Operating profit (loss) after taxes	134	4	8	1	52	(53)	146
Profit from extraordinary items after taxes	–	–	26	–	–	3	29
Net profit (loss)	134	4	34	1	52	(50)	175
% return on equity							15.4%
Average balance of assets	10,319	369	141	108	4,624	1,676	17,237
Average balance of liabilities	10,549	723	–	–	1,740	1,264	14,276
Average balance of risk assets	7,363	319	131	104	4,624	1,235	13,776
Average balance of mutual fund and supplementary training fund assets	–	–	1,242	–	–	–	1,242
Average balance of securities	–	–	4,646	–	–	151	4,797
Average balance of other assets under management	475	–	–	–	–	–	475
Margin from credit-granting activities	424	2	2	2	123	19	572
Margin from accepting deposits	132	–	–	–	17	24	173
Other	77	6	–	–	28	12	123
Total net interest income	633	8	2	2	168	55	868
Balance of credit to the public	11,602	529	182	126	4,624	1,169	18,232
Balance of deposits of the public	11,344	–	–	–	1,740	1,344	14,428

Main changes in the net profit

Net profit in the small business segment totalled NIS 252 million in 2008, compared with NIS 175 million in the corresponding period in 2007, an increase of 44.0%. Operating profit after taxes totaled NIS 234 million, compared with NIS 146 million in the corresponding period in 2007, an increase of 60.3%.
The increase in profit derived mainly from a decrease in expenses of NIS 185 million, arising mainly from the non-payment of bonuses to employees in respect of 2008, and from an increase in total income by NIS 31 million, which was partially offset by an increase in provisions for doubtful debts in the sum of NIS 43 million.

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*: various types of credit, financing and international trade, investment and counseling services, capital market activities, financial instruments designed to hedge against market risks, complex transactions (projects, mergers and acquisitions), etc. Services outside of Israel are provided to the corporate segment primarily by Bank Leumi USA, Bank Leumi (UK) and other overseas offices of the Bank.

The Structure of the Segment[(1)]

The corporate banking segment is managed in Israel by the Corporate Division, which is comprised of five sectors. Service to customers is provided 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 mainly managed through departments located in central branches, which specialize in handling large customers and customers with diverse activities, as well as through the Bank's overseas offices. Transactions involving the acquisition of means of control are handled by a designated unit specializing in handling transactions of this kind, due to the complexity and level of risk involved. In addition, a special unit exists that handles complex transactions involving the financing of investments in infrastructure projects (power stations, desalinization plants, toll roads, BOT projects (Build-Operate-Transfer), etc.). This unit examines the transactions and builds the financing packages, including possible involvement of additional banks and institutional market entities in the financing of such transactions.
The Credit Department, including the Credit Risk Management Unit (CRMU), was established in 2006 with the objective of tightening credit controls, improving the quality of the Bank's credit portfolio, complying with regulatory requirements and improving service to customers. The CRM Unit operates independently and performs examinations and in-depth analyses of the credit applications of the Corporate Division's customers. Upon completing this process, the CRM Unit approves the applications or submits them for deliberation by the appropriate credit committee. The unit is also responsible for validating the risk rating assigned to each customer.
The Credit Department is also responsible for developing methodologies relating to credit and credit risks (including the development of methodologies and work routines for analyzing and managing the Bank's credit portfolio as a whole), for recommending methods for handling problem loans, for developing control and monitoring processes and for the assimilation of credit-related work procedures in relation to all segments, including at the Bank level.
The Credit Department's activities in these fields include analyzing the new regulatory directives and preparing to implement and assimilate them as of 31 December 2009: the Basel II directive and the directives regarding the measurement and disclosure of impaired debts, credit risks and provisions for credit losses.

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(1) Regarding the Construction and Real Estate Division, see below on pages 124 to 127.

Bank Leumi USA and Bank Leumi (UK) enable Israeli and local companies belonging to the corporate banking segment to receive banking services, and credit for financing their activities in international trade, real estate, mergers and acquisitions. The subsidiary in the United States, which is headquartered in New York, and the subsidiary in the United Kingdom, which is headquartered in London with a branch in Manchester, 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 46 to 47.

Against the backdrop of the financial crisis in the capital and money markets and the substantial write-offs by major banking groups worldwide, we are witnessing a slowdown in economic activity in many countries around the world, which leads to a drop in the demand and to the collapse of multinational companies and businesses. Israel, as part of the global village, is affected by the consequences of the global crisis, and we are also witnessing a slowdown the local economy, a slowdown that is likely to continue throughout 2009.
The effect of the said crisis is also manifest by the complete “dehydration” of the capital market, which, until 2008, had prospered and expanded (also at the expense of the banking system).
In light of the forecast that 2009 will be characterized by a significant slowdown in economic activities in Israel, there is a growing need for coping intelligently with the expected risks resulting from the developments in the financial markets around the world and in Israel. Therefore, the Bank will continue to implement a cautious credit policy in relation to the economic sectors, the various activities and credit segments, while closely monitoring the credit portfolio (including ongoing examination of the risk ratings of the economic sectors). The implications of the declines on global stock exchanges on the ability of financially weak companies to raise sources will also be taken into account, including the issue of repayments of debentures raised through the capital market during the years when the markets were prospering.

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 Commissioner of the Capital Market, Insurance and Savings, the Antitrust General Director, the Israel Securities Authority and additional entities. Overseas, the Bank’s subsidiaries and representative offices operate by virtue of 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 level of the indebtedness of large borrowers and of the six largest groups of borrowers of the Group. The Bank operates pursuant to a restriction, whereby the 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. On 31 December 2008, the indebtedness of the largest group of borrowers reached 22.6% of the Bank’s capital. The indebtedness of the largest single borrower reached 8.1% of the Bank’s capital, and the indebtedness of the six largest groups of borrowers reached 109.3% of the Bank’s capital.
Furthermore, Proper Banking Management Directive No. 323 imposes a regulatory restriction relating to the credit balance for all transactions for the acquisition of control/means of control. Pursuant to this Directive, the total credit for all transactions for the acquisition of a means of control in corporations fulfilling the conditions as defined in the Directive, when the ratio between the financing rate and the acquisition 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 acquisition 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. On 31 December 2008, the indebtedness arising from all transactions for the acquisition of a means of control totaled NIS 7,822 million. The indebtedness from transactions for the acquisition of a means of control in a banking corporation, which meet the requirements of the Directive, totaled NIS 1,316 million.

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 areas of reference, such as: mapping of the economic sectors having horizontal characteristics; mapping and examination of key issues and potential customers in respect whereof an in-depth examination is required, due to the sensitivity and the potential impact on the financial statements, as well as the establishment a professional work team and support unit for the purpose of providing solutions and assistance in this regard; the dissemination of procedures and guidelines for modes of operation and for dealing with issues; and the instituting of many measures in order to inform business entities at the Bank.

Developments in the Markets of the Segment or Changes in the Characteristics of its Customers

The largest customers and the largest groups of borrowers in the economy constitute a considerable share of the Bank's corporate customers. Within the context of merger and acquisition activities that have taken place in the economy in recent years, the proportion of large borrowers and large groups in banking activities has grown, and today they constitute a significant share of the Bank's corporate segment customers.

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 entities. As of the second half of 2008, there has been a dramatic reversal of this trend, with the upheavals on the global and Israeli markets causing a "dehydration" of non-bank sources of financing and to a complete halt of capital raising activity on the capital market. It is therefore possible that some companies have difficulty raising sources for payments to debenture holders.

Regarding the developments in each of the sectors that comprise the segment, see pages 79 to 84 above.

Technological Changes that may have a Material Impact on the Segment

The information systems that serve the corporate banking segment are intended to assist in analyzing customers' needs and in the ongoing 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 levels of management and interpersonal abilities (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, improvement of professionalism and ongoing monitoring of the changes occurring in the market in order to identify potential and 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 solutions to customers' needs within suitable response times.

The Main Entry and Exit Barriers in the Segment

In order to provide service to customers in the corporate banking segment, high-quality human resources are required, possessing considerable professional skill in familiarizing themselves with the customers in the segment, the diversity of their activities and in analyzing their needs. The management of customers in this segment requires an in-depth familiarity with the customers, their financial data and their spheres of activity, and requires the Bank to adapt its products to these data. Moreover, appropriate preparation is required for complying with the regulatory restrictions and for monitoring and controlling 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 for providing long-term financing are limited in comparison with the sources available for short to medium-term financing, it is expected that, in relation to the financing of long-term projects (primarily infrastructure projects and income-generating properties), 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.

The Segment's Products and Services

The services provided include, *inter alia*, ongoing financing according to the customers' needs, financing of investments to maintain and expand operations, provision of solutions in the spheres of financing and international trade (including the financing of projects abroad), financing and guidance of national and international projects, financing of mergers and acquisitions, financial instruments to hedge against currency risks, interest risks and fluctuations in commodities prices, activities in the capital market, as well as counseling services in the field of investments. The service also includes the initiation and promotion of banking services to the managements and employees of companies in the segment.

Customers

Customers belonging to this sector are characterized by their leading position in the market and dominance in their field of activity, by operating turnovers exceeding NIS 250 million, by high financing needs and an *obligo* exceeding NIS 80 million (for further details, see page 18.) These companies are, for the most part, public companies, from a variety of different sectors of the economy, with complex organizational structures comprised of numerous management echelons and a broad span of control.

Tower Semiconductor Ltd.

On 25 September 2008, agreements were signed between Leumi and Tower Semiconductor Ltd. ("Tower") and Bank Hapoalim B.M. ("Hapoalim") for the restructuring of Tower's debts to Leumi and Hapoalim.

Within the scope of these agreements, on 29 September 2008, US$ 100 million of Tower's debts to Leumi were converted into capital notes convertible into shares of Tower, and amendments were made in the financing agreement between Tower, Hapoalim and Leumi.

Together with the conversion of the debt to Leumi as detailed, US$ 100 million of Tower's debts to Hapoalim were converted into capital notes convertible into shares of Tower, US$ 50 million of Tower's debts to the Israel Corporation Ltd. (a shareholder of Tower) were converted into capital notes convertible into shares of Tower, and the Israel Corporation injected US$ 20 million into Tower against capital notes convertible into shares of Tower and undertook toward Tower to inject additional capital under certain conditions.

It is noted that appropriate provisions were made also in relation to the amounts included in the said arrangement.

Marketing and Distribution

Service and marketing to customers are provided by customer relations managers who specialize in the sector of the economy in which the customers operate, and who coordinate the Group's services to customers.

Competition

The competition that the Bank has been facing in the corporate banking segment has been strong in recent years and included 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 entities and the capital market. There are indications that the competitive arena will change in 2009, since the capital market and institutional entities do not currently constitute a source of competition at all in the provision of credit.

Human Capital

In 2008, the average number of positions assigned to the segment totalled 1,183 positions, of which, 468 were management positions, compared with 1,017 positions in 2007, 413 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 at 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 standards.

The Construction and Real Estate Division operates under the Corporate Banking Segment General

The division specializes in providing financial services to customers whose principal business is in the field of construction and real estate, and in the field of infrastructure projects. The construction sector is financed using instruments and analytical tools which are unique to the segment, while instituting prudent policies. A significant portion of the project financing is provided in the form of closed construction lending, which is subject to tight controls and monitoring and with the emphasis placed on meticulous scrutiny of each project.

The Credit Risk Management Unit in the Credit Department examines and approves the transactions or submits them for deliberation by the appropriate credit committee.

The Structure of the Division

Most of the corporate activity in the construction and real estate sector is carried out through the Construction and Real Estate Division. The division supplies a comprehensive range of banking services, both to major business enterprises in the economy and to middle-market business enterprises, engaging in construction and real estate.

The division is divided into two sectors, each operated by three to four senior customer relations managers, who possess specific expertise in the real estate sector. The senior customer relations managers coordinate all handling of the banking needs of the customers assigned to the department.

These two sectors are: the construction companies sector, which supplies an extensive range of banking services to the major customers in the economy in the construction and real estate field, and the contractors sectors, which specializes in providing services to middle-market business customers. The majority of the activity focuses on financing income-producing properties and the financing of the residential housing branch, which is handled via the closed construction lending method.

Another section of the division specializes in financing major-scale infrastructure projects, including PPP projects (Public & Private Partnership – based on cooperation between the public and private sectors). The head of the section is a senior customer relations manager who coordinates the financing arranged for these projects.

The Bank, through the Construction and Real Estate Division, occasionally participates in the provision of credit, by participating in the initiation and development of projects and by purchasing properties via the Bank’s subsidiaries in the United States, England and Romania. Financing, as stated, is provided to the Bank’s customers in Israel for their activities abroad or to other customers of the above-mentioned subsidiaries operating in this sector.

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 46 to 47.

The Real Estate Division is involved in the segment of major and middle-market customers in the real estate field. The strategic objective is to deepen its relative advantage and to continue to improve its contribution to the Group's profits. The division's goals are to guide the activity in this sector, while carefully and prudently scrutinizing the particular exposures deriving from the global economic crisis that is affecting customers operating in this sector, and, at the same time, to expand the variety of products and services being offered to customers, and to leverage its long-standing relations with customers in order to develop businesses in conjunction with various units of 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 Department, the Commissioner of the Capital Market, Insurance and Savings, the Antitrust General Director, the Israel Securities Authority and additional entities. Overseas, the Bank's subsidiaries and representative offices operate by virtue of permits from the Banking Supervision Department, and are also subject to local regulations.

For further details, see pages 121 to 122 above under the corporate banking segment.

Business and operational preparations have been completed at the Bank for depositing payments from purchasers of housing units in projects being handled using the voucher method, and for handling the issuance of uniform sale guarantees, pursuant to legislation of the Knesset and with directives prescribed by the Bank of Israel.

Pursuant to a Bank of Israel directive, when the total indebtedness of a particular sector to a banking corporation exceeds 20% of the total indebtedness of the public to the banking corporation (the bank on a nonconsolidated basis), this excess is considered an exceptional excess in terms of the concentration of sectoral indebtedness. In such a case, an additional provision for doubtful debts is required in respect of the sum of the exceptional excess. The exceptional excess in this sector at the end of 2008 reached the rate of 2.27%, compared with the exceptional excess of 0.75% at the end of 2007.

Developments in the Markets of the Segment or Changes in the Characteristics of its Customers

The sub-prime crisis that began during the summer of 2007 and the resulting global "credit crunch" has already began to effect activities in the global real estate sector towards the end of 2007, particularly in the United States and in some western European countries. Nonetheless, during the first half of 2008, the ramifications of this crisis did not affect the activity in Israel or some of the Israeli companies operating abroad, and the level of activity did not diminish significantly from the previous year. On the other hand, beginning in September 2008, when the American investment bank, Lehman Brothers, collapsed, and the global financial crisis intensified, there has been a significant drop in activity by the sector's customers in Israel, as well as a freeze on transactions in many regions of activity internationally, particularly in eastern Europe.

As is commonly known, in 2006 and 2007, real estate companies in Israel sharply increased their debenture raising activities. Some of the debenture issues were used for investments abroad, *inter alia*, for the purchase of lands designated for the establishment of projects in eastern Europe. Debenture repayments were expected to be based on project completions, the realization of assets and additional capital recruitments. In light of the devaluation of the assets, the macro-economic influences abroad and the prevailing uncertainty, some of the companies are likely to encounter difficulties in raising sources to repay the debenture holders.

Residential construction was characterized by a persisting downtrend in construction starts, with the number of new apartments under private initiatives available for sale at the end of December 2008 being some 10% lower than at the end of December 2007[2]. The majority of the construction starts were concentrated in the traditional high demand residential areas. The trend in housing unit sales in these areas was characterized by moderation in low cost construction and for the middle market, which intensified during the last quarter of 2008, and by a decline in the luxury residential segment, to the point of a freeze during the last few months the year. At the same time, there was a significant rise in the construction input prices, which peaked at the end of the first half of the year and became more moderate during the last few months of 2008.

During the first half of 2008, the field of income-producing properties (office buildings and commercial properties) was characterized by demands exceeding the existing supply of offices in the central region of the country, while in the commercial construction field, purchases of properties of this type continued.

This trend changed during the second half of 2008, and particularly during the last quarter, arising from the above-mentioned economic crisis, and due to the assessments of a decrease in the scope of demand and in price levels. This change is expressed by a sharp decrease in the volume of transactions and by a rise in the yield rates demanded in these transactions.

The execution of large scale national infrastructure projects has continued to increase moderately in recent years, with the infrastructure sectors active in this field being mainly water, transportation, energy and electricity.

Technological Changes that may have a Material Impact on the Segment

The information systems that serve the construction and real estate segment are intended to assist in analyzing customer needs and in the ongoing 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 levels of professional, management and interpersonal abilities (both *vis-à-vis* the customers and within the organization), expertise in the segment, familiarity with the customers, including their financial position, and the prospects/risks inherent in working with them, proper management and control of the Bank's financing of the project, correct reading of the market in order to identify potential and avoid risk, credit risk management and control, constant investment in technological aids, and diligence in maintaining contact, providing service and providing solutions for 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, who possess considerable skill in familiarizing themselves with the segment's customers, the diversity of their activities and in analyzing their needs. The management of customers in this segment requires an in-depth familiarity with them, their financial data, their fields of activity, and adaptation of the Bank's products to these data. Moreover, appropriate preparations are required for complying with the regulatory restrictions and internal restrictions imposed by the Bank's Board of Directors, as well as for monitoring and controlling various risks and exposures. The Credit Risk Management Unit of the Credit Department is involved in these preparations.

Alternatives to the Products and Services of the Segment, and the Changes that have occurred therein

During 2006 – 2007, sources developed as alternatives to bank credit, which were offered by non-banking financial entities, and particularly, by institutional entities, such as public and private offerings of shares, debentures and other securities in the capital markets in Israel and abroad. The financial crisis, and its

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[2] Central Bureau of Statistics, from 29 January 2009.

impact on the value of the institutional entities' assets, together with the halt in activity in the secondary market, have led to a freeze in this segment and have caused these entities to significantly curtail their financing activities.

Another trend that has significantly increased during the last year is that of the organization of acquiring groups for the establishment of joint projects, mainly for residential buildings. In light of the unique nature of projects of this type, and since the financing is provided to each member of the group according to its particular abilities and needs, the financing to the acquiring groups within the Leumi Group is provided by Leumi Mortgage Bank.

Structure of the Competition in the Segment and the Changes that have occurred therein

There is strong competition over financing of the real estate sector, both from the four major banking groups in Israel, and from small banks in the system, including mortgage banks. In recent years, the involvement of institutional entities, such as insurance companies and pension funds, has become considerable, and foreign banks have also entered the arena of long-term financing of income-producing properties and of infrastructure projects. At the same time, as stated, a trend developed of an increase in corporate debenture raising. However, due to the macro-economic events occurring globally and in Israel, and due to a concern about their impact on the companies operating in the real estate segment, this financing channel has almost completely closed during the past year.

The Segment's Products and Services

The construction and real estate sector is financed by using specific analytical and monitoring tools that assist in the decision-making process and in controlling the financing granted to the various projects. The sector is financed with the aim of diversifying the credit portfolio and while differentiating between the various segments – residential, income-producing properties designated for commerce and offices, and construction for industry and commerce. The financing policy of the Construction and Real Estate Division for 2009 will focus on giving preference to the financing of residential projects in the typical high-demand areas. Residential projects will be financed, as a rule, using the closed construction lending method, which enables high frequency, tight supervision of the project being financed. Furthermore, the Construction and Real Estate Divisions continues its involvement in the financing of national projects under the PPP (Public & Private Partnership) methods. These transactions are analyzed in conjunction with a special unit in the division's Credit Products Department, which examines the transactions and collaborates on the formulation of the financing package, taking into account the characteristics of the customer, analysis of its debt servicing ability, the right of recourse to the customer, the operating contract limitation, technical constraints, etc.

Customers

The department's customers are major companies in the economy in the field of real estate initiatives, performance and infrastructure contractors, and select middle-market business entities engaging in real estate and contracting initiatives.

Marketing and Distribution

The Real Estate Division's activity *vis-à-vis* its customers is coordinated by senior customer relations managers who maintain regular, constant contact with the customers, and provide solutions for all their banking needs.

Following are condensed operating results of the corporate banking segment:

	Banking and finance in Israel	Credit cards	Capital market	Real estate	Overseas activities: Banking and finance	Overseas activities: Real estate	Total
	2008						
	NIS millions						
Net interest income:							
From external sources	**2,684**	**46**	**–**	**1,185**	**(9)**	**(1)**	**3,905**
Intersegmental	**(1,392)**	**(15)**	**–**	**(648)**	**31**	**2**	**(2,022)**
Operating and other income:							
From external sources	**35**	**219**	**25**	**50**	**6**	**–**	**335**
Intersegmental	**1**	**(165)**	**–**	**–**	**–**	**–**	**(164)**
Total income	**1,328**	**85**	**25**	**587**	**28**	**1**	**2,054**
Provisions for doubtful debts	**722**	**6**	**–**	**341**	**1**	**–**	**1,070**
Operating and other expenses:							
To external sources	**292**	**88**	**12**	**100**	**18**	**–**	**510**
Intersegmental	**1**	**1**	**–**	**–**	**–**	**–**	**2**
Operating profit (loss) before taxes	**313**	**(10)**	**13**	**146**	**9**	**1**	**472**
Provision for taxes (benefit)	**118**	**(2)**	**5**	**54**	**3**	**–**	**178**
Operating profit (loss) after taxes	**195**	**(8)**	**8**	**92**	**6**	**1**	**294**
Profit from extraordinary items after taxes	**–**	**2**	**–**	**–**	**–**	**–**	**2**
Net profit (loss)	**195**	**(6)**	**8**	**92**	**6**	**1**	**296**
% return on equity							**4.5%**
Average balance of assets	**47,777**	**411**	**1**	**23,404**	**724**	**3**	**72,320**
Average balance of liabilities	**20,718**	**3,073**	**–**	**4,271**	**1,285**	**177**	**29,524**
Average balance of risk assets	**60,059**	**381**	**1**	**22,064**	**777**	**3**	**83,285**
Average balance of mutual fund and supplementary training fund assets	**–**	**–**	**746**	**–**	**–**	**–**	**746**
Average balance of securities	**–**	**–**	**70,398**	**–**	**204**	**–**	**70,602**
Average balance of other assets under management	**290**	**–**	**–**	**–**	**–**	**–**	**290**
Margin from credit-granting activities	**850**	**20**	**–**	**395**	**10**	**–**	**1,275**
Margin from accepting deposits	**52**	**–**	**–**	**15**	**12**	**1**	**80**
Other	**390**	**11**	**–**	**127**	**–**	**–**	**528**
Total net interest income	**1,292**	**31**	**–**	**537**	**22**	**1**	**1,883**
Balance of credit to the public	**48,632**	**495**	**4**	**26,832**	**597**	**3**	**76,563**
Balance of deposits of the public	**17,596**	**–**	**–**	**4,730**	**608**	**177**	**23,111**

Main Changes in the Volumes of Activity

In the corporate banking segment, there was an increase in credit to the public of some NIS 12.4 billion (19.4%), while there was a decrease in deposits of the public of some NIS 1.3 billion, 5.2%.
There was a decrease in activity in securities of some NIS 32.3 billion (38.3%), which derived primarily from a decline in market values. In off-balance sheet activity, there was an increase in guarantees and documentary credit in the segment of 5.8%.

Corporate Banking Segment (continued)

	Banking and finance in Israel	Credit cards	Capital market	Real estate	Overseas activities: Banking and finance	Overseas activities: Capital market	Total
	2007						
	NIS millions						
Net interest income:							
From external sources	2,103	27	–	1,325	(19)	–	3,436
Intersegmental	(1,041)	(11)	–	(752)	76	–	(1,728)
Operating and other income:							
From external sources	255	196	29	41	7	2	530
Intersegmental	1	(153)	–	–	–	–	(152)
Total income	1,318	59	29	614	64	2	2,086
Provisions for doubtful debts	(37)	2	–	(36)	–	–	(71)
Operating and other expenses:							
To external sources	304	68	19	104	30	–	525
Intersegmental	–	–	–	–	–	–	–
Operating profit (loss) before taxes	1,051	(11)	10	546	34	2	1,632
Provision for taxes (benefit)	391	(3)	4	210	10	1	613
Operating profit (loss) after taxes	660	(8)	6	336	24	1	1,019
Profit from extraordinary items after taxes	–	–	18	–	–	–	18
Net profit (loss)	660	(8)	24	336	24	1	1,037
% return on equity							16.5%
Average balance of assets	44,383	320	5	21,165	1,167	–	67,040
Average balance of liabilities	20,281	2,915	–	3,366	1,978	–	28,540
Average balance of risk assets	53,629	309	6	21,165	1,033	–	76,142
Average balance of mutual fund and supplementary training fund assets	–	–	459	–	–	–	459
Average balance of securities	–	–	78,363	–	–	566	78,929
Average balance of other assets under management	558	–	–	–	–	–	558
Margin from credit-granting activities	734	(11)	–	404	24	–	1,151
Margin from accepting deposits	62	–	–	14	33	–	109
Other	266	27	–	155	–	–	448
Total net interest income	1,062	16	–	573	57	–	1,708
Balance of credit to the public	41,448	337	1	21,165	1,178	–	64,129
Balance of deposits of the public	19,009	–	–	3,366	2,007	–	24,382

Main Changes in the Net Profit

Net profit in the corporate banking segment totaled NIS 296 million in 2008, compared with NIS 1,037 million in the corresponding period in 2007, a decrease of 71.5%. The decline in profit derived mainly from an increase of NIS 1.1 billion in provisions for doubtful debts.

4. The Commercial Banking Segment

General

Commercial banking specializes in the provision of the entire spectrum of financial services to middle-market business entities in all sectors of the economy, for which credit facilities of usually from NIS 10 million to NIS 80 million (until 31 December 2006, up to NIS 100 million) have been approved, for the interested parties of the business companies, including shareholders and senior officeholders.
Service and marketing to these customers are carried out on an individual basis, and include mainly the financing of transactions with credit instruments tailored 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. Banking services abroad, including the provision of credit lines to finance international trade, real estate purchases, and company mergers, are available to companies mainly through Bank Leumi USA, Bank Leumi (UK) and Bank Leumi Romania.

The subsidiaries in the United States, the UK and Romania view the ongoing servicing of these companies as a direct continuation of the banking activities in Israel.

For further details about the subsidiaries abroad, see pages 165 to 171.

The Structure of the Segment

The segment is managed by the Commercial Banking Division. 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 affords the Division a competitive edge. 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 attributed geographically to four commercial districts. The branches specialise in the management of business activities characteristic of the Division's customers, giving it a competitive advantage.

Leumi USA has branches in New York, California, Florida and in Illinois. Leumi UK has a main branch in London, a branch in Manchester and a subsidiary company on the Isle of Jersey. Leumi Romania has 37 branches across Romania.

For further details, see page 18.

Within the scope of the measures to improve the quality of the Bank's credit portfolio, and in order to comply with the regulatory requirements, the Credit Risk Management Department (CRM) was established during 2008 in the Commercial Banking Division. The CRM Department is responsible for managing all aspects of the credit risks in the division, including determining the methodology for the activity segments that are relevant and/or unique to the division, for the assimilation of the various credit methodologies in all units of the division, for scrutinizing and thoroughly analyzing the credit applications of the division's customers, while assessing the risk and issuing preliminary opinions to the credit committees, for approving credit applications that are within the scope of its authority, for handling and approving applications relating to problem loans, including management of the portfolio of problem loans in the division.

Strategy

The following information is "forward-looking information". For the meaning of this term, see pages 46 to 47.

Commercial banking serves middle-market business customers. These customers have potential for profitability that is relatively higher than that 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 by 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 35 to 48 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, infrastructure, 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, either directly by customers or through subsidiaries of some of the customers in the segment.

Since September 2008, during which the American investment bank Lehman Brothers collapsed and the global financial crisis intensified, a decline in activities of the segment's customers in Israel has been evident, as well as a decline in investments in equipment and machinery, and a rise in the risk of some of the segment's customers. The risk is expressed by a drop in income of firms, by a decline in investments made, by a decline in profitability and also the accumulation of losses. The losses may be material for customers with inadequate financial strength.

For details on the sectors of the economy, see pages 79 to 84 of the Report.

Technological Changes

– The segment's employees are assisted by computerized systems that support various processes carried out in the segment, such as control, definition and measurement of targets, 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 response time and raising the standards 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 a strict approach in relation to all matters pertaining to compliance.

The Main Entry and Exit Barriers in the Segment:

– Training professional manpower with diverse skills;
– Maintaining a range of products tailored to the customers' needs;
– Establishment of a network of distribution channels whose spread corresponds to the business potential;
– Establishment and development of technological means to serve customers and employees.

Competition

The competitors in this segment of activity, in both the credit and investments spheres, are all banks operating in Israel (domestic and foreign), banks abroad, entities operating in the capital market, and insurance companies. The insurance companies are competitors for customers in the segment in both the credit sphere and in the investment services sphere, while private investment houses are competitors in the investments sphere. The intensity of the competition that the Bank has been facing in the commercial banking segment in recent years has been strong, but the economic events during 2008 have led to a significant weakening of the competition.

The competition over customer activities in this segment derived from the regulatory restrictions on a single borrower and on a group of borrowers, and depends upon the economic situation in the economy and the ability of companies to recruit capital.

Human Capital

- The average number of positions assigned to the segment in 2008 totalled 1,799, of which 662 were management positions, compared with 1,687 positions in 2007, 657 of which were management staff positions.
- The branches and the headquarters are staffed by employees and managers who have undergone appropriate training in accordance with the needs of commercial customers and have gained expertise in the management of the typical business activities of the division’s customers.

Following are the condensed operating results of the commercial banking segment:

	Banking and finance in Israel	Credit cards	Capital market	Mortgages	Real estate	Overseas activities			Total
						Banking and finance	Capital market	Real estate	
	2008								
	NIS millions								
Net interest income:									
From external sources	**1,224**	**11**	**2**	**30**	**361**	**500**	**–**	**167**	**2,295**
Intersegmental	**(377)**	**(3)**	**(1)**	**(24)**	**(170)**	**(227)**	**–**	**(104)**	**(906)**
Operating and other income:									
From external sources	**222**	**48**	**48**	**1**	**25**	**31**	**16**	**11**	**402**
Intersegmental	**–**	**(32)**	**–**	**–**	**–**	**–**	**–**	**–**	**(32)**
Total income	**1,069**	**24**	**49**	**7**	**216**	**304**	**16**	**74**	**1,759**
Provisions for doubtful debts	**272**	**1**	**–**	**–**	**67**	**135**	**–**	**10**	**485**
Operating and other expenses:									
To external sources	**441**	**20**	**39**	**3**	**55**	**261**	**–**	**42**	**861**
Intersegmental	**1**	**4**	**–**	**–**	**–**	**(7)**	**–**	**(1)**	**(3)**
Operating profit (loss) before taxes	**355**	**(1)**	**10**	**4**	**94**	**(85)**	**16**	**23**	**416**
Provision for taxes (benefit)	**145**	**–**	**4**	**2**	**34**	**(24)**	**4**	**7**	**172**
Operating profit (loss) after taxes	**210**	**(1)**	**6**	**2**	**60**	**(61)**	**12**	**16**	**244**
Group's share in the operating profits of companies included on an equity basis	**–**	**1**	**–**	**–**	**–**	**–**	**–**	**–**	**1**
Net operating profit (loss)	**210**	**–**	**6**	**2**	**60**	**(61)**	**12**	**16**	**245**
Profit from extraordinary items after taxes	**–**	**26**	**–**	**–**	**–**	**–**	**–**	**–**	**26**
Net profit (loss)	**210**	**26**	**6**	**2**	**60**	**(61)**	**12**	**16**	**271**
% return on equity									**6.9**
Average balance of assets	**27,193**	**288**	**25**	**375**	**5,928**	**14,168**	**–**	**2,875**	**50,852**
of which: investments in companies included on an equity basis	**–**	**4**	**–**	**–**	**–**	**–**	**–**	**–**	**4**
Average balance of liabilities	**19,070**	**709**	**–**	**110**	**2,125**	**7,665**	**–**	**854**	**30,533**
Average balance of risk assets	**25,314**	**295**	**29**	**353**	**5,970**	**14,626**	**–**	**2,603**	**49,190**
Average balance of mutual fund and supplementary training fund assets	**–**	**–**	**2,833**	**–**	**–**	**–**	**–**	**–**	**2,833**
Average balance of securities	**–**	**–**	**36,764**	**–**	**–**	**–**	**2,458**	**–**	**39,222**
Average balance of other assets under management	**963**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**963**
Margin from credit-granting activities	**541**	**6**	**1**	**3**	**140**	**184**	**–**	**54**	**929**
Margin from accepting deposits	**112**	**–**	**–**	**1**	**13**	**120**	**–**	**11**	**257**
Other	**194**	**2**	**–**	**2**	**38**	**(31)**	**–**	**(2)**	**203**
Total net interest income	**847**	**8**	**1**	**6**	**191**	**273**	**–**	**63**	**1,389**
Balance of credit to the public	**25,057**	**297**	**10**	**460**	**5,778**	**13,665**	**–**	**3,239**	**48,506**
Balance of deposits of the public	**18,480**	**–**	**–**	**75**	**1,908**	**8,537**	**–**	**659**	**29,659**

Commercial Banking Segment (continued)

	Banking and finance in Israel	Credit cards	Capital market	Mortgages	Real estate	Overseas activities: Banking and finance	Overseas activities: Capital market	Overseas activities: Real estate	Total
	2007								
	NIS millions								
Net interest income:									
From external sources	1,030	7	2	20	385	550	–	133	2,127
Intersegmental	(210)	(3)	(2)	(14)	(182)	(251)	–	(26)	(688)
Operating and other income:									
From external sources	234	46	56	1	31	35	11	13	427
Intersegmental	–	(31)	–	–	–	–	–	–	(31)
Total income	1,054	19	56	7	234	334	11	120	1,835
Provisions for doubtful debts	173	–	–	(1)	6	(2)	–	4	180
Operating and other expenses:									
To external sources	501	17	43	2	61	225	1	49	899
Intersegmental	1	(1)	–	–	–	–	–	–	–
Operating profit before taxes	379	3	13	6	167	111	10	67	756
Provision for taxes	147	1	5	1	65	36	3	17	275
Operating profit after taxes	232	2	8	5	102	75	7	50	481
Group's share in the operating profits of companies included on an equity basis	–	5	–	–	–	–	–	–	5
Net operating profit	232	7	8	5	102	75	7	50	486
Profit from extraordinary items after taxes	–	–	16	–	–	–	–	–	16
Net profit	232	7	24	5	102	75	7	50	502
% return on equity									12.2
Average balance of assets	26,799	204	36	292	6,102	14,378	–	2,821	50,632
of which: investments in companies included on an equity basis	–	10	–	–	–	–	–	–	10
Average balance of liabilities	18,392	653	–	98	2,337	10,182	–	1,824	33,486
Average balance of risk assets	25,780	174	42	246	6,102	14,905	–	2,505	49,754
Average balance of mutual fund and supplementary training fund assets	–	–	2,651	–	–	–	93	–	2,744
Average balance of securities	–	–	38,754	–	–	–	2,709	–	41,463
Average balance of other assets under management	1,222	–	–	–	–	–	–	–	1,222
Margin from credit-granting activities	563	12	–	(1)	132	150	–	35	891
Margin from accepting deposits	130	–	–	–	12	65	–	24	231
Other	127	(8)	–	7	59	84	–	48	317
Total net interest income	820	4	–	6	203	299	–	107	1,439
Balance of credit to the public	27,702	273	14	294	6,088	13,681	–	2,890	50,942
Balance of deposits of the public	19,074	–	–	54	2,328	7,065	–	1,796	30,317

Main Changes in the Volumes of Activity

The credit to the public declined by some NIS 2.4 billion (4.8%), of which a decline of NIS 2.7 billion was from the activity of the segment in Israel.
Deposits of the public declined by some NIS 0.7 billion (2.2%), of which some NIS 0.6 billion in the segment in Israel.

Activity in securities decreased by NIS 12.4 billion, at the rate of 25.8%, which derived mainly from a decline in market values. In off-balance sheet activity, there was a decline of 2.5% in guarantees and documentary credit.

Main Changes in the Net Profit

Net profit in the commercial banking segment totaled NIS 271 million in 2008, compared with NIS 502 million in the corresponding period in 2007, a decline of 48.0%. The decline in the net profit derived mainly from an increase in the provisions for doubtful debts by some NIS 305 million, of which, NIS 162 million is in the activity in Israel and NIS 143 million is in the activity abroad at the subsidiaries in the US and the UK. In addition, there was a decrease in the total income in the UK subsidiary. On the other hand, expenses decreased by NIS 41 million.

5. The Private Banking Segment

General

Private banking provides services to wealthy customers in Israel and worldwide. The activities are carried out through unique centers in Israel designated for foreign and Israeli residents, as well as through the Bank's subsidiaries in the United States, the United Kingdom, Switzerland, Luxembourg and Romania and through its representative offices in Europe, Latin America, Canada, Hong Kong and Australia. Furthermore, Leumi Switzerland and Leumi Luxembourg operate representative offices in Israel to provide private banking services to their customers in Israel. The strategic objective of private banking is to expand the customer base and to increase the volume of activity of private banking customers in Israel and worldwide.

The Structure of the Segment

The private banking line operates in Israel by way of the provision of exclusive and personal service by professional teams in seven 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 areas of interest.

Outside of Israel, private banking services are provided mainly within the framework of the subsidiaries and representative offices

Objectives and Business Strategy

The vision of private banking is to be "the private banking choice of customers as 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, and the highest standards 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.

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 Commissioner of the Capital Market, Insurance and Savings, the Antitrust General Director, the Israel Securities Authority and other entities. The Bank's overseas subsidiaries and representative offices operate by virtue of 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 39 to 40 above.

Developments in the Markets of the Activity Segment, or Changes in its Customers' Characteristics

On 1 January 2005, the tax rates 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 second half of 2008 was characterized by the global financial crisis, which affects the entire banking and financial industry. Customers opted to switch to solid investments, mainly government bonds, and refrained from investing in sophisticated products as they had in previous years.

The popular economic magazine, "Euromoney" declared in its February 2009 edition: "Leumi Private Banking – the best private banking in Israel." The selection of Bank Leumi was based on an international survey conducted among 45,000 private banking managers and customer relations managers in Israel and throughout the world. Among the fundamental criteria examined that constituted the basis for the magazine's decision were the standard of private banking services of the banks in each country, the level of profitability in this segment, the volume of assets being managed, the market share and reputation.

Technological Changes

The private banking segment in Israel began implementing the Odyssey system during 2005, which provides detailed reports to customers regarding their investments and assets. This is an advanced technological system, which is tailored to the segment's customers, improves service, and assits the counselors to better manage and monitor the customers' portfolios.

During 2008, the integration of an advanced CRM system continued, which strengthens relations between the counselors and customers, with the objective of providing improved service and increasing customer satisfaction. The "Odem" system was developed, which serves as a tool for researching customers and for obtaining recommendations about the level of risk and the recommended investment mix for the customer.

This system began to be assimilated during the first quarter of 2009. In addition, use is made of the Reuters and Bloomberg systems as decision-making support information.

Critical Success Factors in the Private Banking Segment

– A range of comprehensive and advanced solutions and products for managing customers' assets and responding to their needs;
– Counseling of customers by a professional team supported by analysts and information systems;
– Provision of personal and customized VIP services, over and above routine financial services;
– Expansive international spread of the Group's subsidiaries and representative offices.

The Main Entry and Exit Barriers in the Segment

– Training of skilled, qualified manpower possessing high levels of professionalism and service abilities;
– International spread of centers of activity throughout the world;
– Implementation of means of control over the entire range of activities;
– Establishment, maintenance and upgrading of advanced technological information systems;
– Offering a broad spectrum of financial products and services.

Marketing and Distribution

The marketing objective is to increase the customer base while creating image differentiation, both within the Group and *vis-à-vis* the competition. In addition, marketing efforts are geared to preserving customers and to increasing the Bank's share in the customers' asset portfolio. Marketing the private banking segment is carried out through image advertising in the media and press aimed at an affluent target audience, as well as through customer events, professional conferences, group meetings, direct mailings and the internet.

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 substantial 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 2008, the average number of positions assigned to the segment totalled some 898 positions, of which 410 were management positions, compared with 872 positions in 2007, 379 of which were management positions.

Employees of the private banking segment undergo comprehensive training, including professional courses and managerial workshops in Israel and abroad. Particular attention is paid to the recruitment and training of employees as investment counselors, including training towards obtaining an investment counselor's license from the Israel Securities Authority.

Cooperation Agreements

As stated, the private banking segment offers customers a broad range of products in cooperation with international entities, within the framework of open architecture. Through this cooperation, Leumi offers a range of advanced investment products constituting the main attraction for foreign resident investors – both existing and new investors – which consequently 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 further details, see pages 171 to 172 below.

Following are condensed operating results of the private banking segment:

	Banking and finance in Israel	Credit cards	Capital market	Real estate	Overseas activities: Banking and finance	Overseas activities: Capital market	Overseas activities: Real estate	Total
	2008							
	NIS millions							
Net interest income:								
From external sources	**(515)**	**–**	**–**	**(1)**	**(80)**	**–**	**(1)**	**(597)**
Intersegmental	**661**	**–**	**–**	**10**	**285**	**–**	**3**	**959**
Operating and other income:								
From external sources	**36**	**1**	**118**	**5**	**99**	**137**	**1**	**397**
Intersegmental	**1**	**1**	**–**	**–**	**13**	**–**	**–**	**15**
Total income	**183**	**2**	**118**	**14**	**317**	**137**	**3**	**774**
Provisions for doubtful debts	**–**	**–**	**–**	**–**	**10**	**–**	**–**	**10**
Operating and other expenses:								
To external sources	**149**	**2**	**40**	**7**	**262**	**120**	**1**	**581**
Intersegmental	**–**	**1**	**–**	**–**	**(3)**	**1**	**–**	**(1)**
Operating profit (loss) before taxes	**34**	**(1)**	**78**	**7**	**48**	**16**	**2**	**184**
Provision for taxes	**14**	**–**	**29**	**3**	**22**	**4**	**–**	**72**
Operating profit (loss) after taxes	**20**	**(1)**	**49**	**4**	**26**	**12**	**2**	**112**
Minority interests in profits of consolidated subsidiaries	**–**	**–**	**–**	**–**	**(2)**	**–**	**–**	**(2)**
Net operating profit (loss)	**20**	**(1)**	**49**	**4**	**24**	**12**	**2**	**110**
Profit from extraordinary items after taxes	**–**	**3**	**–**	**–**	**–**	**–**	**–**	**3**
Net profit	**20**	**2**	**49**	**4**	**24**	**12**	**2**	**113**
% return on equity								**19.0%**
Average balance of assets	**1,448**	**49**	**–**	**231**	**8,378**	**–**	**64**	**10,170**
Average balance of liabilities	**22,921**	**–**	**–**	**597**	**15,351**	**–**	**301**	**39,170**
Average balance of risk assets	**842**	**49**	**–**	**217**	**6,327**	**–**	**61**	**7,496**
Average balance of mutual fund and supplementary training fund assets	**–**	**–**	**2,957**	**–**	**–**	**1,670**	**–**	**4,627**
Average balance of securities	**–**	**–**	**28,557**	**–**	**–**	**33,565**	**–**	**62,122**
Average balance of other assets under management	**292**	**–**	**–**	**–**	**–**	**–**	**–**	**292**
Margin from credit-granting activities	**16**	**–**	**–**	**3**	**30**	**–**	**1**	**50**
Margin from accepting deposits	**116**	**–**	**–**	**4**	**154**	**–**	**1**	**275**
Other	**14**	**–**	**–**	**2**	**21**	**–**	**–**	**37**
Total net interest income	**146**	**–**	**–**	**9**	**205**	**–**	**2**	**362**
Balance of credit to the public	**1,292**	**50**	**–**	**291**	**4,741**	**–**	**64**	**6,438**
Balance of deposits of the public	**23,098**	**–**	**–**	**719**	**13,939**	**–**	**301**	**38,057**

Private banking segment (continued)

	Banking and finance in Israel	Credit cards	Capital market	Real estate	Overseas activities Banking and finance	Overseas activities Capital market	Total
	2007						
	NIS millions						
Net interest income:							
From external sources	(1,083)	–	–	(15)	(192)	–	(1,290)
Intersegmental	1,240	–	–	23	504	–	1,767
Operating and other income:							
From external sources	38	1	123	4	132	163	461
Intersegmental	2	1	–	–	13	–	16
Total income	197	2	123	12	457	163	954
Provisions for doubtful debts	1	–	–	(1)	–	–	–
Operating and other expenses:							
To external sources	170	2	69	8	332	103	684
Intersegmental	–	–	–	–	2	1	3
Operating profit before taxes	26	–	54	5	123	59	267
Provision for taxes	9	–	21	2	32	12	76
Operating profit after taxes	17	–	33	3	91	47	191
Minority interests in profits of consolidated subsidiaries	–	–	–	–	(5)	–	(5)
Net operating profit	17	–	33	3	86	47	186
Profit from extraordinary items after taxes	–	–	6	–	–	–	6
Net profit	17	–	39	3	86	47	192
% return on equity							33.4%
Average balance of assets	1,465	32	–	167	8,593	–	10,257
Average balance of liabilities	25,008	–	–	550	17,019	–	42,577
Average balance of risk assets	1,039	28	–	167	5,725	–	6,959
Average balance of mutual fund and supplementary training fund assets	–	–	3,346	–	–	2,289	5,635
Average balance of securities	–	–	28,783	–	–	36,268	65,051
Average balance of other assets under management	417	–	–	–	–	–	417
Margin from credit-granting activities	16	–	–	3	64	–	83
Margin from accepting deposits	133	–	–	3	318	–	454
Other	8	–	–	2	(70)	–	(60)
Total net interest income	157	–	–	8	312	–	477
Balance of credit to the public	1,433	48	–	167	5,490	–	7,138
Balance of deposits of the public	23,998	–	–	550	16,368	–	40,916

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 99 billion as at 31 December 2008, compared with NIS 109 billion at the end of 2007, a decline of 9.2%. Deposits of the public in this segment declined by some NIS 2.9 billion (7%), which derived mainly from a decline of some NIS 2.2 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 decreased by some NIS 0.7 million. The decline derived mainly from appreciation of the shekel against most other currencies. There was a decrease in the value of securities, including mutual funds, of some NIS 12.5 billion (17.2%), as a result of a decline in market values of securities.

Changes in the Net Profit

Net profit of the private banking segment in 2008 totaled NIS 113 million, compared with NIS 192 million in the corresponding period in 2007, a decrease of NIS 79 million, such being 41.1%.
The decrease in the segment derived mainly from the subsidiaries in Luxembourg, the UK and Switzerland, which was partially offset by the increase in activities in Israel and in the US. The decline in the activity abroad was mainly caused by the decrease in value of investments in securities in the said subsidiaries.

6. 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 areas 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 investment instruments (primarily debentures and 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 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 that are institutional investors;
- Sub-custody management.

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, 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 policies for capital management and capital adequacy requirements, policies for managing market risks and the *nostro*, while devoting attention to management of the current liquidity and to durability under stress conditions, and the interest and financial margin policies. The business objectives of the financial management segment are to meet profit targets (with the activities being 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, including: the Bank of Israel and the Banking Supervision Department, the Commissioner 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 by virtue of permits from the Banking Supervision Department, and are also subject to local regulations.

The Segment's Profit

The segment's profit is mainly affected by the *nostro* activities and the dealing rooms. Following are the principal components of net interest income:

– 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 of the market risks from the other operational segments are also transferred.
– Results of capital management, including capital raising and offerings to the public;
– Profits/losses from the realization of securities and from provisions for declines in values of securities in respect of declines of a non-temporary nature, and from unrealized profits/losses from adjustments of securities for trading to market value.
– Adjustments of derivatives to market value;
– Effects of foreign currency/shekel exchange rate and consumer price index differentials, including adjustments from the translation of overseas investments, including the effects of related taxes;
– Income deriving from the investment of pension, jubilee and regular holiday reserves;
– Particular costs relating to pension liabilities;
– Profits of companies included on an equity basis.

Operating expenses of the segment include mainly direct operating expenses, as well as indirect expenses involved in the management of market risks, management of the independent securities portfolios (the *nostro*), and management of the dealing rooms.

In 2008, the segment's loss totaled NIS 1,469 million, compared with a profit of NIS 411 million in 2007.

This segment includes the Group's share of the profits of companies included on the equity basis, as detailed below on page 142.

The loss from operating activities is explained by the following factors:

- A decrease of NIS 1,413 million in the net interest income, arising mainly from a decrease in value of investments in available-for-sale securities, and from losses from realizations of investments in securities;
- A loss in operating income of NIS 622 million, arising from the realization of available-for-sale securities (funds) at a loss, as well as from the realization of funds for trading;
- An increase in operating expenses in the sum of NIS 710 million, arising from an increase in operating expenses not allocated to other operational segments, mainly an increase in the liability for pensions of pensioners, an increase in the provision for severance pay and pensions, due to the losses of the severance pay fund and the provident funds which are used as a reserve for the said liabilities.

The Principal Developments in the Business Environment

The crisis that began in 2007 intensified in 2008 in the global financial markets and in Israel. Despite the unprecedented support of the banking systems by governments of their countries, and the injection of capital by the central banks, the standing of the global banking system was weakened. Against this background, the management of exposures became increasingly crucial to banking systems worldwide.

Therefore, in 2008, the activity of this segment focused on minimizing exposures, diversifying risks and diverting investments to uses bearing low risks and yields.

The segment's results in 2008 were adversely affected by decrease in value of the *nostro* portfolios, against the background of the crisis in the global securities markets and in Israel.

Human Capital

In 2008, the average number of positions assigned to the segment was some 478 positions, of which 235 were management positions, compared with 361 positions in 2007, 209 of which were management staff positions.

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 investments of the Leumi Group in companies included on the equity basis totaled some NIS 1,837 million on 31 December 2008, compared with NIS 1,873 million on 31 December 2007.

	Balance Sheet Value (NIS millions)			Market Value (NIS millions)	
	31 December	31 December	Change	**31 December**	31 December
Name of Company	**2008**	2007	%	**2008**	2007
The Israel Corporation Ltd.	**1,186**	1,138	3.8	**1,184**	5,613
Paz Oil Company Ltd.	**485**	560	(13.4)	**571**	920
Others	**171**	175	(2.3)	–	–
Total	**1,842**	1,873	(1.9)	**1,755**	6,533

The contribution of the companies including on the equity basis to the Group's profit in 2008 amounted to NIS 249 million, compared with NIS 184 million for the corresponding period in 2007. The increase in the contribution to the Group's profit in 2008 arises from increased profits of the Israel Corporation Ltd. ("the Israel Corporation") and the Paz Oil Company Ltd. ("Paz").

As a result of the global crisis and the recession in the economy, the operating results of the companies were adversely affected in the fourth quarter of 2008. With regard to the Israel Corporation, the deterioration derived mainly from the losses of Zim and Oil Refineries Ltd.

Following are the contributions of the companies to the Group's net profit (in NIS millions):

	2008	2007	% change
The Israel Corporation Ltd.	**157**	110	62.7
Paz Oil Company Ltd.	**82**	65	26.2
Others	**10**	9	11.1
Total	**249**	184	47.3

The Israel Corporation Ltd. – Restrictions in the Control Permit of Oil Refineries Ltd. (ORL)

The control permit for ORL, which was issued to 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 as long as: the Israel Corporation is a controlling shareholder of ORL, and Paz is a controlling shareholder of ORA, and the Bank has a right or the ability to appoint, to recommend or to otherwise influence the appointment of a director in the Israel Corporation and in Paz.

Paz Oil Company Ltd.

Leumi Real Holdings Ltd. holds 15.73% of Paz. In January 2007, Leumi appointed two directors in Paz, constituting 20% of its Board of Directors. Following the Israel Corporation's acquisition of the control over ORL, the Government Companies Authority considered amending the control permit for ORA, which was issued to Paz's controlling shareholders. In a letter dated 16 September 2007, the Government Companies Authority advised that:

"In light of the Immediate Reports filed by Bank Leumi le-Israel on 5 July 2007 and 22 August 2007 regarding its intention of attempting to sell its holdings in the Paz Oil Company Ltd. ("Paz"), following 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, which had been issued to Paz on 27 September 2006."

Holdings in Real (Non-banking) Holding Corporations (Conglomerates)

The Bank's holdings in real (non-banking) corporations are subject to restrictions prescribed in the Banking (Licensing) Law, 1981 (the "Banking Law"). The Banking Law prescribes, *inter alia*, in section 24A of the Law, that a banking corporation may hold a means of control in one conglomerate only (a "real (non-banking) holding corporation") (a corporation whose capital exceeds some NIS 1,901 million and that operates in more than three branches of the economy). With regard to a memorandum for the amendment of section 24A of the Banking Law, see pages 145 to 146. The Bank holds 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 Paz's shareholders' equity exceeds the minimal amount of capital for the definition of a conglomerate (a real (non-banking) holding corporation).

Prior to the publication of the aforesaid financial statements, discussions had already been held between the Bank and the Bank of Israel with regard to the interpretation of the Banking Law with respect 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 pursuant to 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 by 30 June 2009. Following discussions in August 2007 regarding the Bank's holdings in real (non-banking) holding companies, and in light of the Bank of Israel's position (and subject to the course of the discussions still underway with the Bank of Israel in this regard, whereby the Bank disagrees with the Bank of Israel's position), the Bank intends to attempt to sell its holdings in Paz (15.73% of the share capital and voting rights – 15.31% on a fully-diluted basis); this being subject to the conditions, 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 timetable or in the position of the Bank of Israel by then.

Migdal Financial and Insurance Holdings Ltd.

The Bank holds 9.85% of the issued and paid-up share capital of Migdal Financial and Insurance Holdings Ltd. ("Migdal Holdings"), (9.74% fully diluted), which controls the Migdal Insurance Company Ltd.
Pursuant to the Bank of Israel's interpretation of the Banking (Licensing) Law (an interpretation with which the Bank disagrees), the Bank must also sell its holdings in Migdal Holdings, since, according to the said law, it is considered a "real (non-banking) holding corporation."
It should be noted that, pursuant to the legislation enacted following the capital market reform, the Bank may hold five percent of the capital of an insurance company, and ten percent of the capital of a corporation controlling an insurance company.

On 25 December 2008, the Bank of Israel extended the permit issued to the Bank for the holding of Migdal shares until 30 August 2009, provided that the shares were transferred to a trustee. The shares were transferred to a trustee on 4 January 2009. Pursuant to the Bank of Israel directives, if the shares held by the trustee are not sold by 30 April 2009, the trustee will sell the shares to a third party by no later than 30 August 2009. The trustee was vested with all the rights that the shares confer (excluding the rights vested with the Bank – the right to sell the shares to a third party or the right to distribute them as a dividend *in specie* up until 30 April 2009, and the right to receive dividends).

On 19 March 2009, a Banking (Licensing) Law amendment memorandum was distributed, pursuant to which the Ministry of Finance, with the consent of the Bank of Israel, is proposing to exclude insurance companies from the definition of a conglomerate. The Bank is holding discussions with the Bank of Israel regarding the effect of the said memorandum on the Bank's holding in the shares of Migdal Holdings.

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 a portion of the activities of the capital market companies that is not attributed to other segments. The main companies are Leumi Partners and Leumi Capital Market Services.

The latter company was formerly was a provident fund management company, which sold its operations due to the capital market reform legislation, and which became a company engaging mainly in the provision of operating services to management companies in the field of provident funds. In addition, a separate department of the company engages in the provision of distribution operating services (monitoring the performance of the counselors' recommendations, receiving answers and forwarding forms) of pension products, including supplementary training funds, for Bank Leumi.

Leumi Capital Market Services provides operating services to 18 management companies, of which five are companies that purchased the assets from the Leumi Group. The value of the assets being operated by the company amounted to some NIS 44.6 billion on 31 December 2008. Most of the operating services are provided to the aforesaid five companies, and the company is affiliated with them through agreements for a number of years.

In 2008, the loss of the Others Segment totaled NIS 189 million, compared with a profit of NIS 194 million in 2007, a decrease of NIS 383 million.

The following table presents a summary of the main changes, in NIS millions:

	2008	2007	Difference
Profit from extraordinary items	-	26	(26)
Operating activity at the Bank	**79**	35	44
Leumi Partners(1)	**(56)**	120	(176)
Leumi Capital Market Services	**(4)**	6	(10)
Other companies in Israel	**(4)**	(24)	20
Companies abroad	**4**	20	(16)
Tax adjustments(2)	**(208)**	11	(219)
Total	**(189)**	194	(383)

(1) Resulting mainly from a decrease in value of securities. The profit in 2007 arose mainly from the sale of a portion of the shares of 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 21 May 2008, Leumi Card allotted 20% of the issued and paid-up share capital of Leumi Card to Canit – Investment and Finance Management Ltd. The net profit recorded in respect of this operation amounted to NIS 234 million.

In 2007, the sale of a portion of the provident funds to Prisma Provident Funds Ltd. and the sale of the supplementary training funds to Midgal Capital Markets were completed. The net profit recorded in 2007 in respect of the aforesaid amounted to NIS 350 million.

The profit from extraordinary items from the allotment of share capital in Leumi Card and from the sale of the provident funds were allocated to the various operational segments, according to their proportionate share in the income from this activity.

For further details regarding the allotment of share capital to Canit, see pages 146 to 147.

Activities in Products

A. Capital market activities

The Group’s activities in the capital market include investment counseling and pension counseling activities, brokerage in the securities and financial instruments market, including activity carried out through the foreign currency dealing rooms and the Israeli and foreign securities dealing rooms, brokerage and custody services, and banking and financial services to entities active in the capital market. A subsidiary of Leumi Partners Ltd., Leumi Partners Underwriters Ltd. engages in underwriting and the distribution of private and public offerings. The Group's activity in the capital market was materially affected by the capital market reform, and in 2008, by the global crisis in the capital and money markets.

For details regarding the impact of the capital market reform legislation on the Group’s activities, and the steps taken subsequently, see pages 35 to 39 of these Financial Statements.

Net profit from capital market activities totaled NIS 241 million, compared with NIS 559 million in the corresponding period in 2007, a decrease of NIS 318 million. The decrease in the net profit arises from:

1. A decrease in the net profit from extraordinary items in the sum of NIS 348 million, as a result of the execution of the sales of activities in 2007.
2. On the other hand, net operating profit increased from NIS 211 million to NIS 241 million, due to the decrease in operating expenses in the amount of NIS 202 million, which was partially offset by a decline in income of NIS 150 million due to a decrease in activity.

The following table presents 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 Partners:

	House-holds	Small businesses	Corporate banking	Commercial banking	Private banking	Financial management and Others	Overseas activities	Total
	2008							
	NIS millions							
Net interest income	**1**	**1**	**–**	**1**	**–**	**–**	**–**	**3**
Operating and other income	**451**	**20**	**25**	**48**	**118**	**93**	**154**	**909**
Total income	**452**	**21**	**25**	**49**	**118**	**93**	**154**	**912**
Operating and other expenses	**265**	**7**	**12**	**39**	**40**	**48**	**121**	**532**
Operating profit before taxes	**187**	**14**	**13**	**10**	**78**	**45**	**33**	**380**
Net profit	**118**	**9**	**8**	**6**	**49**	**26**	**25**	**241**

	House-holds	Small businesses	Corporate banking	Commercial banking	Private banking	Financial management and Others	Overseas activities	Total
	2007							
	NIS millions							
Net interest income	–	2	–	–	–	–	–	2
Operating and other income	505	21	29	56	123	150	176	1,060
Total income	505	23	29	56	123	150	176	1,062
Operating and other expenses	392	11	19	43	69	95	105	734
Operating profit before taxes	113	12	10	13	54	55	71	328
Operating profit after taxes	70	8	6	8	33	31	55	211
Profit from extraordinary items after taxes	278	26	18	16	6	4	–	348
Net profit	348	34	24	24	39	35	55	559

B. Credit cards - Leumi Card

This activity includes mainly the activity of issuing credit cards to private customers and providing voucher 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 of Visa cards and MasterCard cards and for the provision of acquiring services.

On 21 May 2008, the Board of Directors of the Bank and the Board of Directors of Leumi Financial Holdings Ltd. (a subsidiary of the Bank) resolved to approve a transaction whereby Leumi Card shall allot shares of Leumi Card to Canit – Investment and Finance Management Ltd., constituting 20% of the issued and paid-up share capital of Leumi Card, for the consideration of a total of NIS 360 million payable to Leumi Card. On 26 May 2008, the aforesaid transaction was signed and completed and the consideration was transferred to Leumi Card. Within the scope of the transaction, Canit has customary minority protection rights, as well as a right to appoint two directors. In addition, Leumi Financial Holdings Ltd. (the owner of 80% of the shares of Leumi Card) received various customary rights at the time of a sale or an addition of a partner.

The net profit recorded as a result of the aforesaid allotment is some NIS 234 million.

As from 2001, Leumi Card has operated as the company issuing "Leumi Visa" credit cards and "MasterCard" credit cards jointly with the Bank. In addition, Leumi Card independently issues credit cards to customers of all of the banks, the majority of these customers being members of various clubs who, as stated, are not customers of the Bank. Leumi Card also operates in the field of Visa credit card and MasterCard credit card transaction acquiring services for businesses.

The turnover of the credit card activity rose in 2008 at the rate of 11% compared with 2007.

The acquiring service turnover increased during this period at the rate of 12%.

During 2008, Leumi Card continued to expand the services being offered to its customers. Leumi Card continued to offer prepaid, private label cards to customers – cards that replace vouchers, both as gift cards and as loyalty cards in chain stores. In addition, Leumi Card continued to lead the market in the issuance of “Multi” revolving credit cards.

For business customers, the company offered services in the B2B (business to business) payments field, 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, totaled some NIS 789 million in 2008, compared with some NIS 685 million in 2007.

Leumi Card ended 2008 with a net profit of NIS 146 million, compared with NIS 104 million in 2007, an increase of some 40.4%. Net operating profit amounted to NIS 129 million, compared with NIS 104 million in 2007, an increase of 24.0%.

The following table presents a summary of income from credit card activities (in NIS millions):

	2008	2007
Net operating profit of Leumi Card	146	104
The Bank’s share in the interchange fee, before tax	73	68
Card fees, before tax, collected by the Bank	79	52

In addition, the Bank collected interest amounting to NIS 85 million in 2008 in respect of credit provided for the financing of purchases by credit card (in 2007 – NIS 68 million).

The following table presents data on credit card activities as presented in the various operational segments:

	Households	Small businesses	Corporate banking	Commercial banking	Private banking	Total
	2008					
	NIS millions					
Net interest income	**118**	**11**	**31**	**8**	**–**	**168**
Operating and other income	**668**	**25**	**54**	**16**	**2**	**765**
Total income	**786**	**36**	**85**	**24**	**2**	**933**
Provisions for doubtful debts	**18**	**1**	**6**	**1**	**-**	**26**
Operating and other expenses	**456**	**26**	**89**	**24**	**3**	**598**
Operating profit (loss) before taxes	**312**	**9**	**(10)**	**(1)**	**(1)**	**309**
Operating profit (loss) after taxes	**213**	**5**	**(8)**	**(1)**	**(1)**	**208**
The Group's share in the profits of companies included on the equity basis, net	**–**	**–**	**–**	**1**	**–**	**1**
Profit from extraordinary items	**202**	**18**	**2**	**26**	**3**	**251**
Net profit (loss)	**402**	**23**	**(6)**	**26**	**2**	**447**

	Households	Small businesses	Corporate banking	Commercial banking	Private banking	Total
	2007					
	In NIS millions					
Net interest income	75	8	16	4	–	103
Operating and other income	594	18	43	15	2	672
Total income	669	26	59	19	2	775
Provisions for doubtful debts	13	–	2	–	–	15
Operating and other expenses	464	20	68	16	2	570
Operating profit (loss) before taxes	192	6	(11)	3	–	190
The Group's share in the profits of companies included on the equity basis, net	–	–	–	5	–	5
Net profit (loss)	136	4	(8)	7	–	139

Interchange Fee

On 31 August 2006, the Antitrust Tribunal handed down a ruling regarding the question of determining the appropriate methodology for calculating the cross acquiring fee (interchange fee) (the "Decision on the Methodology"), which is payable by the acquirers to the issuers of Visa cards, this following an application filed with the Tribunal for the approval of a restrictive arrangement signed between the Bank, Leumi Card, Israel Discount Bank Ltd., Israel Credit Cards Ltd. ("CAL"), and the First International Bank of Israel. Within the scope of the Decision on the Methodology, the Tribunal rejected the arguments of the applicants for the approval of the arrangement (the credit card companies and the banks controlling them), and ruled that, in general, when calculating the interchange fee, the following components must be taken into account: the cost of approving the transaction, the cost of guaranteeing payment and the cost of financing the credit.

Regarding the customary categories of interchange fee rates, the Tribunal ruled against the position of the credit card companies and the banks applying for the approval, and declared that when determining the categories, the costs of guaranteeing payments in various transactions, the cost of approving transactions and the determining of benefit from the payment guarantee service should be taken into account.

The Tribunal further ruled in its decision that the rates of all costs comprising the interchange fee should be determined by an independent external expert, on the basis of relevant data to be furnished to him.

On 1 February 2007, the Bank, Leumi Card and the other applicants for the approval, filed an appeal on the Decision on the Methodology to the Supreme Court. A hearing of the appeal has been scheduled for 8 July 2009.

On 30 October 2006, an arrangement was signed between Isracard Ltd., Leumi Card, and CAL and the banks that control each of these companies, which regulates the cross acquiring services for Visa and MasterCard cards (the "Arrangement"). The Arrangement is for a period of six and a half years and enables, for the first time, cross acquiring services for Visa and MasterCard brands by all three major credit card companies in Israel, this, as opposed to the cross acquiring arrangement that had been customary up until then, which regulated the services for Visa cards only.

The Arrangement includes, *inter alia*, determinations in respect of the rates of the interchange fee, a format for a gradual reduction of the interchange fee over the period of the Arrangement and the gradual downsizing of the structure of categories customary today in relation to the interchange fee rate.

The Arrangement also 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 designed to ensure the safeguarding of fair competition and to prevent cross-subsidizing in the competition between the credit card companies.

On 30 October 2006, the Arrangement was filed for the approval of the Antitrust Tribunal, and for the granting of a temporary permit. On 31 October 2007, the Tribunal decided to grant a temporary permit for the Arrangement, after having previously issued a provisional permit for the Arrangement.

From December 2006 until February 2007 a number of objections to the application for approval of a restrictive arrangement 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 additional acquirers joining 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, the Tribunal decided, in November 2007, to appoint an expert who is to examine the assessment of the competitive effect of the rate of the interchange fee prescribed in the Arrangement, and that the expert is to be appointed by and be directly subordinate to the Antitrust Authority. The Tribunal prescribed that the expert would be required to present to the Tribunal and to all parties in the case his detailed methodology for implementing the Decision on the Methodology. Following the questioning of the expert in relation to his opinion, he will be required to proceed with his examination, until the interchange fee obtained from implementing the methodology is examined.

Pursuant to the Tribunal's decision, Dr. Yossi Bachar was appointed as an evaluating expert, and, on 1 January 2009, his opinion was submitted to the Tribunal and to the parties. The Tribunal has yet to set a date for questioning the expert about his opinion.

The total interchange fees received by the Bank in 2008 totaled NIS 73 million, following transfer of NIS 31 million to Leumi Card, compared with NIS 68 million during the corresponding period in 2007.

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 discounting credit card transactions. Within the framework of the purchase agreement, Leumi Card was granted an option to purchase an additional 67% of Gamma'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 subject to the terms stipulated in the sale agreement.

On 29 April 2008, an agreement was signed between the shareholders of Gamma and Leumi Card inclusively, and Phoenix Holdings Ltd., pursuant whereto, the Phoenix purchased 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 sum of some NIS 64 million.

In addition, shareholder loans that Leumi Card had provided to Gamma were repaid, in the amount of some NIS 11 million. On the same date, an agreement was signed between Leumi Card and Gamma, under which Gamma sold to Leumi Card its entire stake in Leumi Check Ltd. (25% of the issued and fully paid share capital of Leumi Check), and in Leumi Check Limited Partnership (the "Partnership") (24.75% of all partnership rights in the partnership), for the consideration of the sum of NIS 3,750 thousand. In addition, the Partnership repaid to Gamma the balance of the loans that Gamma had provided to the Partnership, in the amount of some NIS 875 thousand.

In respect of these transactions, the Company recorded a net profit from extraordinary items, after taxes, of NIS 17 million.

C. Construction and Real Estate

This activity includes the activity in the field of construction and real estate in the Bank's various operational segments.

For further details see pages 124 to 127 under the operational segments.

The following table sets out data regarding construction and real estate activities, as presented in the various operational segments:

	Small businesses	Corporate banking	Commercial banking	Private banking	Overseas activity	Total
	2008					
	NIS millions					
Net interest income	**183**	**537**	**191**	**9**	**149**	**1,069**
Operating and other income	**47**	**50**	**25**	**5**	**12**	**139**
Total income	**230**	**587**	**216**	**14**	**161**	**1,208**
Provisions for doubtful debts	**24**	**341**	**67**	**-**	**10**	**442**
Operating and other expenses	**77**	**100**	**55**	**7**	**51**	**290**
Operating profit before taxes	**129**	**146**	**94**	**7**	**100**	**476**
Net profit	**82**	**92**	**60**	**4**	**82**	**320**

	Small businesses	Corporate banking	Commercial banking	Private banking	Overseas activity	Total
	2007					
	NIS millions					
Net interest income	168	573	203	8	107	1,059
Operating and other income	46	41	31	4	13	135
Total income	214	614	234	12	120	1,194
Provisions for doubtful debts	31	(36)	6	(1)	4	4
Operating and other expenses	99	104	61	8	49	321
Operating profit before taxes	84	546	167	5	67	869
Net profit	52	336	102	3	50	543

Profit centers in the Group

The following table presents details on the contribution of the Group's principal profit centres to the net operating profit:

	2008(1)	2007(1)	Change	**2008**(2)	2007(2)	Change
	NIS millions		%	NIS millions		%
The Bank	**(644)**	1,934	(7)	**(453)**	2,127	(7)
Consolidated subsidiaries in Israel (4)	**432**	710	(39.2)	**432**	710	(39.2)
Consolidated subsidiaries abroad (5)	**(110)**	220	(7)	**(301)**	27	(7)
Companies including on an equity basis (4)	**164**	120	36.7	**164**	120	36.7
Net operating profit	**(158)**	2,984	(7)	**(158)**	2,984	(7)
Profit (loss) of the subsidiaries abroad, in nominal terms (US$ millions) (6)	**(26)**	91	(7)	**(26)**	91	(7)

(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.
(3) After neutralizing the effect of the special salary expenses, the net operating profit decreased by 90.2%.
(4) Companies including on an equity basis of subsidiaries in Israel were included in consolidated subsidiaries in Israel.
(5) Following particular adjustments to Israeli accounting principles.
(6) As reported by the subsidiaries abroad, including branches abroad and minority interests.
(7) A change was not specified due to the transition from profit to loss.

Following are the principal changes in the contributions of the profit centers (after translation adjustments):

The Bank

The decline in the net operating profit at the Bank derived mainly from:

- A decline of NIS 1,090 million in the net interest income;
- An increase of NIS 1,433 million in the provisions for doubtful debts;
- A decrease of NIS 1,128 million in operating income;
- An increase of NIS 26 million in operating and other expenses;
- The decrease in net interest income and in operating expenses arises mainly from provisions for a decline in value and losses from the realization of investments in securities, against the background of the global financial crisis.

Subsidiaries in Israel

The decline in the net operating profit of consolidated subsidiaries in Israel derived mainly from a decline in the profits of Leumi Mortgage Bank in the amount of NIS 93 million, mainly as a result of an increase in the provisions for doubtful debts, and from a loss of Leumi Partners in the amount of NIS 46 million, mainly as a result of an devaluation of the investments in securities, compared with a profit in the amount of NIS 128 million in 2007. On the other hand, Leumi Card's profits improved, in the sum of NIS 12 million.

Subsidiaries Abroad

The decline in profits of subsidiaries abroad derived from a decline in profitability of the subsidiaries in the United States, Romania, Switzerland and Leumi Re, and from losses of the subsidiaries in England and in Luxembourg. The total contribution to profit of the subsidiaries abroad (excluding foreign branches), in a convenience translation to US dollars, totaled some US$ 5.8 million, compared with some US$ 79 million in the corresponding period in 2007. The contribution of the subsidiaries abroad to the net operating profit in shekels (with particular adjustments to accounting principles in Israel, and after offsetting exchange rate differentials in respect of the sources of financing after the tax effect) totalled a loss of NIS (110) million, compared with a profit of NIS 220 million in the corresponding period in 2007.

Excluding the effect of the exchange rate differentials in respect of the net cost of the sources of financing, the loss in the subsidiaries abroad totalled NIS 301 million, compared with a profit of NIS 27 million in the corresponding period in 2007. This decrease of NIS 328 million was derived from a decline in profits, primarily as a result of a decline in the value of securities, from an increase in provisions for declines in the value of investments in securities and from an increase in provisions for doubtful debts.

The following table presents a summary of the aforesaid data:

	For the year ended December 31	
	2008	2007
	NIS millions	
Operating profit (loss) of the subsidiaries in shekels (the Group's share)	**(23)**	335
Exchange rate differentials in respect of the investment	**(278)**	(308)
Exchange rate differentials in respect of the net cost of the sources of financing	**191**	193
Total contribution of the subsidiaries (after offsetting the net cost of the sources of financing)	**(110)**	220
Total contribution of the subsidiaries without offsetting the cost of the sources of financing	**(301)**	27

For further details about the subsidiaries, see pages 165 to 171.

Companies Included on the Equity Basis

The increase in the profits of the companies included on an equity basis derived from an improvement in the profits of the Israel Corporation and Paz.

For further details, see pages 142 to 143.

Activities According to the Group's Structure

The volume of activities in Israel rose in 2008 by 4.7%, while the volume of activities abroad declined by 6.3%.

Credit to the public in activities in Israel totaled some NIS 189.2 billion at the end of 2008, compared with NIS 173.6 billion at the end of 2007, a rise of 9.0%. Credit to the public in overseas activities totaled some NIS 24.0 billion at the end of 2008, compared with NIS 24.9 billion at the end of 2007, a decline of 3.8%.

Deposits of the public in activities in Israel totaled some NIS 212.9 billion at the end of 2008, compared with NIS 203.2 billion at the end of 2007, an increase of 4.8%. Total deposits in overseas activities totaled some NIS 31.9 billion at the end of 2008, a decline of 8.5%.

Information According to Geographical Regions*

The following table presents principal data according to geographical regions (in NIS millions):

	Total Balance Sheet			Credit to the Public			Deposits of the Public		
	December 31								
Region	**2008**	2007	Change	**2008**	2007	Change	**2008**	2007	Change
			%			%			%
Israel	**268,792**	257,326	4.5	**189,208**	173,598	9.0	**212,923**	203,243	4.8
United States	**22,033**	22,427	(1.8)	**13,810**	13,371	3.3	**15,971**	17,774	(10.1)
United Kingdom	**8,760**	11,027	(20.6)	**6,457**	7,860	(17.8)	**5,901**	9,033	(34.7)
Switzerland	**3,453**	3,110	11.0	**1,977**	2,192	(9.8)	**1,408**	543	159.3
Luxembourg	**5,312**	5,893	(9.9)	**111**	135	(17.8)	**7,111**	5,861	21.3
Romania	**1,874**	1,790	4.7	**1,204**	942	27.8	**979**	1,148	(14.7)
Others abroad	**568**	578	(1.7)	**448**	459	(2.4)	**490**	443	10.6
Total	**310,792**	302,151	2.9	**213,215**	198,557	7.4	**244,783**	238,045	2.8

* Classified according to the location of the office.
For details regarding exposures to foreign countries, see the Management Review, Exhibit F of the Report.

The following table presents a breakdown of the net profit by geographical regions:

	NIS millions		
Region	**2008**	2007	% Change
Israel (1)	**516**	3,308	(84.4)
United States (2)	**31**	(37)	+
United Kingdom (3)	**(243)**	45	–
Switzerland (4)	**25**	9	178
Luxembourg (5)	**(192)**	26	–
Romania (6)	**(54)**	(29)	86.2
Others abroad (7)	**9**	35	(74.3)
Total	**92**	3,357	(97.3)

The profit from activities abroad is shown according to their contribution in the consolidated financial statements.

1. Net profit in Israel declined by some NIS 2,792 million. Operating profit after tax at the Bank in Israel declined by some NIS 2,580 million (excluding companies included on the equity basis). The decline at the Bank derived mainly due to the reasons detailed on page 152 above.
   The net profit also declined at a number of subsidiaries in Israel, mainly: Leumi Mortgage Bank, Arab Israel Bank, and Leumi Partners.
2. The decrease in the profits of the subsidiary in the United States derived from the low appreciation of the shekel against the dollar in 2008, compared with a higher appreciation in 2007, and from the decline in the subsidiary's profitability as a result of losses and from provisions for the decline in value of securities.
3. The contribution of the subsidiary in the United Kingdom was negative, and was derived from the subsidiary's losses due to an increase in the provisions for doubtful debts, from the decline in value of securities held for investment and from the negative exchange rate differentials resulting from the appreciation of the shekel against the pound sterling.
4. The decline in profits of the subsidiary in Switzerland derived from the provisions in respect of the decline in value of securities, which was partially offset by the depreciation of the shekel against the Swiss franc.
5. The losses of the subsidiary in Luxembourg derived from the losses in respect of investments in securities.
6. The increase in profit of the subsidiary in Romania derived from an increase in activities.
7. The profit relates mainly to Leumi Re.

For further details, see note 28B to the Financial Statements.
For further details on the profits of the subsidiaries abroad, as reported by them, see below, on pages 163 to 164.

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 pages 142 to 144 with regard to investments in non-banking corporations).

The Bank's total investments in subsidiaries and affiliates amounted to NIS 12,518 million on 31 December 2008, compared with NIS 12,258 million on 31 December 2007, and their contribution to the Group's net profit amounted to NIS 295 million, compared with NIS 857 million in 2007. After offsetting translation adjustments in respect of overseas investments, their contribution to profit was NIS 508 million, compared with NIS 1,050 million in 2007.

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 Net Profit		
		2008	2007	**2008**	2007	Change
		%	%	NIS millions		%
The Bank (2)		**-**	-	**(410)**	2,305	-
Consolidated subsidiaries in Israel, total		**8.3**	10.9	**449**	709	(36.7)
of which:	Leumi Mortgage Bank	**6.1**	11.7	**126**	219	(42.5)
	Arab Israel Bank	**20.4**	24.6	**73**	88	(17.0)
	Leumi Card	**36.7**	86.6	**134**	104	28.8
	Leumi Partners(3)	**-**	39.9	**(46)**	128	-
	Leumi Securities and Investments	**6.7**	1.5	**3**	12	-
	Leumi Capital Market Services Ltd.	**-**	3.6	**(3)**	20	-
	Leumi L.P. Ltd.	**4.8**	-	**1**	(1)	+
	Leumi Real Holdings	**16.9**	13.4	**84**	65	29.2
	Leumi Industrial Development	**2.5**	3.7	**3**	4	(25.0)
	Leumi Agricultural Development	**1.9**	1.8	**1**	1	-
	Leumi Finance	**6.9**	6.5	**11**	10	10.0
	Leumi Leasing and Investments	**5.9**	5.5	**48**	43	11.6
	Others	**2.9**	3.1	**14**	16	(12.5)
Overseas consolidated subsidiaries, total (2)		**-**	5.0	**(111)**	223	-
of which:	Leumi USA (BLC)	**2.1**	3.9	**47**	92	(48.9)
	Leumi (UK)	**-**	10.1	**(103)**	77	-
	Leumi Switzerland	**2.3**	2.3	**12**	14	(14.3)
	Leumi Luxembourg	**-**	14.1	**(58)**	17	-
	Leumi Romania	**-**	-	**(17)**	(19)	+
	Leumi Re	**5.2**	36.1	**5**	37	-
Companies included on the equity basis, total		**12.7**	10.2	**164**	120	36.7
Group's total net profit		**0.5**	17.4	**92**	3,357	(97.3)

(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 pages 153 to 154.
(3) Previously Leumi & Co. Investment House Ltd. Including the profit and/or loss of Leumi Partners' companies included on the equity basis.

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.

* For the 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 5,561 million on 31 December 2008, compared with NIS 5,201 million on 31 December 2007. Their contribution to Group net operating profit amounted to some NIS 432 million in 2008, compared with NIS 709 million in 2007, a decrease of NIS 277 million, or 39.1%. The reduction in profit stems mainly from a decrease in the profits of Leumi Mortgage Bank and the Arab Israel Bank and the loss of Leumi Partners which was partially offset by the increase in profit of Leumi Card. The Group’s return on its investment in the above companies was 8.3% in 2008 compared with 10.9% in 2007.

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 solutions for the special requirements of the Arab population.

The Arab Israel Bank operates through two Districts (North and South Galilee and the Triangle) and 27 branches, situated mainly in the north of Israel and in the northern Triangle, and serves the Arab population. Arab Israel Bank engages in the entire range of banking activities. The Arab Israel Bank's total assets amounted to NIS 4,772 million at the end of 2008, compared with NIS 4,216 million at the end of 2007. Net profit of the Arab Israel Bank totaled NIS 73.5 million in 2008, compared with NIS 88.5 million in 2007, a decrease of 16.9%. The net return on shareholders' equity reached 19.5% in 2008, compared with 23.4% in 2007.

Shareholders' equity of the Arab Israel Bank amounted to NIS 344 million as at 31 December 2008, compared with NIS 334 million as at 31 December 2007. The Arab Israel Bank distributed a dividend of NIS 80 million in respect of 2008.

The ratio of equity to risk assets reached 17.84% as at 31 December 2008, compared with 16.38% as at 31 December 2007.

In December 2008, the Arab Israel Bank raised NIS 100 million in Tier II capital by issuing a subordinated capital note to the Bank; the note has no-repayment date but may be redeemed on advance notice of five years.

The Arab Israel Bank receives comprehensive operating and financial services from the Bank. In consideration for the services received from the Bank, the Arab Israel Bank paid the Bank NIS 28.1 million in 2008, compared with NIS 19.2 million in 2007.

According to a Bank of Israel audit report, dated 15 July 2008, dealing with the prohibition of money laundering, *prima facie* defects were found in compliance with the various statutory provisions dealing with the prohibition of money laundering and the financing of terrorism. In the letter accompanying the audit report, the Bank of Israel notified the Arab Israel Bank that it would, at a later date, receive notice of a request to impose a financial sanction pursuant to section 14(a) of the Prohibition of Money Laundering Law, 2000.

At this stage, it is not possible to estimate the size of the financial sanction (if indeed the request is submitted and if a financial sanction is imposed.)

Medium and Long-Term Financing Companies[1]

The assets of these companies amounted to NIS 12 billion at the end of 2008, compared with NIS 11.0 billion at the end of 2007. The business activity of these companies complements the activity of the Bank. The net profit of these companies amounted to some NIS 63.4 million in 2008, compared with NIS 61.1 million in 2007.

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 function of the Group.
The balance of credit to the public totaled NIS 948 million as at 31 December 2008, compared with NIS 976 million at the end of 2007.
The company’s total assets totaled NIS 1,062 million as at 31 December 2008, compared with NIS 1,071 million at the end of 2007.
The net profit in 2008 totaled NIS 48.3 million, compared with a profit of NIS 43.4 million in 2007.

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 10,792 million at the end of 2008, compared with NIS 9,687 million at the end of 2007. Shareholders’ equity amounted to NIS 157.3 million as at 31 December 2008. The company's net profit amounted to NIS 10.6 million in 2008, compared with net profit of NIS 10.2 million in 2007.

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 21 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 2008, similar to the end of 2007. Shareholders' equity amounted to NIS 104 million as at 31 December 2008. The net profit of Leumi Industrial Development amounted to NIS 2.6 million in 2008, compared with a net profit of NIS 3.9 million in 2007.

Leumi Agricultural Development Ltd.

Leumi Agricultural Development’s total assets amounted to NIS 100 million at the end of 2008, similar to the end of 2007. Shareholders' equity amounted to NIS 99.7 million as at 31 December 2008. The net profit of Leumi Agricultural Development amounted to NIS 2.0 million in 2008, compared with NIS 3.6 million in 2007.

(1) Including Leumi Industrial Development, Leumi Agricultural Development, Leumi Finance Company and Leumi Leasing & Investments.

Leumi Mortgage Bank Ltd.

Leumi Mortgage Bank was founded in 1921 and is the oldest mortgage bank in Israel.

Leumi Mortgage Bank concentrates its activities mainly on the granting of loans to apartment purchasers, loans for construction and renovation of real estate and loans for any financing purpose on the basis of the pledge of an existing residential property. The main sources for the financing of its activity are provided by the Bank (the parent company) and the total of deposits that the Bank had made available to Leumi Mortgage Bank as at 31 December 2008 amounted to NIS 26 billion.
Total credit to the public at Leumi Mortgage Bank was NIS 39.8 billion at the end of 2008, compared with NIS 35.8 billion at the end of 2007, an increase of 11.2%. This amount does not include credit from deposits according to the extent of collection totaling NIS 7.7 billion, compared with NIS 8.0 billion at the end of 2007, 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 banking system as at 31 December 2008, according to the Bank of Israel report on activities, was 25.6%, including credit to contractors.

Leumi Mortgage Bank's total assets amounted to NIS 40.0 billion on 31 December 2008, compared with NIS 36.0 billion at the end of 2007, an increase of 11.2%.

The net profit of Leumi Mortgage Bank amounted to NIS 126 million in 2008, compared with NIS 219 million in 2007, a decrease of 42.5%. The net return on shareholders' equity came to 6.1% in 2008, compared with 11.6% in 2007.

Shareholders' equity of Leumi Mortgage Bank amounted to NIS 2,150 million at the end of 2008, compared with NIS 2,024 million at the end of 2007, an increase of 6.2% which stems mainly from accumulated net profit.

The capital adequacy ratio (ratio of equity to risk assets) was 9.24% at the end of 2008, compared with 9.96% at the end of 2007. The minimum rate required by the Supervisor of Banks is 9.0%.

Leumi Mortgage Bank operates through representative offices spread throughout the country and its operations in Leumi branches (81 mortgage desks) and through 11 independent branches.

In consideration for the use of the Bank's branches, and the use of communications and other services, Leumi Mortgage Bank paid NIS 35 million to the Bank in 2008, compared with NIS 34 million in 2007.

Amendments to the Execution Law, 1967 (see page 46 above regarding details of the above-mentioned amendment) - as announced by the management of Leumi Mortgage Bank, the scope of the effect of the amendment of the Law on the profitability of Leumi Mortgage Bank may be material to Leumi Mortgage Bank, and will be determined according to the number of cases where Leumi Mortgage Bank demands that a debtor vacate a residential apartment.

Regarding the legal claims against Leumi Mortgage Bank – see Notes 18 G(3) to G(4) to the Financial Statements.

Leumi Partners Ltd. (formerly Leumi & Co. Investment House Ltd)

Leumi Partners 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, underwriting, organizing public and private issues, economic advice and appraisals. With regard to underwriting services, see paragraph D below.

On 4 February 2008, Leumi & Co. Investment House changed its name to Leumi Partners Ltd. Leumi

Partners and its subsidiaries employ 34 employees, most of whom are economists, accountants or graduates in other subjects.

Leumi Partners finished 2008 with a loss of NIS 48 million, compared with a profit of NIS 134 million in 2007.

The loss in 2008 arose from the decline in value of the company's investments.

Shareholders' equity as at 31 December 2008 totaled NIS 322 million, compared with NIS 492 million at the end of 2007.

Below are details concerning developments and main fields of activity:

A. Investments in Non-Banking Companies

Leumi Partners is responsible for the management of the non-banking investment portfolio of the Leumi Group.
Leumi Partners engages in initiating, locating and carrying out direct investments in businesses and companies. Leumi Partners has invested in 56 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 2008 amounted to some NIS 973 million.

The non-banking investment policy of the Leumi Group is in line with the restrictions of the Banking (Licensing) Law, which permits minority holdings up to 20% of all means of control, and without control. The Group focuses on investments with the potential for long-term returns.

When considering investments in companies, the following considerations, *inter alia*, are taken into account:

– The quality of the partners, management ability and control systems.
– An examination of the risks and exposures and the possible ways of realizing the investment.
– An estimation of the 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 varying the 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 in funds. When choosing funds, emphasis is placed on the quality of the management team and the organizational infrastructure, historical performance, investment strategy, the contribution of the investment to the spread of risk in relation to the existing portfolio, the terms of participation (legal structure of the fund, management agreements, partnership agreements and the management costs of the fund) and the identity of additional partners.

Leumi Partners 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 the law's restrictions, Leumi Partners stringently examines the quality of the management, the strength of the partners and the manner of investment.

The investment portfolio of Leumi Partners includes, *inter alia*, holdings in:

- Super-Pharm Israel Ltd., Israel's leading drugstore chain
- Africa Israel Properties Ltd., which is responsible for the activities of the Africa Israel Group in initiating, establishing and operating buildings for industry, offices 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 Kibbutz Industries Fund and Tene Growth Capital (Investment Fund), which specialize in investments in mature companies among kibbutz industries.
- Kotlav 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 and brass products (through Tene High Pressure Casting Investment Fund L.P.).
- In addition, Leumi Partners has invested NIS 451 million in venture capital, real estate and private equity funds out of undertakings to invest some NIS 821 million. The balance of the amount is transferred to the funds on request.

B. Strategic Cooperation with an Overseas Investment Bank

In April 2005 Leumi Partners entered into 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.
The agreement ended on 2 August 2008.

C. Investment Banking Services

Leumi Partners assists its customers in executing merger and acquisition (M&A) 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 Partners cooperates with investment houses and other entities in Israel and around the world.

D. Underwriting and Management of Issues

Since 1 July 2007, following the entry into force of the Securities (Underwriting) (Amendment) Regulations, 2007, which impose significant restrictions on the management of issues by underwriting firms in which banking corporations hold an interest of 20% or more, Leumi Partners Underwriting Ltd. (previously Leumi & Co. Underwriting Ltd.) assumed the status of an inactive underwriter and suspended its underwriting activity. Since then and through July 2008, Leumi Partners was involved in underwriting through Psagot-Leumi & Co. Underwriting Ltd. ("Psagot-Leumi Underwriting"), a company in which Leumi Partners held 19.99% of the capital and voting rights. The remaining rights in the company were held by Psagot Investment House Ltd. ("Psagot"). In July 2008, after Psagot announced its decision to leave the underwriting field, Leumi Partners transferred to Psagot its holdings in Psagot Leumi Underwriting without consideration. Psagot-Leumi Underwriting ceased its underwriting activity. Psagot undertook to make available to Psagot-Leumi Underwriting the resources necessary to meet its obligations, due to the cessation of its underwriting activities, including, *inter alia*, its obligations to the company's Chief Executive Officer pursuant to the agreement with him.

Leumi Partners Underwriters Ltd. has absorbed some of Psagot Leumi Underwriting's employees and managers. Until 18 February 2009, Leumi Partners Underwriters Ltd. operated by virtue of its qualification as a distributor, as defined in the Securities (Underwriting) Regulations, 2007 and on 18 February 2009, it was registered in the Underwriters Register, and returned to operating as an underwriter

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. On 4 February 2009, the company changed its name to Leumi Partners Research Ltd.

The company prepares economic studies and valuations for the purposes of capital raising, 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.

F. Leumi Start Venture Capital Fund

Leumi Partners 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 which invests in venture capital funds through a Fund of Funds structure, which has raised some NIS 65.5 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.

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 debentures 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 2008 amounted to NIS 11.4 million, similar to 2007. The company's net profit in 2008 amounted to NIS 5.3 million, compared with NIS million 4.3 million in 2007.

Competition

The company's main competitors are the large accounting and law firms, some of the trustee companies owned by other banks 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; to business customers, companies and institutional bodies it provides trust services for debenture issues, options to employees, pledges on shares and representation at general meetings of companies.

The growth trend in the field of trust services for debenture issues and particularly for exchange traded certificates, continued in 2008, and NIS 1.5 billion in new trusteeships was added.

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.

The trust activities in the Group yielded the following income:

- Trusteeship for monies, securities, and real estate:	some NIS 11.5 million (NIS 13.8 million in 2007)
- Estate and property management:	some NIS 1.7 million (NIS 0.7 million in 2007)
- Agent for deposits and loans, share transfers, and management of investment accounts:	some NIS 20.5 million (NIS 18.0 million in 2007)
- Trustee for debenture and mutual fund holders:	some NIS 3.8 million (NIS 3.7 million in 2007)

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 22 countries in 88 offices and branches. The Bank's main subsidiaries 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 potential for business with Israeli corporate customers, local middle-market customers operating in sectors of the economy in which Leumi has the expertise, know-how and resources needed to provide financial services, international entities operating in Israel and the local Jewish communities in the places 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.

In parallel with the launching of the strategic aim of expanding the Bank's international activity and as an integral part thereof, the Bank is strengthening the monitoring and control of its overseas units.

For this purpose, The International and Private Banking Division has established a department which collects information regarding risk exposure at the subsidiaries. This department will engage in ongoing monitoring, analysis, identification, mapping and evaluation of material focuses of risk in the overseas subsidiaries. This unit will report to the Management of the Bank and to the Board of Directors on a quarterly basis on ongoing developments and special findings.

The Bank's total investment in overseas units at the end of 2008 amounted to NIS 4,057 million, compared with NIS 4,409 million at the end of 2007.

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 for the year ended 31 December				Contribution to the Group's profit					
	2008*	2007*	**2008****	2007**	**2008***	2007*	**2008****	2007**	Rate of change	
	%		%		NIS millions				%	%
Leumi USA (B.L.C.)	**2.1**	3.9	**1.5**	-	**47**	92	**32**	(42)	(48.9)	-
Leumi UK	**-**	10.1	**-**	5.8	**(103)**	77	**(243)**	45	-	-
Leumi Switzerland	**2.3**	2.3	**4.8**	1.6	**12**	14	**25**	10	(14.3)	150.0
Leumi Luxembourg	**-**	14.1	**-**	15.3	**(58)**	17	**(64)**	18	-	-
Leumi Re	**5.2**	36.1	**3.1**	30.3	**5**	37	**3**	31	(86.5)	(90.3)
Leumi Romania	**-**	-	**-**	-	**(17)**	(19)	**(54)**	(29)	-	-
Others	**1.9**	2.2	**-**	-	**3**	5	**(1)**	(3)	(40.0)	-
Total of overseas consolidated companies	**-**	5.0	**-**	0.7	**(111)**	223	**(302)**	30	-	-

* 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 (14.8) million in 2008, compared with NIS (134.5) million in 2007.
Leumi UK-NIS (139.8) million in 2008, compared with NIS (32.3) million in 2007.
Leumi Switzerland-NIS 12.9 million in 2008 compared with NIS (4.2) million in 2007.
Leumi Luxembourg-NIS (6.1) million in 2008 compared with NIS 1.3 million in 2007.
Leumi Romania-NIS (37.3) million in 2008 compared with NIS (10.6) million in 2007.

** 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 2008 amounted to a loss in the amount of NIS 302 million, compared with a profit of NIS 30 million in 2007.

The change in the contribution to profit derives mainly from the losses in the UK and Luxembourg subsidiaries and from the decline in the profitability of the other subsidiaries, and from the effect of the appreciation of the shekel against the dollar, the euro and the pound sterling, which was partially offset by the depreciation of the shekel against the Swiss franc. The net effect of the exchange rate differentials was to decrease profits by NIS 278 million in 2008 compared with a NIS 308 million decrease of profits in 2007. Net financing expenses incurred by the Bank which partially offset these exchange differentials amounted to some NIS (191) million in 2008 compared with NIS (193) million in 2007.

The following table sets out a summary of the above data:

	For the year ended 31 December	
	2008	2007
	In NIS millions	
The units' profits (losses) in shekels (the Group's share of operating activities)	**(23)**	33
Exchange rate differentials in respect of the investment	**(278)**	(30
Total	**(301)**	2
Exchange rate differentials in respect of the cost of sources of finance, net	**191**	19
Total contribution of the units (after offsetting the sources of finance, net)	**(110)**	22

The following table sets out details of the net profit (loss) of the overseas units, as reported by them:

	2008	2007	Change
	In millions		%
Bank Leumi USA ($)	**21.5**	35.1	(38.7)
Bank Leumi UK (£)	**(4.0)**	12.1	-
Bank Leumi Switzerland (CHF)	**3.6**	10.7	(66.4)
Bank Leumi Luxembourg (euro)	**(14.1)**	2.3	-
Luxinvest ($)	**1.9**	2.0	(5.0)
Leumi Romania (ron)	**7.5**	1.4	435.7
Leumi Re ($)	**(2.2)**	9.7	-
Others ($)	**2.5**	3.0	-
Overseas branches ($)	**(32.0)**	4.9	-
Total in $ as reported by the unit	**(27.8)**	92.4	-

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	
	2008	2007
Credit to the public	6,271	6,450
Deposits with banks	3,183	2,235
Securities	2,516	3,590
Other assets	540	452
Total	12,510	12,727
Deposits of the public	9,090	9,366
Deposits from banks	1,137	944
Other liabilities	1,286	1,252
Shareholders' equity	997	1,165
Total	12,510	12,727
Total trust deposits and managed securities	9,055	11,274

The assets of the consolidated overseas subsidiaries and branches of the Bank amounted to NIS 48 billion (US$ 12.5 billion) at the end of 2008, compared with NIS 49 billion (US$ 12.7 billion) at the end of 2007.

* The translation to US$ is a convenience translation of the data according to the representative rates of exchange on 31 December 2008 and 31 December 2007, respectively.
- The amounts are as published by the units.
- The data in shekel terms is 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 2008:

	USA	UK	Switzerland	Luxembourg	Romania
Total assets	**5,762**	**2,295**	**1,003**	**1,034**	**473**
Credit to the public	**3,582**	**1,680**	**520**	**29**	**319**
Deposits of the public	**4,815**	**1,585**	**157**	**693**	**260**
Shareholders' equity	**611**	**140**	**441**	**28**	**92**
Trust deposits and managed securities	**2,804**	**415**	**5,011**	**617**	**1**
Net profit (loss)	**22**	**(6)**	**4**	**(20)**	**0.5**
Return on equity (%)	**3.6**	**-**	**2.3**	**-**	**2.9**

The loss for all the consolidated overseas companies, including overseas branches, as published by them, totaled US$ 26 million in 2008, compared with a profit of US$ 91 million in 2007, a decrease of US$ 117 million.

The contribution of the overseas units to the net profit of the Group in shekels in 2008 amounted to a loss of NIS 301 million, compared with a profit of NIS 27 million in 2007.

The decrease in the units' contribution in shekels derives mainly from the losses and decline in profitability of the units and from the negative exchange rate differentials in respect of the overseas investments.

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 2008, similar to the end of 2007, and the annual profit amounted to US$ 21.5 million, compared with US$ 35.1 million in 2007, a decrease of 38.7%.

The decline in the net profit resulted primarily from losses in the amount of some US$ 7.2 billion from the sale of securities, from provisions for the decline in value of the subsidiary's securities portfolio in the amount of some US$ 9.5 million, and from an increase in the provision for doubtful debts in the amount of US$ 15 million compared with US$ 2 million in 2007, as a result of the implications of the global economic crisis' on the borrowers.

The return on equity of BLL Corp. reached 3.6%, compared with 6.8% in 2007.

As at 31 December 2008, the equity amounted to US$ 611.8 million. The ratio of equity to total assets was 10.29% and the ratio of equity to risk assets was 12.64%.

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 two branches in New York State, 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$ 5.76 billion on 31 December 2008, compared with US$ 5.81 billion at the end of December 2007. Total shareholders' equity amounted to US$ 464 million on 31 December 2008 compared with US$ 455 million at the end of 2007. Credit to the public totaled US$ 3,582 million at the end of 2008, an increase of 3.7%, while deposits of the public, which totaled US$ 4,871 million, decreased by 0.3%.

Customers' managed securities portfolios, which are not included in the balance sheet, totaled US$ 2,804 million at the end of 2008, compared with US$ 3,468 million at the end of 2007.

BLUSA ended 2008 with a net profit of US$ 19.0 million, compared with US$ 30.5 million in 2007.

The decline of 37.7% in net profit, resulted primarily from losses in the amount of some US$ 7.2 million from the sale of securities, from provisions for the decline in value of BLUSA's securities portfolio in the amount of some US $9.5 million and from an increase in the provision for doubtful debts in the amount of US $15 million, compared with US $2 million in 2007, as a result of the implications of the global economic crisis' on the borrowers.

The return on equity of net profit in 2008 was 4.6% compared with 7.6% in 2007.

The balance of the provision for doubtful debts amounted to US $ 64 million at the end of 2008, constituting 1.78% of total credit to the public. This provision is 1.5 times more than the non-performing loans.

The ratio of equity to total assets was 7.7% (7.4% in 2007) and the ratio of equity to risk assets was 12.4% (11.03% in 2007). These ratios exceed the US supervisory authorities' capital adequacy requirements.

BLUSA established and, since June 2001, has been operating in New York a wholly-owned brokerage company 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 for the sale of insurances and markets mutual funds managed by large investment houses.

For details of an SEC order concerning LISI see the section "Legal Proceedings" on page 218 below.

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 center for the management of international private banking customers in Aventura, Florida. Some of the activities carried out in New York have been transferred to this center. In parallel, BLUSA expanded private banking activity for wealthy local customers.

BLUSA is taking steps to expand the volume of its activity organically, as well as by locating opportunities for acquisitions and mergers.

At the beginning of 2008, BLUSA decided to replace most of its existing computer systems (infrastructure and ancillary systems). Negotiations were held with suppliers and the project will begin in 2009. The project will continue for 2 to 3 years and its estimated cost is 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.

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$ 1,267 million at the end of 2008 (before offsetting mutual balances), compared with some US$ 1,196 million at the end of 2007. Credit to the public totaled US$ 130 million at the end of 2008, compared with US$ 110 million at the end of 2007. Deposits of the public totaled US$ 1,297 million at the end of 2008, compared with US$ 887 million at the end of 2007. The loss for 2008 amounted to US$ 32 million, compared with a profit of US$ 4.9 million in 2007.

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 has a banking subsidiary in the Island of Jersey, and also 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.

On 18 June 2008, Mr. Menachem Friedman was dismissed from his position as Managing Director and CEO of Bank Leumi (UK). Mr. Friedman was dismissed in light of irregularities in the approval of loans while he served as the manager of a branch of the Bank in Israel, and this matter has no connection whatsoever with Bank Leumi (UK) or its customers.

On 15 October 2008, the Board of Directors of Bank Leumi (UK) approved the appointment of Mr. Lawrence M. Weiss to serve as Managing Director and CEO of the subsidiary. He took office on 9 December 2008 after receipt of the approval of the UK authorities.

Total consolidated assets of Bank Leumi (UK) amounted to £ 1,573 million at the end of 2008, compared with £ 1,423 million at the end of 2007.

Deposits of the public decreased from £ 1,190 million at the end of 2007 to £ 1,086 million at the end of 2008. Bank Leumi (Jersey)'s portion of the balance of deposits at the end of 2008 was £ 363 million.

Credit to the public expanded from some £ 1,007 million at the end of 2007 to £ 1,151 million at the end of 2008. Bank Leumi (Jersey)'s portion of the balance of credit at the end of 2008 was £ 151 million.

Capital, reserves and surpluses totaled some £ 96 million on 31 December 2008, compared with some £ 95 million at the end of 2007.

In February 2008, Bank Leumi (UK) increased its Tier II capital by £ 5.0 million. In April 2008, Tier II capital was increased by £ 7.5 million by means of the issue of a subordinated capital note to the Bank and an additional increase of Tier II capital was carried out on 30 December 2008, in the amount of £ 17 million, by means of the issue of a further subordinated capital note to the Bank.

On 6 August 2008, the Bank invested £ 10 million in the share capital of Bank Leumi (UK).
The ratio of equity to assets amounted to 6.1% (6.7% in 2007).

Bank Leumi (UK) ended the year 2008 with a loss of £ 4.0 million, compared with a profit of £ 12.1 million in 2007.

The loss resulted from two main causes: a significant increase in the provision for doubtful debts, to an amount of £ 24.1 million compared with £ 2.5 million in 2007, as a result of the implications of the global financial crisis and votality of the capital markets for the borrowers, and the reduction in the fair value of financial instruments in the amount of £ 6.9 million, compared with £ 0.6 million in 2007.

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 had a wholly-owned subsidiary that managed mutual funds, and was closed towards the end of 2008, and has 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 1,070 million at the end of 2008, compared with CHF 956 million at the end of 2007. The profit in 2008 amounted to CHF 3.6 million, compared with CHF 10.7 million in 2007, a decrease of 63.6%.

Total capital and reserves, including inner reserves, amounted to CHF 167 million at the end of 2008 (of which CHF 2 million was inner reserves), similar to the end of 2007.

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 capital note to the Bank, and the distribution of 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 norm in the Swiss banking industry.

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 began in July 2008. In December 2008, the Swiss court convicted the employee of embezzlement, forgery and improper management, and sentenced him to 8 years in prison.

At the end of 2008, the volume of trust deposits and securities portfolios managed and/or held for customers amounted to CHF 5.3 billion, compared with CHF 5.7 billion at the end of 2007.

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. On 18 December 2006, the registration of such securities that were 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. No funds raising was effected through the above-mentioned program during the years 2006- 2008.

In total, LII has raised US$ 1.087 billion within the context of this program, of which some US$ 663 billion had been repaid by the end of 2008.
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$ 576 million could be raised.

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 variety of private banking services, including deposits, trust deposits and investments in securities.

Total assets at the end of 2008 amounted to some € 740 million, compared with some € 547 million at the end of 2007. At the end of 2008, deposits of the public totaled some € 498 million compared with some € 505 million at the end of 2007. Trust deposits and securities held by customers of the bank totaled € 510 million at the end of 2008, compared with € 657 million in 2007.

Bank Leumi Luxembourg ended the year 2008 with a loss of € 14.1 million, compared with a profit of € 2.3 million in 2007. The loss results primarily from losses due to investments in securities and deposits in banks, which were caused by the global financial crisis.

The capital means of Bank Leumi Luxembourg totaled some € 20 million (including € 2.5 million of uncalled authorized capital), compared with € 29 million at the end of 2007.

In March 2008, Bank Leumi (Luxembourg) increased its Tier II Capital by € 5.9 million, by issuing a subordinated capital note to the Bank.

In light of the developments in the global financial markets and their effect on the bank's nostro, in November 2008, the Leumi Board of Directors approved an additional capital increase of € 6 million. The increase will be carried out by means of an increase in Tier I capital, including the payment of the unpaid issued capital in the amount of € 2.5 million. The capital increase will be carried out after 1 January 2009.

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 general banking services.

Total assets of Leumi (Latin America) were US$ 41.0 million at the end of 2008, compared with US$ 39.2 million at the end of 2007. Capital, reserves and surplus totaled some US$ 7.7 million on 31 December 2008, compared with some US$ 7.8 million at the end of 2007.

The year 2008 ended with a profit of some US$ 540 thousand compared with a profit of some US$ 109.4 thousand in 2007. The balance of off-balance sheet activity totaled some US$ 221 million in 2008, compared with US$ 242 million in 2007.

Brazil Representative Office

In December 2005, an investigation was commenced in Brazil at the Bank's representative office 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 2008, 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.

An additional investigation was commenced in Brazil regarding the activity of the representative office in Porto Alegre in the years 2002-2005. The representative office was closed in mid-2006. The attorney representing the Bank in Brazil has clarified that the investigation deals with the representative's apparent involvement with and assistance in transferring customers' funds out of the country.

The Bank's representative office in Sao Paolo was closed in January 2008. The offices in Rio de Janeiro serve as the representative office in Brazil.

Bank Leumi Romania

In August 2006, the Bank acquired over 99% of the issued and paid-up 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.

Leumi Romania is a banking institution in Romania, and operates some 37 branches and 5 agencies, and engages in varied financial activity that includes the taking of deposits, the extension of credit, international trade and foreign currency activities. Leumi Romania opened a branch in Sofia, Bulgaria, in September 2008.

Leumi Romania ended 2008 with a profit of some 7.5 million Ron (some US $ 3.0 million), compared with a profit of some 1.3 million Ron (some US$ 0.5 million) at the end of 2007.

The increase in profit derives mainly from the increase in net financing profit in the amount of 26 million ron, resulting from the expansion of business activity in 2008, and from foreign currency income, in the amount of some 12 million ron, a result of the ron's weakness against the euro and the dollar. These were partially offset by the increase in the provisions for doubtful debts in the amount of some 9 million ron, and an increase in expenses related to the expansion of business activity, in the amount of some 15 million ron. The increase in the provisions for doubtful debts was the result of the implications of the global economic crisis for the borrowers.

In 2008, the Bank made available to Leumi Romania a line of credit in the amount of US$ 100 million, for the purpose of expanding business activity, through a deposit without a repayment date, with the possibility of repayment after two years from the date on which a request for payment is made. As at the end of 2008, the balance of the deposit stands at some US$ 75 million.

In addition, the Bank was asked to provide Leumi Romania with a liquidity line in the amount of US $50 million, to be used in the event of a liquidity crisis in the bank. This request resulted from a January 2009 letter from the Romanian central bank, according to which all Romanian banks were asked to submit a plan for emergency situations in which they were asked to present, *inter alia*, alternate sources of financing that they would be able to raise in the event of distress. The request was approved by the Board of Directors and by the Bank of Israel.

The total assets of Bank Leumi Romania amounted to 1,343 million ron (US$ 474 million) at the end of 2008, compared with 1,081 million ron (some US$ 440 million) at the end of 2007. Deposits of the public amounted to 737 million ron (some US$ 258 million) at the end of 2008, compared with some 738 million ron (some US$ 301 million) at the end of 2007, and credit to the public amounted to 902 million ron (some US$ 316 million), compared with some 602 million ron (some US$ 245 million) at the end of 2007.

The capital, reserves and surplus amounted to some 260 million ron (some US$ 92 million) at the end of 2008, compared with 219 million ron (some US$ 77 million) at the end of 2007.

1 ron = US$ 0.349 (At the end of 2007 - US$ 0.407).

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 with respect to 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 2008 amounted to US$ 34.4 million, compared with US$ 39.4 million at the end of 2007, and the insurance reserves amounted to some US$ 15.1 million, compared with some US$ 9.2 million at the end of 2007. Shareholders' equity amounted to US$ 14.2 million as of 31 December 2008. The loss for 2008 amounted to US$ 2.2 million, compared with a profit of US$ 9.7 million in 2007.

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

Leumi Global Managers Funds

During the course of 2004, Leumi Global Managers ("LGM"), was established in Luxembourg. LGM manages funds overseas through the manager-of-managers system,. The funds are marketed through 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 2008, managed assets exceeding US$ 134 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 each 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 are suited to the needs of the customers of the Leumi Group.

As at 31 December 2008, the LGM funds had accumulated some US$ 175 million.

For further details regarding income from capital market activity, see page 145.

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 1,842 million as at 31 December 2008, compared with NIS 1,873 million as at 31 December 2007. The contribution to net operating profit of companies included on the equity basis amounted to NIS 249 million in 2008, compared with NIS 184 million in 2007.

See pages 143 to 144 with regard to the sale of two non-banking companies.

For further details, see pages 142 to 143.

Exposure to Risks and Methods of Risk Management

General

The Bank's activity in a wide spectrum of financial activities involves taking risks, primarily credit risks and market risks, including liquidity risks. These risks are accompanied by operational 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, changes occurring in the business environment and the directives and requirements of the Bank of Israel and of other relevant regulatory authorities in Israel and abroad.

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 Operational 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 are 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 and specialized committees, headed by the risk managers.

In light of the importance of the subject of risk management, a Board Committee for risk management was appointed recently. This committee receives current reports from the Management of the Bank, deliberates all issues pertaining to risk management and presents issues to the Board of Directors that require its approval.

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 additional 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 damage that can result from exposure to these risks on the other hand. Risk management is based on forecasts and ongoing assessments of developments in the capital and money markets in Israel and throughout the world. 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, such as interest rates, the CPI, exchange rates, etc.

During 2008, there changes were not made to the limits prescribed by the Board of Directors relating to the management of market risks, including limits on the activity in the dealing rooms and in the *nostro* portfolios. In practice, as of the second half of the year, the level of exposure in these areas was reduced as a result of the deepening crisis in the global capital markets.

The 2009 work plan was formulated against the backdrop of the intensifying crisis in the capital and money markets in Israel and abroad, and mainly against the backdrop of the crisis of confidence that arose following the collapse of banks and investment houses abroad. The work plan reflects a reduction in the degree of risk that the Bank is prepared to take. Accordingly, the limits were made more stringent and the range of approved activities in the *nostro* portfolios and in the trading rooms was significantly reduced.

The limits set at Group level include all of the subsidiaries in Israel and abroad. The subsidiaries abroad set market risk management policy in coordination with the Bank in Israel. The frameworks for market risk exposures are determined according to a uniform format prescribed by the Bank and approved by the Bank's Manager of Market Risks. Leumi Mortgage Bank and Leumi Partners manage market risks independently, but in coordination with the Bank's Manager of Market Risks, due to the dissimilar nature of their activities from the Bank's activities. 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 directives:

	31 December 2008	31 December 2007
	NIS millions	
Capital requirements in respect of		
Interest risks	**333**	321
Share price risk	**4**	55
Exchange rate risk	**78**	113
Inflation risk	**17**	–
Options	**61**	99
Total capital requirement in respect of market risks	**493**	588

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, and the exposure to share indices.

The Bank manages the risks deriving from basis exposure in a controlled manner within the framework of the limits set by the Board of Directors, and establishes the extent of exposure in each linkage sector on an ongoing and up-to-date basis, in accordance with economic forecasts of developments in the capital and money markets, while monitoring the anticipated relative prices in the various sectors and the expected fluctuations in these prices. The subsidiaries abroad generally maintain a balance between the assets and liabilities in the various currencies, and their available capital is invested in the local currency. These subsidiaries manage basis exposures within limits on amounts and periods on the basis of policies anchored in resolutions of their local boards of directors overseas, and coordinated with the Capital Markets Division. The consolidated subsidiaries in Israel generally invest their available capital in securities and in shekel deposits in accordance with the policy approved by their board of directors and in the coordination with the Capital Markets Division.

1.1.1 Basis Exposure and Compliance with Limits

According to accounting principles, the capital is defined as an unlinked shekel source, such that an investment of the capital in a sector other than the unlinked shekel sector is defined as a basis exposure. All of the exposure to the basis risks is measured as a percentage of the Bank's exposed capital that is not invested in the unlinked shekel sector.

The exposed capital, at the Bank level, includes the shareholders' equity and certain reserves, less fixed assets and investments in subsidiaries and associated companies, excluding the investments in subsidiaries abroad that are financed from sources in foreign currency, and are not therefore deducted from the capital. At Group level, the exposed capital includes the shareholders' equity and certain reserves, less fixed assets and investments in companies included on the equity basis.

The state of 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 presented below:

- "non-performing loans in foreign currency" – are 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 loans.
- "deferred taxes" in respect of pension obligations – from an accounting perspective, these are presented in the unlinked shekel sector, as opposed to their presentation as a CPI-linked asset from the economic perspective, pursuant to the obligation in respect of which the tax is 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 quasi-capital obligation in unlinked shekels.
- 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 and recorded in capital fund, while from the economic viewpoint, this provision constitutes a quasi-capital item.

The following table presents the actual exposure at the Group level compared with the limits prescribed by the Board of Directors. The data is presented in terms of a percentage of the exposed capital.

	Approved limits	Actual exposure*	
	Maximum surplus or deficit	31 December 2008	31 December 2007
		%	
Unlinked	**50%-(100)%**	**(9.2)**	(35.2)
CPI-linked	**100%-(50)%**	**10.4**	34.6
Foreign currency and foreign currency-linked	**25%-(10)%**	**(1.2)**	0.6

* In addition, the Bank and subsidiaries have limits on the maximum position allowed for investment in each currency.

During 2008, an average of some 26% of the exposed capital was invested in the CPI-linked sector, which ranged during the year between 10% and 36%. 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 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.

The actual effect of the exchange rate differentials in 2008 is presented on page 164 under the contribution of the consolidated companies abroad to the Group's profit.

During 2008, 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 2008. 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 taxes in respect of the financing of the investments abroad):

	US$	Euro	£	CHF	Yen
	NIS millions				
Increase of 5% in exchange rate	(18)	(63)	(4)	(4)	18
Increase of 10% in exchange rate	(46)	(124)	(9)	(8)	36
Decrease of 5% in exchange rate	9	59	4	5	(16)
Decrease of 10% in exchange rate	7	115	7	10	(32)

These data do not take into account the effect of changes 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 annual profit after taxes by some NIS 10 million, and a rise at an identical rate would effect the profit by a similar sum.

Post-Balance-Sheet Events

After the date of the Financial Statements and up until shortly before their publication, the high volatility in the world's capital and money markets persisted, and found expression, *inter alia*, in the continuing volatility of the shekel *vis-à-vis* most foreign currencies. In order to reduce the fluctuations in profits results from the fluctuations in the exchange rates, the Bank carried out hedging against the tax exposure deriving from its ownership of its subsidiaries abroad. At this stage, it appears that the basis risks to which the Bank is exposed are not expected to have a material effect on its results in the coming quarter.

For changes in exchange rates until prior to the publication of these Financial Statements, see pages 34 to 35 of the Report.

The information presented above is "forward-looking information." For the meaning of this term, see pages 46 to 47 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 risk in respect of 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, 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 of the annual accounting profit resulting from a shift of the yield curve in each of the sectors.

The principal exposure, correct to the date of this Report, 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. In addition, the existence of financial instruments in the international markets facilitates the reduction of the exposure in this sector.

Floating Interest

As mentioned above, a major 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 loans out of the bank's means, which were provided or renewed by the Leumi Mortgage Bank, as published monthly by the Bank of Israel. At the end of 2008, this interest rate was 4.1%.

– 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 with 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 2008 was 4%, and, correct to March 2009 – 2.25%.

– 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. At the end of 2008, the US$ LIBOR rate for three months was 1.4%.

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. During 2008, the Group complied with all interest exposure limits set by the Board of Directors. For detailed data on interest exposure, see Exhibit D to the Management Review below.

	31 December 2008			31 December 2007		
	Unlinked	**CPI-linked**	**In and linked to foreign currency**	Unlinked	CPI-linked	In and linked to foreign currency
Average duration (in years):						
of assets [(1)]	**0.45**	**3.33**	**0.55**	0.42	3.51	0.54
of liabilities [(1)]	**0.36**	**4.18**	**0.39**	0.29	3.84	0.35
The gap in duration in years	**0.09**	**(0.85)**	**0.16**	0.13	(0.33)	0.19
Difference in the internal rate of return (%)	**2.35**	**0.97**	**2.20**	3.04	1.27	1.01

(1) Excluding forward transactions and options.

[(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-free yield curve are deducted i.e., government debentures.

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 that 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 longer, and reaches 4.22 years, while the gap in the internal rate of return (IRR) amounts to 0.95%.

The data presented above take into account early repayments of CPI-linked mortgages, pursuant to a statistical model that 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 2008, according to the original cash flow, without taking into account early repayments, is longer, and reaches 3.56 years, and the IRR gap amounts to some 0.95%.

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 longer and reaches 0.57 years in unlinked shekels and 0.52 years in foreign currency deposits, with the IRR gap reaching 2.86% and 2.42% respectively.

Interest exposure is managed on the basis of economic exposures and is based on various behavioral assumptions regarding the original payment dates of the assets and liabilities. With the aim of limiting interest risks, the Board of Directors of the Bank and the boards of directors of the Israel 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 presents a summary of the exposures to unforeseen fluctuations of interest rates at the Group level (in NIS millions):

	Potential erosion of economic value		Potential erosion of annual profit*	
Effect of an immediate parallel change of 1% in the interest curve:	**31 December 2008**	31 December 2007	**31 December 2008**	31 December 2007
Actual	**321**	330	**320**	256
Limit	**1,000**	1,000	**600**	500

* The maximum erosion of the annual profit based on an examination of the next three years.

During 2008, the potential erosion of the economic value and annual profit ranged between NIS 372 million in January to NIS 122 million in September, and between NIS 327 million in August and NIS 219 million in October, respectively.

The potential erosion of the economic value of the capital resulting from a 1% change in interest rates correct to December 2008 was of similar scope to that of December 2007 (some NIS 320 million), but was not the same in terms of the direction of the exposure. In practice, during 2008, there was a great change in the exposure in the CPI-linked sector, from an exposure to a 1% rise in interest rates, in the amount of some NIS 180 million, to an exposure to a 1% drop in interest rates, in the amount of some NIS 140 million. The sharp increase in the exposure to a decline in the CPI-linked sector derived from the raising of long-term sources – subordinated deposits, savings schemes, derivatives and from the activity in the trading portfolios.

The potential erosion of the accounting profit resulting from a 1% change in interest rates increased from the beginning of the year by some NIS 64 million and totalled NIS 320 million at the end of December 2008. During the year, the trend was mixed with an upward direction. In the CPI-linked sector – a reduction of the exposure in the trading portfolio increased the exposure to a decline, since a large portion of the futures transactions in shekels (with a long-term CPI-linked obligation) was left not offset. In the unlinked shekel sector – the exposure to a fall in interest derived mainly from the structure of the balance sheet, in which there is a material gap between the credit on the basis of Bank of Israel interest and the deposits with the same basis.

During 2008, the Group complied with all interest exposure limits prescribed 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 2008 increased from NIS 321 million to NIS 985 million, and the potential erosion of the accounting profit decreased from NIS 320 million to NIS 176 million.

The following table presents the impact of the hypothetical changes in the interest rates on the economic value of the financial instruments of the Bank and its consolidated subsidiaries, excluding non-monetary items:

The change in economic value after the effect of changes in interest rates, correct as at 31 December 2008, in NIS millions:								
	Israeli Currency		Foreign currency, including Israeli currency linked to foreign currency					
	Unlinked	CPI-linked	US$	EURO	£	CHF	Yen	Others
Immediate parallel rise of 1%	**(69.8)**	**149.9**	**65.8**	**17.2**	**1.4**	**(11.8)**	**1.5**	**3.1**
Immediate parallel rise of 0.1%	**(0.7)**	**14.9**	**6.6**	**1.7**	**0.1**	**(1.2)**	**0.1**	**0.3**
Immediate parallel drop of 1%	**72.9**	**(161.3)**	**(69.7)**	**(19.0)**	**(3.1)**	**12.3**	**(1.4)**	**1.5**

The economic value is defined as the difference between the present value of assets and liabilities. When calculating present value, the flows in the risk-free yield curve are deducted.

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. According to the Bank of Israel directives, 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, including the positions in the trading portfolios.

The VAR model measures the expected potential loss resulting from possible changes in market prices. In fact, it measures the expected decrease in the present value of the assets less the liabilities in the given mix in the portfolio's structure, at a given confidence level, over a given future period, according to a given statistical distribution. The VAR is calculated monthly at Group level, and more frequently at the Bank level and for the trading portfolios.

The VAR and the limits in VAR terms are calculated according to the parametric model, at a confidence level of 99%, and for a two-week position-holding period. The VAR model has a number of weaknesses. The model assumes that the statistical structure of the changes in prices foreseen in the capital market gives an indication of the future behavior of these prices. The parametric VAR model also assumes a multivariate normal distribution of the changes in the 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 estimated VAR at Group level in NIS millions:

	VaR at Group level		VaR in mark-to-market portfolios	
	31 December 2008	31 December 2007	**31 December 2008**	31 December 2007
Actual	**243**	290	**204**	141
The limit	**600**	700	**500**	500

During 2008, the VAR at Group level decreased by some NIS 47 million. The increase of the exposure to a drop in interest in the CPI-linked sector, which was apparent during the last months of the year, was offset by a decrease in the basis exposure and the reduction of the investment in mutual funds and in the foreign currency fund groups. Due to the low level of interest rates, and despite the rise in volatility, the prices did not have a material effect (the parametric VAR of interest rates takes into account the relative changes in the interest rates and not the interest differentials, so that at low interest levels, the VAR is low, notwithstanding the high volatility of the market). During 2008, the VAR of the economic value ranged between a maximum of NIS 306 million and a minimum of NIS 236 million.

The exposure in terms of VAR on the Group's mark-to-market portfolios during 2008 increased by NIS 63 million. The increase derived mainly from the increased exposure of the accounting profit, as stated, and from the price changes.

During 2008, the VAR on the Group's mark-to-market portfolios according to market value ranged between a maximum of NIS 285 million and a minimum of NIS 115 million.

During 2008, the Group complied with all the VAR limits set by the Board of Directors.

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 under 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. The current limit, which relates solely to market risks, determines that the decrease in economic value of shareholders' equity resulting from a stress scenario will not exceed NIS 2 billion, after taxes. The Bank complied with this limit during 2008.

In light of the circumstances, in 2008 the risk factors in respect of which risk is measured were expanded using stress scenarios. The new set of stress scenarios includes reference to aspects of market risks, credit risks, operating risk, and includes combined scenarios. The Scenarios Committee and the Head of Risk Management Control are responsible for the periodic definition and updating of the stress scenarios.

1.4. Liquidity Risk

Liquidity is defined as the corporation's ability to finance increases in assets and to comply with its payment liabilities. The ability to withstand a liquidity risk involves uncertainty relating to the possibility of raising sources and/or realizing assets unexpectedly within a short period, without causing a significant loss.

In conformance with Bank of Israel directives, the Bank implements an overall liquidity risk management policy in Israeli currency and in foreign currency. 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 principles of the Bank's liquidity management policies have been adopted by the subsidiaries abroad.

This year, against the backdrop of the negative developments on the money markets abroad, the Bank instituted policies to increase the business liquidity, to reduce the liquidity risk and to tighten the controls on the management of the liquid balances. Within this framework, the Bank increased its investment in securities issued by countries with the highest credit rating, and increased the range of deposits at the central banks of these countries. In addition, for the purpose of tightening control over the management of the liquid balances, more conservative limits were set than before for managing the credit risks and the clearing risks inherent in the activities vis-à-vis banks abroad.

The Bank maintains ongoing monitoring of the liquidity position and liquidity risk indices. Liquidity risk is measured and managed through an internal model, Liquidity at Risk (LAR), whose purpose is to evaluate and monitor the liquid means at the Bank's disposal, under various scenarios:

– a normal scenario that assumes the ordinary course of business, which ensures that the Bank will be 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 confidence 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 two quantitative indices: the liquidity gap and the liquidity ratio. The liquidity gap is the difference 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 liquidity ratio is the ratio between total liquid assets and total liquid liabilities, and it is also examined 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 main regulatory limitations on the transfer of liquid means between Group companies in Israel and abroad are as follows: (1) the Bank of Israel does not limit the making of deposits by the Bank with Group subsidiaries in Israel and abroad. However, it has imposed limits on the investment of capital by the Bank in companies abroad. Each material investment requires advance approval from the Bank of Israel; (2) 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; (3) the directives in Great Britain limit the making of deposits with any company in a group and with all group companies combined, to a maximum rate of 25% of the capital of the bank in the UK; (4) the directives in Switzerland require that deposits of sums exceeding 25% of the capital of the bank in Switzerland must be deducted from its capital.

Leumi has prepared a contingency plan as part of its preparations for an extreme scenario, which includes the strategy for managing a liquidity crisis, including the appointment of a management team to be 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. The Market Risks Manager sets limits on this ratio from time to time according to the circumstances in the markets.
– in the Israeli currency and foreign currency sectors, the trends in the liquidity position are examined (daily, monthly, etc.) over a protracted period, in order to monitor the developments in deposits of the public, in credit to the public and liquidity in general.

In September 2008, the Basel Committee issued an updated document addressing liquidity risk management. The document was written as an outcome of the lessons learned from the current financial crisis, and it details a list of new rules pertaining to liquidity management, including: control procedures for the Board of Directors and Management, the need to determine margins and risk "warning signs," costing of the risk, the need to maintain a safety cushion, a list of risk measurement principles, including the use of stress scenarios, management of the intraday liquidity, contingency plans, and more.

The Bank is examining these rules with the objective of implementing them within the scope of its implementation of the Basel II directives.

1.4.1 Liquidity Status 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 scenarios, for a repayment period of one month, as at 31 December 2008:

	Israeli currency for one month		Foreign currency for one month	
	Gap	Ratio	Gap	Ratio
Scenario/period	NIS billions			
Regular	**25.0**	**18.2**	23.8	8.5
Statistical	**17.9**	**3.1**	20.8	4.4
Stress at Leumi	**8.9**	**1.3**	8.4	1.4
Systemic stress	**10.9**	**1.7**	7.3	1.4

Regarding the monetary measures that the Bank of Israel instituted to improve liquidity in the system, see pages 72 to 73 of the Report.

In 2008, the Bank complied with the prescribed liquidity limits.

1.5. Derivative financial instruments

The Board of Directors of the Bank approves 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 brokers abroad, 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 who manage and hedge their 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 and interest trading room trades a wide range of financial instruments, including interest swap contracts, 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, was 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 at 31 December 2008, compared with the previous year (par value in NIS millions):

	31 December 2008	31 December 2007
Hedging transactions	**1,714**	2,734
ALM and other transactions:		
Interest contracts	**159,468**	118,775
Currency contracts	**185,930**	192,160
Contracts re shares, share indices and goods	**14,197**	25,999
Total	**361,309**	339,668

For details regarding accounting policies for recording of balances, income and expenses from these types of instruments, see Note 1(K) – Significant Accounting Policies to the Financial Statements.

In 2008, the net income from expenses for ALM and other transactions in derivatives totalled some NIS 606 million, compared with income of some NIS 6 million in 2007, including exchange rate differentials.

For further details, see Exhibit C to the Management Review and Note 20 to 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 American 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 the 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 inherent 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 parallel between the manner of recording the income and expenses in respect of derivative transactions and the balance-sheet items actually covered.

For details regarding the accounting policy, see pages 50 to 51 in the section on critical accounting policies.
Consequently, there is considerable volatility in profit and loss. For details, see pages 66 to 67 of the Report.

Structured Products – During 2008, activity diminished in structured products, deposits and debentures, which allow customers the chance of a high yield compared with standard, non-structured products, while taking the risk of losing bank interest. This is usually with no risk to the deposit principal. 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 Counterparty 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, 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 activity frameworks, 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 volume of activity 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 a dealing room. The foreign-currency and derivatives dealing room covers activity with customers and the Bank's *nostro* activity on its own account in the format of market-making. 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 is included within the framework of the 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 the actual state of 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 additional limits prescribed for activity in options are mainly 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 stress scenarios of changes in the exchange rates and in volatility.

In respect of activity in options, it was determined that accumulated losses of USD 2.5 million and above must be reported to the Board of Directors.

During 2008, all activity in derivatives was within the limits set by the Board of Directors.

1.6 Policy Implementation and Control of Market Risk Management

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. 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 market risk management policy is discussed, formulated and controlled through the market risk management committee (Assets and Liabilities Committee – ALCO), chaired by the Manager of Market Risks, with the participation of senior Bank officials involved in the management of the assets and liabilities. 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 of the risk managers (credit, market, operating and legal) and the Head of the Risk Management Control Department.

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 reports on the limits and compliance therewith, and, at least once a quarter, the document is distributed to the members of the Board of Directors, for discussion and reports on the limits and exposure policy. In addition, any new activity in financial instruments that significantly differs from existing instruments is submitted for the approval by the Board of Directors.

The policy approved by the senior committee for risk management 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 request for a change in policy is also submitted to the Board of Directors for approval. Towards 2009, a risk management committee was established as a committee of the Board of Directors of the Bank. This committee receives reports from ALCO, sets limits, and submits those matters requiring approval to the Board of Directors for its approval.

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 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 2008, the Group complied with all of the limits at the Board of Directors level.

The basis exposure and interest exposure situation is detailed above on pages 173 to 178 of this Report and in Note 16 to the Financial Statements.

2. Operational risks

The activities of the Bank, as a financial intermediary, include operational 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.

An operational risk is defined as “the risk of a loss resulting from inadequate or failed internal processes, people or systems, or resulting from external events. This risk includes legal risk, but excludes strategic and reputational risks.”

The operational risks are managed in the following way:

A. A Manager of Operational risks was appointed, who is responsible for formulating the policy for managing operational risks, for instructing the various units in the prevention or minimizing of operational risks, and for preparing procedures for monitoring, reporting and control. Within the scope 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 operational risks.

   An operational 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 operational risks; preparing policies and procedures pertaining to the management and control of operational risks; planning and implementation of a methodology for evaluating operational risk; planning and implementation of a risk reporting system for operational 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 liaison with them.

B. A Group-level policy document was prepared, which delineates the modes of operation, the organizational frameworks and the administrative functions that operate in order to minimize operational risks in the Group. The overseas subsidiaries have prepared similar documents, adopted as required to 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 the operational risks in the various divisions. The procedure defines the functions of the business risk control officers, work interfaces, and the principal work processes related to operational risks.

C. One of the main tools for controlling and monitoring of operational risks is mapping. A structured process of mapping the operational 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.

As part of 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 operational risk management policy, the mapping of the Group's risks must be updated every three years. At the end of 2008, an operational risk review was completed in the Leumi Group. Within the scope of this review, the material business processes were documented, and based on them, the risks and the control thereof were mapped and the gravity of the risks and the quality of the controls were assessed. Procedures were formulated in preparation for the review, which defined how the review was to be performed, including a document that specified the risk assessment methodology and instructions for performing the assessment.

D. An information system was developed for documenting and monitoring the management of operational risks that have been identified in the organization and for documenting operational 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 in terms of the various causes of failure, the banking activities, the gravity of the risks, the factors responsible for the risk, etc. Systems were developed on the basis of business law, which generate alerts about irregular/suspicious activity in the various business fields, in order to minimize the exposures in these areas.

E. A model for assessing operational risks was constructed according to the relevant directives of the Basel Committee and the existing methodological tools in this field. The results of the operational 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 assessment system was implemented in relation to projects/prototypes relating to the development of information systems, the findings were analyzed and recommendations were published for comprehensive action for reducing the level of exposure. The assessment of operational 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 assessments 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 and of the subsidiaries in Israel. Events of failure 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 that such events and resulting damages might recur. The forum's decisions are monitored on an ongoing basis until they are fully implemented.

G. In the light of conclusion-drawing processes relating to events of failure, 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 supplemented to assist managers in the control process.

H. Additional activities were carried out to promote assimilation of operational 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. Bank of Israel directives require the banks to take action to ensure business continuity in case of emergency. The Bank makes 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 Terrorism Act, 2005.

The complexity and development of banking activities oblige the Bank to comply strictly with all 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 this Directive, an infrastructure review was carried out, under which the consumer directives and the risks of the occurrence of events that deviate from the directives were mapped, and controls were defined to prevent their occurrence.

The Management of the Bank declared in its 2006 work plan that the subject of compliance was of supreme importance, and that the status and activities of the Compliance Department should be upgraded.

A committee was appointed at the Bank, whose role was to formulate an operating plan for 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, along with the formulation of work processes, means of control, procedures and training.

The committee 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. Furthermore, in light of the great importance that the Bank attributes to this subject, additional resources have been allocated. *Inter alia*, 33 full-time compliance officers were appointed to the Bank's major branches for the focused handling and control of issues of compliance and the prohibition of money laundering.

The Compliance Department maintains contact with the Bank's overseas subsidiaries for the purpose of monitoring the implementation of compliance in general, and the prohibition of money laundering and the financing of terrorism in particular, as also expressed in the Group's policy document, which was formulated in 2008 according to a risk-based approach.

4. Prohibition of Money Laundering and the Financing of Terrorism

During 2008, the Bank continued the activities required for the implementation of the statutory provisions pertaining to the prohibition of money laundering, including: actions for improving data and for blocking accounts, the dissemination of publications to the various units, developing and improving the computer systems and participation in training activities to heighten awareness of this subject and the assimilation thereof.

In addition, Leumi Group's policy document was updated on the issues of the prohibition of money laundering and the financing of terrorism, according to a risk-based approach.

Prohibition of Money Laundering (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 of Money Laundering (Banking Corporations' Obligations regarding Identification, Reporting and Record-Keeping) Order, 2001, was promulgated, which thereafter became known as the "Prohibition of Money Laundering (Banking Corporations' Obligations regarding Identification, Reporting and Record-Keeping for the Prevention of Money Laundering and the Financing of Terrorism) Order" (the "Order").

Various subjects were included in the amended Order, including certain concessions for banking corporations. However, its principal purpose is to extend the application of the Order's directives to include credit cards as well, and to cause the practical implementation of the directives of the Prohibition of the Financing of Terrorism Act, 2005.

For the first time, the Order was applied to activity with debit cards and, as such, it imposes various obligations, both on the banks that themselves issue cards, and on the issuance of cards though companies that are banking auxiliary corporations engaged in the issuance of debit cards.

Furthermore, for the purposes of implementing the directives of the Prohibition of the Financing of Terrorism Act, 2005 (the "Law"), the Order was amended in relation to a number of matters, with stricter provisions imposed mainly with regard to transactions with financial institutions in a state or territory listed in the Fourth Schedule to the Order. The amendments to the Order imposed more stringent reporting obligations and additional obligations concerning activity vis-à-vis countries at risk in general, and vis-à-vis the Palestinian Authority in particular. An obligation was included in the Order requiring banking corporations to examine the parties to certain transactions against the names contained in the list of organizations and persons published by the Ministry of Defence and declared as "a declared terrorist organization" or as a "person who is an active terrorist." For the purposes of implementing the provisions of the Law, the Prohibition of the Financing of Terrorism (Permit for Actions involving Property) Regulations, 2006 were published on the same day, which include the Minister of Finance's permit to banking corporations, by virtue of section 9(d) of the Law.

These amendments to the Order came into effect on 12 February 2008, following a number of deferments of the commencement date of the amendments by the Bank of Israel (Leumi had already been prepared for the commencement of the amendments on 12 December 2007).

Upon the validation of the amendments to the Order, many changes were made in the various computerized systems, which required the investment of resources in trials, the cataloguing of the systems and work processes were revised accordingly.

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 are by their nature combined with the operational risks.

The legal risks dealt with by the Bank under the program that was prepared, as detailed below, include: risks deriving from legislation, regulations, case law and directives of authorities, risks deriving from operations not backed by adequate agreements or without legal counseling or according to deficient legal counseling, and risks deriving from legal proceedings. The purpose of the program is to prevent, 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, as well as internal procedures applicable to the Legal Division, the purpose of which is to ensure that the legal counseling provided in the Bank is professional and up-to-date.

The Bank's subsidiaries in Israel and broad operate pursuant to separate policy documents addressing legal risk management, and each company prepared a legal risk management document appropriate to its activities, in accordance with the instructions specified in the said policy documents.

The program places emphasis on:

– prevention of legal risks;

– identification of sources of material legal risks and the manner of dealing with them;

– preparation of appropriate agreements, guidelines and procedures;

– examination of statutory provisions (including case law) and regulatory directives and the examination of their implications on the work of the Bank.

– drawing conclusions on various matters and implementation of the conclusions drawn in the legal documents used by the Bank, as well as the dissemination of opinions on these subjects to the relevant units in the Bank.

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. The price of certain securities is determined on the basis of assessments obtained from a third party, while, for derivatives, the value is determined on the basis of models. 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 a subjective assessment. Therefore, great care must be exercised when using this information, since it cannot 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 do 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 financial assets at the end of 2008 was NIS 922 million higher than the balance-sheet value (in 2007, higher by NIS 1,427 million), while the fair value of financial liabilities was NIS 2,261 million higher than the balance-sheet value (in 2007, higher by NIS 1,704 million). The majority of the gap derives from the fact that the reduction of the interest on liabilities was greater than the reduction of the interest on credits, due to the expansion of the risk margin.

The change in the fair value of the monetary assets and liabilities beyond that recorded in the Financial Statements in 2008 derives mainly from the decrease in interest rates in the economy, and particularly, in the unlinked shekel segment, similar to the decrease in 2007

7. Exposure and Management of Credit Risks in Credit to the Public

Following are the weighted balances of the credit risk in the balance sheet:

	December 31, 2008						
	Balance-sheet balances	**Weighting rates**				**Deduction from capital**	**Risk balances**
		0%	**20%**	**50%**	**100%**		
	In NIS millions						
Assets							
Cash and deposits in banks	**33,130**	**19,304**	**13,808**	**-**	**18**	**-**	**2,779**
Securities	**44,910**	**20,719**	**16,117**	**-**	**8,074**	**-**	**11,298**
Securities borrowed or purchased under buy-back agreements	**201**	**125**	**-**	**-**	**76**	**-**	**76**
Credit to the public	**213,548**	**14,644**	**900**	**14,761**	**183,243**	**-**	**190,803**
Credit to the government	**520**	**481**	**-**	**-**	**39**	**-**	**39**
Investments in companies included on the equity basis (a)	**1,837**	**-**	**-**	**-**	**1,767**	**70**	**1,767**
Buildings and equipment	**3,445**	**-**	**-**	**-**	**3,445**	**-**	**3,445**
Other assets	**13,529**	**1,361**	**5,473**	**-**	**6,440**	**255**	**7,535**
Total assets	**311,120**	**56,634**	**36,298**	**14,761**	**203,102**	**325**	**217,742**

	December 31, 2007						
	Balance-sheet balances	Weighting rates				Deduction from equity	Risk balances
		0%	20%	50%	100%		
	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 (a)	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

(a) Balances of investments in shares and subordinated capital notes of financial companies are deducted from the capital, and therefore, also from the balance of securities and from investments in companies included on the equity basis.

For details regarding off-balance sheet credit risk, see section 8 on page 199.

Strategies

The Bank's credit policy is based on the spreading of risks and their supervised management. This is implemented by diversifying 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 implementation in the various market segments managed by them, except in relation to certain fields, for which there is Group-wide policy. Since the Bank fulfills a central role in financing the Israeli economy, it 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 objective of improving the quality of the portfolio and reducing the risk inherent in its management. These principles and rules relate both to the individual customer and to the level of the branches of the economy and business sectors.
The Bank's Board of Directors approves the Bank's credit and collateral policy, as well as sectoral and other limits.

Regarding the exposure to groups of borrowers, the Bank had operated until the end of 2006, 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 would not exceed 30% of the Bank's capital, while the total exposure to the six largest groups of borrowers would not exceed 135% of the Bank's capital. Since the beginning of 2007, on receiving the Bank of Israel’s approval, the Bank changed to an alternative exposure policy. Pursuant to this, the total exposure to a group of borrowers will 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 2008, the indebtedness of the largest group of borrowers reached 22.6% of the Bank’s capital. The indebtedness of the largest single borrower reached 8.1% of the Bank’s capital. The indebtedness of the six largest groups of borrowers reached 109.2% of the Bank’s capital.

The slowdown in economic growth recorded during the second and third quarters of 2008 intensified during the fourth quarter. This was manifest by the continuing trend of reduced volumes of investments by foreign residents in Israel, which was offset, for the most part, by a reduction of Israeli investments abroad. The reduction in real-estate purchases by foreign investors, coupled with a rise in the unemployment rate, led to a drop in the demand for housing. There was an increase in the trade deficit compared with the deficit in 2007, which was caused by a rise in the expenditure on energy over most of the year. The rise in the fuel prices and a decline in Israeli residents' income from investments abroad led to a reduction of the surplus in the balance of payments. On the other hand, a rise in (net) income from tourism services improved the surplus to some extent. A significant change became evident during the final months of the year. Compared with the expansion of exports and imports, there was a drop in exports of goods, particularly industrial exports, a reduction in most components, except for the exports of traditional technology industries, which maintained stability. This manifests the decline in the global demand for Israeli exports against the backdrop of the expanding global economic crisis, and the impact of a drop in prices of some of the raw materials, which, at the beginning of the year, worked to expand the dollar export income of particular industries, such as the chemical industry.

The budget deficit in 2008 was exceptional and higher than planned, and higher than that of previous years, mainly against the backdrop of the drop in the State's tax revenue, due to the slowdown in economic activity. The slowdown in global growth is likely to continue, with negative growth expected in many developed countries. A material drop in private consumption in the United States will be the main factor stunting growth. On the other hand, public consumption will be the main factor that is expected to provide a positive contribution to the gross domestic product. Furthermore, instead of contending with the danger of inflation, the economy is now contending with the danger of a drop in prices due to a drop in demand.

The Bank is implementing a cautious credit policy in relation to the branches of the economy and the credit segments characterized by high risk levels.

The Bank is taking measures to identify borrowers whose risk and exposure levels have risen, borrowers that are liable to encounter difficulties, and sectors and populations that are liable to be adversely affected by the developments on the money and capital markets and that are in need of intensive attention and support.

The Bank has been monitoring debts that are based on shares constituting a significant portion of their asset value and/or the collateral upon which the bank is relying,

The Bank is examining borrowers that raised sources of finance in the capital market in recent years (with the emphasis on those characterized by a narrow capital base), and that had intended on basing future repayments on sources raised on the stock exchange and/or on exiting from existing investments, so as to examine these borrowers' ability to continue refinancing current maturities.

Borrowers that had earmarked the monies raised as equity for leveraging investments abroad are also being reviewed.
Regarding Israeli entrepreneurs who are customers of the Bank active in the real-estate segment abroad, including subsidiaries of holding companies based in Israel, the Bank is examining the possibility that, as a result of the global financial crisis, the value of their properties might be eroded, coupled with an adverse impact on their profitability and the cash flow that this activity had been expected to produce.

The Bank is aware that the exposure to changes in the exchange rates adversely impacts mainly the financial/economic position of exporters and/or those highly dependent upon foreign currency proceeds. Volatility in the currency rates and in the prices of raw materials necessitate the execution of currency hedging transactions, mainly by companies engaging in import.

The Bank also assumes that it is highly likely that local manufacturers contending with competing imports will also be adversely affected. Another population that is liable to be adversely affected is borrowers that raised local credit in Israeli currency when the credit obtained was earmarked for investments abroad.

Holding/investment companies are also liable to be adversely affected by the financial crisis. The potential affect on this population is particularly serious, in light of the potential erosion of the value of their holdings, difficulties in executing planned exits, a fall in the value of their financial investments of surpluses, difficulty in refinancing debts by way of raising money on the money and capital markets, coupled with a rise in financing costs, the need to support financially their subsidiaries/affiliates, the possibility of regulatory and/or voluntary restrictions on the distribution of dividends, by their subsidiaries and the like.

The Bank is also cognizant of the continuing deterioration in the payment ethic, and the credit shortage, and, in this context, is more meticulous than ever about examining the credit needs and debt servicing capabilities of the borrowers with which it deals.

The Management of the Bank regularly discusses those exposures that are liable to arise from the crisis, including in-depth discussions of customers that have been defined as sensitive.

The Bank is expanding and incorporating more stringent controls in its credit policy in relation to credit whose risk level has risen, is supervising credit authorities and is imposing restrictions on the degrees of flexibility in approving transactions and increasing exposures. The Bank's credit policy contains strict criteria in relation to the various types of transactions, including the equity and collateral requirements that are needed for the various types of financing.

Against the backdrop of the circumstances described above, the Bank has expanded the preliminary examinations before transactions may be executed and, during the course thereof, examines the possibility of customers failing to comply with the Bank's stipulations. Where necessary the Bank attempts to strengthen its position, by way of capital injection or by improved collateral from the owners.

On a current basis, the Bank examines and updates the risk rating and adjusts it to the borrower's situation, paying particular attention to customers exposed to the effects of declines in demand for consumption and for real estate, customers in certain branches of the economy in Israel and abroad, and also relative to geographical regions that have been particularly affected. The Bank is also continuing to take steps to identify and rectify deficiencies in credit and collateral documents.

The Bank has developed methodologies for identifying, classifying and marking problematic credit and for calculating the adequacy of the provisions, and is integrating them into the business lines.

On 31 December 2007, the Banking Supervision Department issued to the banking corporations an amendment to the regulations for reporting to the public on the subject of “Measurement and Disclosure of Impaired Debts, Credit Risk and Provisions for Credit Losses.” This regulation will be applied in banking corporations' reports to the public as of the reports for the periods commending 1 January 2010. For details, see Note 1(M)13 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 credit policy of spreading the risks among the various branches of the economy, while determining exposure limits for the various branches of the economy and various activity segments. In addition, collateral policy is prescribed within the scope of the credit policy, which includes principles and rules regarding the various types of collateral, the extent of the reliance thereon and more. All this is done in accordance with and subject to all 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 loan review unit operates and performs an ongoing examinations of the risk level of the bank's customers.

Processes:

The Bank performs periodic analyses of the various branches and segment 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 extending 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 transfers them for discussion 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 branch, which is concentrated in a separate department within the scope of the Corporate Division's activity, is carried out using specific analytical and monitoring tools, which assist the Bank in the decision-making process and in monitoring and the financing being provided to the various projects. The Real-Estate Credit Risk Management Unit examines the credit lines of the major borrowers, approves transactions or transfers them for discussions by the appropriate credit committee, in the manner described above.

The financing in this branch is carried out while ensuring diversification of the credit portfolio and by differentiating between the various segments: residential, income-producing properties for commercial and office use, and construction for industry and commercial use, and by differentiating between the geographic regions where the projects are located, according to relevant demand.

A material portion of the financing of construction is carried out in the closed "construction loan" 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, after examining all of their activities in Israel and abroad in preferred countries, and 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 through the Bank's 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 means of control of corporations in the Proper Banking Management Directives, and the Bank is in compliance therewith.

The Bank has established a dedicated unit that examines the transactions and constructs the financing packages, including possible cooperation with other financing entities.

The following are the balances of the main credits provided in this context, according to branches of the economy (in NIS millions):

Economic sector	Balance sheet credit*	Of which, off-balance sheet credit*
	NIS millions	
Industry	1,596	-
Trade	1,137	-
Real estate	1,806	100
Communications	1,200	-
Finance and holding companies	2,082	-
Total	7,821	100

* Less provisions for doubtful debts and collateral which may be deducted.

The Bank also has a designated unit to handle complex transactions for financing investments in infrastructure projects (power stations, desalination facilities, toll roads, BOT (Build-Operate-Transfer) 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 lines of credit 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 their 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 depend on the PD (the Probability of Default) by the borrower during a given period, the extent of the EAD (the extent of the Exposure in respect of the borrower At Default) and the LGD (the Loss Given Default – the expected loss from the borrower in default). The borrower evaluation system, coupled 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 prepared for and implements the provisions of the Supervisor of Banks' Proper Banking Management Directive No. 339, which addresses the management of the Bank's credit risks. The directive 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 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

For details about the policy for determining specific provisions for doubtful debts and the additional provision, see page 48 in the section on critical accounting policy.

Policy and Processes regarding Validation and Management of Collateral

As a policy, the Bank aims to avoid providing credit without collateral. The scope of collateral required from a borrower derives, *inter alia*, from the level of credit risk. The collateral being received is not the principal consideration in 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 providing the credit, but special attention is given to 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 real-estate CRMU of the Corporate Division is responsible for the operation of the 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 data justifies 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 borrower's risk rating. The lower the collateral is in relation to the credit, the less influence it has on improving the risk rating, and the higher the echelon of authority that is required to approve it.

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.), the handling of the receipt of collateral, and monitoring changes in collateral and in its value. Officers authorised to approve the credit operate according to prescribed policy. The rates of collateral are automatically calculated by the computerized system according 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 guidelines 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 in accounts administered at the Bank or with external entities (shekel/foreign currency deposits, savings, securities, provident funds);
- pledge of sources for repayment which are paid into an account with the Bank (deferred receivables, credit card vouchers, direct debits, open accounts);
- bank guarantees from banks in Israel and abroad / sovereign guarantees / retaining of interbranch securities;

– third-party guarantees;
– foreign trade risk insurance policies;
– real estate;
– floating charges;
– movable property (vehicles, equipment);
– pledge and assignment of rights by way of charge (pledges of contract/invoices).

The following table presents data on reductions in credit risk in the Group as at 31 December 2008, in NIS millions:

	Secured by government securities	Secured by bank securities	Secured by deposits	Covered by bank guarantees	Covered by credit risk insurance
Cash and deposits with banks	**-**	**-**	**-**	**-**	**69**
Credit to the public	**1,547**	**3**	**13,125**	**775**	**19**
Other assets	**60**	**-**	**140**	**-**	**-**
Book value of transactions in which the balance represents a credit risk.	**205**	**-**	**2,638**	**521**	**1**
Book value of derivatives	**198**	**-**	**248**	**-**	**-**

The following table presents data on reductions in credit risk in the Group as at 31 December 2007, in NIS millions:

	Secured by government securities	Secured by bank securities	Secured by deposits	Covered by bank guarantees	Covered by credit risk insurance
Cash and deposits with banks	-	-	-	-	75
Credit to the public	2,247	13	12,573	1,710	22
Other assets	14	–	41	–	–
Book value of transactions in which the balance represents a credit risk.	176	–	2,215	578	1
Book value of derivatives	201	–	411	–	–

The above data are for the purpose of reducing the risk assets for the capital adequacy calculation, as required in the Bank of Israel directives.

Structure and Organization of Risk Management Functions

The Risk Management Committee of the Board of Directors – in September 2008, the Board of Directors established a risk management committee which holds deliberations on a variety of subjects pertaining to risk management, including the Basel II requirements in this regard.

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, and whose members are the Bank's risk managers – managers of market risks, legal risks, operational 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 is 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 the 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 Risk Management Committee chaired by the Head of the Credit Department – chaired by the Head of the Credit Department and comprised of personnel from all relevant units at the Bank. This committee convenes quarterly and according to the circumstances, and discusses all issues associated with credit risks, including topics defined by the Senior Committee for Risk Management and by the Credit Risk Management Committee.

The Credit Department – the Credit Department, which 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 Department, in order to validate the borrowers' risk ratings, this beyond the routine daily control that the relationship managers perform in relation to customers under their care. The majority of the unit's work focuses on making an independent examination of the relationship managers' recommendations for determining credit facilities, dealing with the customers under their care, and identifying customers whose situation has deteriorated, while indicating the main risks characterizing the credit portfolio and providing recommendations for the continued treatment 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 approved by the CRMU. This allows the credit committees to devote more time to discussing borrowers characterized by a high level of exposure and to 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: evaluating the performance of the Bank's credit portfolio (in terms of yield against risk), creating transparency in the structure of the credit portfolio according to risk levels and risk factors, formulating guidelines for the credit portfolio structure that is desirable for 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 carrying-out transactions/operations to improve the structure and risk of the portfolio. It is assumed that active, advanced management of the credit portfolio will lead to reprioritizing the capital allocation and to freeing up capital against which credit with a low level of contribution was granted, in favor of business initiatives with more profitable market sectors/borrowers, and thus lead to improved margins.

Credit Policy and Risks 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 on large individual borrowers, groups of borrowers and transactions for the acquisition of means of control. 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 individual borrowers and groups of borrowers, transactions for the acquisition of means of control, sectoral 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 appointment re credit authority, publications in the fields of credit and collateral, the checking credit and collateral documents, as well as the validity of insurance policies relating to pledged assets.

Additional Units Engaging in Credit Risks:

The Credit Risks Management Department in the Commercial Banking Division – the CRM Department is responsible for managing all aspects of the credit risks in the Division, including determining and the assimilation of the methodology for the segments of activity and/or unique to the Division, such being benefit on the basis of the credit risk management policies set in the Bank. The Department is also responsible for scrutinizing and thoroughly analyzing the Division's customers, while assessing the risk and issuing preliminary opinions to the credit committees, for approving credit applications that are within the scope of its authority, for dealing with applications regarding problem loans and for monitoring these loans.

Special Credits Department – reports directly to the Manager of Credit Risks, and coordinates the handling of the Bank's problem customers, who are transferred for the Department's attention according to criteria determined by the Bank's Management. The objective is to rehabilitate the customer and improve his financial strength and his debt servicing capability. In the absence of 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, which reports to the Chief Executive Officer.

The Unit produces to the C.E.O. and to the Board of Directors a review of the loan review activity, 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 rating of the borrowers, as included in their files.

Its functions include, *inter alia*, controlling the implementation of the Bank's credit policy, identifying credit risks, from which systemic issues may be derived having implications on the Bank's overall credit risk, as well as advancing the Bank's preparations towards implementing the Basel II directives.

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.

Model Development for 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 the improvement of 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 directives.

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 available to the decision-makers on credit matters. The Bank insists upon the maintenance of ongoing, up-to-date reporting to members of the Bank's Management and to the Banking Supervision Department. The reporting to the Banking Supervision Department includes reports on various credit matters, including credit risk according to the branches of the economy, financial instruments, the structure of the shareholders' equity and the minimum capital ratio, large individual borrowers and groups of borrowers, problem loans, the additional provision, the credit exposures of the subsidiaries abroad, related persons, 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 the quarterly reviews of the risk rating of borrowers in particular and of the overall credit portfolio in general, quarterly reports on credit concentration according to branches of the economy, individual borrowers and groups of borrowers, countries, Israeli and foreign banks in relation to the limits set by the Banking Supervision Department and internal limits, the spread of problem credit 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 increased monitoring, supervision and control activities. To this end, the Bank has updated the instructions addressing the matching required between the basis currency of the credit and the currency of the cash flow constituting the source of the repayment of the credit. Following the continuing erosion of the U.S. dollar's 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 has been raised and special attention 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 an overall 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 considered 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's *obligo*, 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 throughout the world, 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 allocation required for that borrower and/or activity is subject to an effective regulatory limit.

8. Credit Risk in Activity in Derivative Instruments

The following table presents the weighted balances of the off-balance-sheet credit risk:

	December 31, 2008						
	Par value balances	**Book value**	**Weighting rates 0%**	**20%**	**50%**	**100%**	**Risk balances**
	NIS millions						
Off-balance-sheet instruments							
Transactions whose balance represents a credit risk	**96,273**	**25,252**	**2,870**	**1,290**	**-**	**21,092**	**21,350**
Derivatives	**251,733**	**25,552**	**449**	**16,066**	**-**	**9,037**	**12,250**
Others	**1,595**	**159**	**-**	**-**	**-**	**159**	**159**
Total off-balance-sheet instruments	**349,601**	**50,963**	**3,319**	**17,356**	**-**	**30,288**	**33,759**

	December 31, 2007						
	Par value balances	Book value	Weighting rates 0%	20%	50%	100%	Risk balances
	NIS millions						
Off-balance-sheet instruments							
Transactions whose balance represents credit risk	92,593	26,633	2,418	1,202	–	23,013	23,254
Derivatives	226,230	23,113	678	15,076	–	7,359	10,374
Others	1,123	112	–	–	–	112	112
Total off-balance-sheet instruments	319,964	49,858	3,096	16,278	–	30,484	33,740

The par value of a transaction in derivatives does not reflect its credit risk. Credit risk is measured by the amount of the maximum loss, according to scenarios, that the Bank may incur if the counterparty 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, a control overview is carried out in relation to all the 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 with regard to the actual activity and collateral frameworks.

Application of the Financial Assets Agreements Act (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 subject to insolvency proceedings. Accordingly, the legal forms have been amended and the customers' signature were obtained to the amended documents.

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 cushion to cover a possible impairment of 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 every 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 for 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 indebtedness to the Bank, the credit risk deriving from derivatives is included in the customer's total indebtedness to the Bank.

The following table presents the exposures pertaining to a counterparty's credit risk, in NIS millions:

	31 December 2008	31 December 2007
Derivatives hedging a positive gross fair value	**75**	98
ALM derivatives with a positive gross fair value	**9,972**	4, 849
Total fair value	**10,047**	4,947
Total collateral held	**86**	55

The following table presents the credit exposure with respect to the fair value of derivatives, according to counterparties to the contract (presented in other assets), as at 31 December 2008, in NIS millions:

	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Under B-	Unrated	Total
Foreign banks							
United States	36	393	-	-	7	-	436
Euro zone	628	477	-	-	-	-	1,105
Great Britain	687	1,242	24	-	-	-	1,953
Other	98	310	-	-	-	1	409
Total foreign banks	1,449	2,422	24	-	7	1	3,903
Israeli banks	6	904	218	-	-	27	1,155
Corporate customers, according to branches of economy							
Financial services							2,328
Industry							974
Construction and real estate							388
Transportation and storage							219
Trade							199
Electricity and water							138
Business services							125
Private individuals							122
Communications and computer services							67
Others							36
Total corporate customers							4,596
Others*							393
Total exposure							10,047

* Reverse transactions carried out by the customers and offset for risk purposes according to branch of economy.

9. Management of Bank's Credit Risks

The credit risk inherent in the Group's activity in derivatives, in deposits with banks, and in the debentures portfolio is managed with special focus on diversifying the risk among many business entities (mainly foreign banks and Israeli companies), and while meticulously scrutinizing the other party to the transaction (the "Borrower"). In addition to examining the Borrower's quality, which is carried out both for Israeli companies and for foreign banks, tests of foreign banks are also made against such parameters as: external rating, their volume of equity after write-offs during the last year, the volume of new capital raised and the like, as well as information gleaned from the market, such as CDS margins, share price, etc. During the last year, with the deepening of the global crisis, the portfolio of bank debentures and derivatives in the Group is managed while also considering the strength of the economy in which the Borrower is located, and the extent of the commitment and responsibility demonstrated by and reported in relation to the relevant government regarding the financial system under its responsibility.

10. 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 assessments of the level of the various risks.

Risk factors are assessed according to their degrees of severity – low, moderate 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 moderate 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 applies only to the materialization of unforeseen damages. The assessments of a fixed and foreseen level of adverse events is 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 are liable to 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 threshold has been chosen of a 90% probability that damage will not materialize in a particular year (that is to say, the probability that damage will occur at the level of severity indicated in a particular year is less than 10%).

The quantitative definition for the various risk levels is performed in relation to the unforeseen changes in the coming year. A low risk was defined as a risk whose materialization would not cause the minimum capital ratio to drop below 11% during the year, while a moderate risk was defined as a risk whose materialization would not cause the minimum capital ratio to drop below 10.5% during the year. Losses, of course, are assessed after 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 reference is to all the credit risk of the Bank, and includes, *inter alia*, credit to the public, derivatives, deposits in banks and investments in debentures.

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 policies stringent controls over credit whose risk level has risen, the supervision of credit-granting authorities, expansion of the preliminary examinations prior to the execution of transactions, the setting of stringent criteria in relation to the various types of transactions 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 credit risk inherent in the Group's activity in derivatives, deposits with banks, and in the debentures portfolio is managed with special focus on diversifying the risk among many business entities (mainly foreign banks), while also meticulously scrutinizing the other party to the transaction (the "Borrower") relying on known parameters, such as: external rating, CDS margins, the volume of their equity, etc. During the last year, with the deepening of the global crisis, the management of the Group's portfolio also takes into consideration the strength of the economy in which the Borrower is located, and the extent of the commitment and responsibility demonstrated by and reported in relation to the relevant government regarding the financial system under its responsibility.

The Group has surplus capital in relation to the Bank of Israel's requirement for a minimum risk capital ratio of 9%. This capital surplus reduces the adverse impact of credit events and ensures that no damage will be caused 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 quantitative assessments of the credit risk place it in the high range. Following are the overall credit risk components:

1.1 The risk in respect of borrowers and collateral – the spread of the loss of all the borrowers in the Bank was examined. The maximum loss at the prescribed confidence level is of moderate level.

1.2 The risk in respect of sectoral concentration – the spread of the loss was examined, while significantly increasing the failure correlations between borrowers in the same branch of the economy. The added risk in respect of sectoral concentration at the prescribed confidence level, beyond the risk in respect of borrowers and collateral, is of a low level.

1.3 Groups of borrowers – the spread of the loss was examined assuming that each of the groups of borrowers constitutes a single borrower. The significance of this assumption is a perfect correlation between all of the companies in a particular borrowing group. The additional risk in respect of groups of borrowers at the prescribed confidence level, beyond the risk in respect of borrowers and collateral, is of a low level.

For further details regarding credit risk exposures, see page 189 and 199.

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. The market risk is assessed for the entire Group, and includes shares held for investment purposes.

In order to assess 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. The unforeseen damage to shares for investment purposes must be added to this value. 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 categorized as low.

For further details regarding exposure to and management of market risks see page 163 and 179.

3. Liquidity risk

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 indices, and the subsidiaries also comply with the indices that they set for themselves.

For further details, see page 181 and 182.

4. Operational risk

Operational risk is "the risk of a loss resulting from inadequate or failed internal processes, people or systems, or resulting from external events. This risk includes legal risk, but excludes strategic and reputational risks."

At the Bank and at its subsidiaries, a structured process of mapping operational risks and assessing their severity is carried out on an ongoing basis. This includes defining how the risk should be managed and the recommended modes of operation for minimizing the risks. To support these processes, an information system was developed for documenting and monitoring the management of operational risks. Concurrently, the Bank carries out processes for assessing and hedging the risks of its computerized systems – both the development and production systems.

Within the scope of the first pillar of Basel II, Leumi allocates capital for operational risks according to the basic indicator approach which computes losses for operational risk in the 99.9 percentile. After adjusting the result for damage of once every ten years, and from reviews of actual past events, one can determine that the risk is low.

For further details, see pages 184 to 186.

5. Legal risk

According to the Bank of Israel's definition, a legal risk is the risk of loss resulting from the inability to legally enforce the performance of an agreement.

The legal risks that the Group handles within the scope of the prepared plan include: risks deriving from legislation, regulations, case law and regulatory directives, risks deriving from operations not backed by adequate agreements or without legal counselling or according to deficient legal counseling, and risks deriving from legal proceedings.

A plan for managing legal risks is implemented in the Group whose objective is to identify, prevent, manage and minimize legal risks. The Group's legal risk is categorized as low.

For further details, see pages 187 to 188.

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 confidence 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 the 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 Leumi Group strictly ensures that the products and services that it provides are of high quality. The treatment of employees and customers is manifest by the minimal number of complaints. The Group's reputational risk is categorized as low.

7. Strategic risk

Strategic risks are those threats having a material impact on the Bank's ability to survive, the risk of the current and future implications on profits, capital, reputation or standing, deriving from erroneous business decisions, from the improper performance of decisions or from the failure to respond to sectoral, economic or technological changes, and the compatibility risk relating to strategic goals, the business strategies developed to achieve these goals, the resources allocated to meet these goals and the quality of the implementation.

The risk derives, *inter alia*, from entering new fields, from expanding existing services, from mergers and acquisitions, and from increasing investment in infrastructure for the purpose of realizing the business plan, and it arises from the gap between the opportunities and the threats in the external environment and the Bank's internal capabilities (strengths and weaknesses). A strategic risk is inherent in every forward-looking decision.

The process of managing strategic risks which has been developed at Bank Leumi, includes a number of stages: identification of the risk, mapping the risk, measuring the risk and the actions to be taken to reduce and monitor it.

The said process includes distribution of the strategic risks among the various levels in the Bank's environment: the remote external environment, the close external environment (the business/competitive environment) and the internal environment. The Group's strategic risk is assessed as low.

8. Systemic 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 may significantly affect the financial risks described in the preceding paragraphs.

The following table presents an assessment of the risk factors in the Group as at 31 December 2008:

	Risk Factor	**Severity of the risk**
1	Overall effect of credit risks*	High**
1.1	Risk in respect of the quality of borrowers and collateral	Moderate
1.2	Risk from sectoral 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	Operational risk	Low
5	Legal risk	Low
6	Reputational risk	Low
7	Strategic risk	Low

* Relates to the overall credit risk assets of the Bank, and includes, *inter alia*, credit to the public, derivatives, deposits with banks and debentures.

** A high risk is defined as a risk, the realization of which could lead to the minimal capital ratio dropping below 10.5%.

Note:
The assessment of risks is "Forward-looking information" (for the definition of this term, see pages 46 to 47). 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.

Credit Exposure to Foreign Financial Institutions

The following table presents the credit exposure to foreign financial institutions [(1)] as at 31 December 2008:

External credit rating [(5)]	Balance sheet credit risk [(2)]	Securities [(3)]	Current off-balance sheet credit risk[(4)]	Current credit exposure
	NIS millions			
AAA to AA–	**6,195**	**3,921**	**2,084**	**12,200**
A+ to A–	**9,353**	**8,999**	**3,755**	**22,107**
BBB+ to BBB–	**221**	**225**	**39**	**485**
BB+ to B–	**402**	**–**	**15**	**417**
Lower than B–	**8**	**111**	**3**	**122**
Unrated	**679**	**9**	**105**	**793**
Total current credit exposure to foreign financial institutions	**16,858**	**13,265**	**6,001**	**36,124**
Balances of problem loans	**–**	**135**	**–**	**135**

(1) Foreign financial institutions include: banks, investment banks, insurance companies, and institutional entities.
(2) Deposits in banks, credit to the public, securities loaned or purchased under reverse repo agreements, and other assets in respect of derivatives (fair value of derivatives).
(3) Mainly bank debentures, of which NIS 2,546 million are subordinated debentures.
(4) Mainly guarantees and undertakings to provide credit (without off-balance-sheet derivatives).
(5) As a rule, the foreign banks in respect of which there is credit exposure are rated by two or three of the leading rating agencies in the world (S&P, Moody's, Fitch).

Notes:
a. The credit exposures are presented after deducting the specific provisions for doubtful debts.
b. The credit exposures do not include investments in asset-backed securities (see details under the Note on securities).
c. Some of the banks received government support in various ways, including through a direct investment in the bank's capital, via government guarantee of particular asset portfolios of the banks, guarantees for recruiting sources for banks, etc.
d. For further information about the components of the credit exposures to banks and dealers/brokers (local and foreign) in respect of derivatives, see Note 18 to the Financial Statements.

The credit exposure to foreign financial institutions relates to commercial banks, bank holding companies, investment banks, insurance companies and institutional entities. On 31 December 2008, some of the exposure (some 3%) was still considered as exposure to investment banks. Today, all the financial institutions to which the Bank is exposed have received a banking license or ceased to exist as independent investment banks.

Exposures by country are broken down as follows: the United States 34%; Europe (Germany, France, Italy, Spain and the Benelux countries) 40%; United Kingdom 14%; other countries 12%.

The exposure includes mainly deposits in foreign banks, some 90% of which are short-term deposits of up to one week, and debentures, usually for a period of up to five years. Against the backdrop of the crisis in the financial markets, and the weakening of banks' financial strength, the Bank is closely monitoring the condition of banks throughout the world. During 2008, the Bank significantly reduced the list of banks with which the Bank and its overseas subsidiaries make deposits, and reduced the volume of exposure to them.

Against the backdrop of the global financial crisis, the Bank is acting and taking steps to reduce the exposures and risks to the extent possible.

During 2008, deposits in foreign banks were reduced by some US$ 5.2 billion, of which a reduction of some NIS 7.0 billion during the fourth quarter of the year. This reduction mainly reflects the diversion of investments to government securities of the United States and France (totaling some US$ 900 million and some EUR 100 million, respectively), deposits in central banks (in the American FED, and in Luxembourg), a voluntary reduction in swap transactions with foreign banks, and an increase of some US$ 700 million in loans. This activity is intended to reduce the exposures and risks.

During the fourth quarter of 2008, there was a reduction in the off-balance-sheet credit risk in the amount of some NIS 4.9 billion, resulting from a reduction of the credit lines of foreign banks, mainly in shekels.

For further details on the investment in securities, mainly debentures of foreign banks, see page 94.

Management of the exposure and credit lines for foreign financial institutions takes into account, *inter alia:*

– their size, as reflected, *inter alia*, in their shareholders' equity after the write-offs in respect of losses and the capital increases of the past year;
– their strength, as reflected in their capital adequacy ratios (particularly Tier I capital);
– the market's assessment, as reflected in the market value of their shares and the risk, as estimated using their credit derivatives (CDS);
– their credit rating according to the international credit rating agencies;
– the financial strength of the country where the bank's center of activity is located.
– additional considerations, such as the extent of backing, including direct investments in banks' capital by governments, for the purpose of ensuring the financial strength of those banks and other banks in their countries.
– the policy for managing the exposure to foreign financial institutions includes, *inter alia*, limits on the amounts of exposure at the bank and country level.

Exposure to foreign countries

The exposure to foreign countries according to final risk is distributed among geographical areas and countries, the main exposure being to countries in Western Europe and in North America.

The following table presents the exposure to countries according to the credit rating of the countries as rated by the World Bank, in NIS millions:

Rating	Balance sheet exposure	Off-balance-sheet exposure	Total exposure	Ratio of exposure to total	Of which, are problematic
OECD countries	62,197	29,554	91,751	94.5	2,035
High-income countries	1,907	215	2,122	2.2	184
Countries with mid-high income	2,141	484	2,625	2.7	9
Countries with mid-low income	474	135	609	0.6	7
Countries with low income	27	4	31	-	-
Total	66,746	30,392	97,138	100.0	2,235

The countries are rated according to national income per capita as follows:
High income - exceeding US$ 11,455 per capita.
Mid-high income - from US$ 3,706 to US$ 11,455 per capita.
Mid-low income - from US$ 936 to US$ 3,706 per capita.
Low income – up to US$ 935 per capita.

Following are the names of the principal countries in each of the categories:

a. OECD countries:

USA, Italy, Australia, Austria, Ireland, Belgium, Canada, Czech Republic, Denmark, Finland, Hungary, France, Great Britain, Japan, Spain, Switzerland, Luxembourg, the Netherlands, Sweden.

b. Countries with high income:

Israel, Cyprus, Hong Kong, Monaco, Singapore, Slovenia, Cayman Islands.

c. Countries with mid-high income:

Argentina, Brazil, Bulgaria, Chile, Mexico, Panama, Poland, Romania, Russia, South Africa, Turkey, Venezuela, Uruguay.

d. Countries with mid-low income:

China, Colombia, Ecuador, Egypt, India, Jordan, Peru, Paraguay, the Philippines, Thailand, the Ukraine.

e. Countries with low income:

A large number of the African countries, Haiti, Nepal.

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 public's trend in recent years towards preferring securities listed on the stock exchange over bank deposits, came to an end in 2008. The volume of deposits of the public rose in 2008 by 2.8%, as against a decrease of 27% in the securities portfolio of the Group's customers – in comparison with increases of 2.7% and 14.4%, respectively, in 2007. The substantial drop in the securities portfolio is a result of the collapse of the markets.

The Bank has maintained liquid assets in excess of the amount of its liquid liabilities throughout the year.

The following are the main changes that took place during 2008 in liquidity status, according to repayment periods and divided according to linkage sectors:

The unlinked shekel sector

Some 42% of assets at the end of 2008 are in the unlinked shekel sector. Most of the activity in this sector is concentrated in short periods of up to a year.

The volume of credit rose during 2008 by NIS 13 billion, some 14.7%, which was funded by an increase in the balance of deposits of the public.

During the first half of the year, there was a moderate increase in the volume of deposits, and during the second half of the year, there was a significant accrual of deposits, mostly short-term. On an overall annual basis, there was an increase of NIS 15.3 billion, a 15.8% rise, in shekel deposits.

An examination of the spread according to repayment periods shows that at the end of 2008 there was a surplus of liabilities over assets for periods of up to a year which had increased by some NIS 5.0 billion as compared with the surplus in 2007. The increase arose from an increase in short-term deposits, and from a decrease in short-term derivatives.

For periods of over a year, there was an increase in the surplus of assets in the amount of NIS 11.2 billion, compared with 2007. The increase in the surplus resulted primarily from the transfer to short term credits, and from an increase in derivatives.

The CPI-linked sector

Most of the transactions in this sector are for periods longer than a year.

There was a reduction of some NIS 950 million in the investment of capital in this sector as compared with 2007, as a result of the raising of capital through the issue of capital notes and subordinated capital notes, and a certain increase in other liabilities, which were offset by the reduction in the volume of futures transactions with CPI-linked liabilities.

The downward trend in the volume of CPI-linked deposits of the public, which characterized the years 2003-2007, came to an end in 2008. The balance of deposits of the public in the sector at the end of 2008 amounted to NIS 27.5 billion, an increase of NIS 0.6 billion (some 2.2%).

Derivative transactions for the purpose of purchasing CPI hedging by the public decreased by some NIS 1.4 billion (14.1%), net, both because the public released existing transactions and because of a reduction in the volume of new transactions that were carried out.

Credit to the public in the sector amounted to some NIS 53.5 billion at the end of 2008, similar to the end of 2007.

An examination of the spread according to repayment periods shows that at the end of 2008 there was a surplus of assets over liabilities of NIS 0.6 billion for periods of up to one year, compared with a surplus of liabilities over assets of NIS 3.5 billion in 2007. For repayment periods of over one year to five years, the surplus of assets decreased, resulting primarily from an increase in deposits from the public.

Foreign currency and foreign-currency linked sector

The majority of the activity in this sector is concentrated in short periods of up to three months. 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 condition of the financial markets.

Since the beginning of 2008, a decrease in the amount of NIS 8.8 billion (7.7 %) was recorded in the volume of deposits of the public in foreign currency. Most of the decrease was in foreign currency deposits of corporations. After the effect of changes – primarily that of the strengthening of the shekel relative to most currencies – is neutralized, the decline was at the rate of 3.5%.

On the other hand, credit to the public, which constitutes only some 55% of the deposits of the public in this sector, rose by NIS 1.6 billion – an increase of 2.9%, and after the effect of changes in the exchange rate is neutralized, credit rose by 7.1%. The investments in foreign currency securities amounted to some NIS 26.1 billion, a decrease of some NIS 1.1 billion compared with 2007.

These trends led to an increase in the surplus of foreign currency liabilities over assets for a period of up to one 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 at 31 December 2008**			
	Unlinked Israeli currency	**CPI-linked**	**Foreign currency including foreign currency linked**	**Total**
Period remaining to maturity:	**NIS millions**			
Up to 1 month	**(8,347)**	**80**	**(27,431)**	**(35,698)**
From 1 month to 1 year	**(7,156)**	**563**	**(14,654)**	**(21,157)**
From 1- 5 years	**20,366**	**2,171**	**29,354**	**51,891**
From 5 - 10 years	**12,409**	**(3,245)**	**10,034**	**19,198**
More than 10 years	**5,018**	**9,195**	**3,526**	**17,739**
Without maturity date	**2,315**	**(353)**	**666**	**2,628**
Total	**24,605**	**8,411**	**1,585**	**34,601**

Surplus of assets over liabilities*	As at 31 December 2007			
	Unlinked Israeli currency	CPI-Linked	Foreign currency including foreign currency linked	Total
Period remaining to maturity:	NIS millions			
Up to 1 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

* After offsetting surplus (deficit) balances 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 172 to 184 above.

B. Liquidity Status and Funding

The system’s liquidity status -

In 2008, the crisis developed in the United States and became a global crisis which impacted on the liquidity situation in the world money markets as well as on the Israeli market, The Bank of Israel’s policy in 2008 responded to the development in the world markets. Thus, in 2008 the Bank of Israel decreased the net volume of *Makam* tenders by some NIS 5 billion to a level of some NIS 71 billion, compared with a level of some NIS 76.0 billion at the end of 2007.

The balance of the banking system’s monetary deposits with the Bank of Israel stood at some NIS 28.3 billion at the end of December 2008, compared with the end of December of 2007, when no use was made of this tool. The average net volume of monetary loans (less the monetary deposits) to the banking system was at a level of some NIS 3.5 billion at the end of 2008, a decrease of some NIS 4.8 billion compared with the 2007 average.

Leumi’s balance of monetary deposits with the Bank of Israel at the end of December 2008 amounted to some NIS 11.9 and at the end of 2008, the Bank had no monetary loans. The average net volume of the monetary loans (less the monetary deposits) in 2008 was some NIS 1.3 billion, a reduction of some NIS 2.3 billion compared with the 2007 average.

As of March 2008, the Bank of Israel has been implementing a program to increase the levels of the foreign currency balances though foreign currency purchases of some $25 million per day for two years, and as of July 2008, the Bank of Israel announced that it would increase the rate of its foreign currency purchases to $100 million per day.

Since the beginning of July 2008, the Bank of Israel has operated weekly "repo" tenders, which allow for shekel credit to be received against a pledge of government debentures and *Makam*, with a volume of NIS 2 billion, including a mechanism for the daily revaluing of collateral. These are alongside existing monetary tenders. In addition to the banking corporations, the pension funds, provident funds, insurance companies and mutual funds may also participate in the "repo" tenders.

In October 2008, the Bank of Israel announced the reduction of interest paid to banks on their foreign currency deposits with the Bank of Israel. These deposits, other than overnight deposits, are recognized as security for Israeli currency credit from the Bank of Israel. The interest in foreign currency deposits which will be paid for periods of 30 to 90 days, is to be equal to the return on United States government treasury bills for the same period, as demonstrated by the Bank of Israel, while deposits for up to a week will not bear any interest.

On 24 December 2008, the Bank of Israel published a monetary program for increasing liquidity in the economy, which included four measures:

1. A reduction of the absorption of liquidity surpluses to be carried out through the issuance of *Makam*, beginning from January 2009.

2. In addition to the monetary loans that were currently given to the banking system in the framework of tenders offered to the banking system for periods of one day and one week, such loans would be given for longer periods as well. This decision has not yet been carried out.

3. The Bank of Israel's interest spread at the credit window and at the commercial banks' deposits window dropped from 1.0% to 0.5%. (Later, on 23 February 2009, it dropped again to 0.25%.)

4. The offering of repo tenders to commercial banks and institutional entities for periods of a month, from the beginning of 2009, instead of for periods of one week as had been offered until the end of 2008. At the end of February 2009, the Bank of Israel returned to offering one week tenders instead of one month tenders.

On 16 February 2009, the Bank of Israel announced that it would act in the open market and carry out transactions in government debentures in the secondary market. The purpose of this measure, according to the announcement was to increase the liquidity available to financial institutions, businesses and households, and to increase the effectiveness of monetary policy. The Bank of Israel estimated that these actions would increase the effect of the interest rate fixed by the Bank of Israel on longer term interest rates as well.

Regarding further measures taken by the government and by the Bank of Israel to improve the liquidity situation in the economy, see pages 27 to 28.

It should also be noted that on 26 May 2008, the shekel joined CLS (Continous Linked Settlement) as a traded currency. Leumi serves as a Nostro Agents in shekels for its customers and as a shekel Liquidity Provider to the CLS bank. The CLS bank serves as a clearinghouse for inter-currency transactions while reducing the clearing risks and the requirements for liquidity

Liquidity Status at the Bank

The structure of the Bank's assets and liabilities continues to indicate a high level of liquidity. This is the result of a deliberate policy of raising stable and diversified sources, while placing importance on the raising of deposits from a large number of customers, for varying periods of time, including long term. It is also the result of the expansive monetary policy practiced by the Bank of Israel. Some 36% of the assets are deposited in banks and/or are invested in securities, primarily in debentures.

There was no material change in 2008 in the mix of deposits of the public according to periods, and there continued to be a spread of periods to maturity.

The Bank has cash and deposits in banks amounting to some NIS 58 billion.

The Bank also has a securities portfolio of some NIS 37 billion, which is mainly invested in Israeli government debentures, foreign government debentures, and foreign banks.

The Bank's net liquid assets – cash, deposits at banks and securities (excluding shares and funds) less deposits from banks stood at 33.3% of the Bank's total assets as at 31 December 2008, compared with 34.8% as at 31 December 2007. During the course of the year, the liquidity risk was reduced with the transfer in the foreign currency sector to investments in government securities, an increase in the deposits in foreign central banks and a reduction of the periods of deposits in foreign banks.

The ratio of credit to the public to deposits of the public on 31 December 2008 was 65.3% - compared with 64.2% on 31 December 2007.

Leumi monitors, on an ongoing basis, its liquidity status and the indices that are intended to warn of changes in the liquidity position, *inter alia*, by using an internal model that was developed at the Bank pursuant to a directive of the Bank of Israel. The various assumptions forming the basis of the model are examined and updated regularly according to developments in the major relevant parameters.

See also page 179 of the Report.

During the first half of 2008, the liquidity surpluses in Israeli currency declined primarily because of the provision of large volumes of credit from the deposits that had been raised, along with the payment of a dividend. There was a significant increase in the liquidity surpluses in Israeli currency during the second half of the year, due to the reduction in the volume of credit provided, along with the monetary measures carried out by the Bank of Israel, such that on an overall basis for the entire year 2008, there was an increase in the liquidity surplus in Israeli currency at the Bank.

During the course of 2008, there was a decrease in foreign currency liquidity surpluses due to the provision of loans, a decline in the value of the securities portfolio and a decrease in deposits of the public.

For additional details regarding the liquidity status, see the Risk Management section at page 181.

Sources and Uses in the Bank

During the second half of 2008, against the background of the crisis in the capital markets a trend began of the diversion of monies held by the public from investments in the capital market to deposits.

The balance of deposits of the public at the Bank rose during 2008 by NIS 13.0 billion, 6.2%. Most of the increase was in the unlinked sector, which rose by 17.7%. On the other hand, there was a 4.5% reduction in foreign currency deposits, of which 4.2% derives from the strengthening of the shekel in relation to most foreign currencies.

During 2008, subordinated capital notes, traded on the Tel Aviv Stock Exchange, were issued through Leumi Finance Company. CPI-linked subordinated capital notes were issued in the amount of some NIS 0.8 billion for an average term of some 7.7 years. Unlinked shekel subordinated capital notes were issued in the amount of some NIS 1.7 billion, for an average period of 4.7 years.

In 2008, the volume of credit to the public rose by NIS 10.8 billion, 8.1%. The increase was mainly in the unlinked shekel segment, which rose by NIS 9.1 billion, at the rate of 11.7% and foreign currency credit, which rose by 10.0%. After neutralizing the effect of the strengthening of the shekel, foreign currency credit rose by 11.8%.

Basel II

Bank of Israel Directives

On 31 December 2008, the Bank of Israel published the Basel II Directive in the context of provisional directive "Working Framework for the Measurement of Capital Adequacy" will enter into effect at the end of 2009. The Working Framework is based on the recommendations of the Basel Committee that were published in June 2006. In the letter accompanying the Provisional Directive, the Supervisor of Banks states that the Directive is the conclusion of a process that began in the middle of 2007, in the context of which drafts regarding various subjects were distributed to the banking system. These drafts were discussed at ongoing meetings with representatives of the banking corporations and in the context of joint working teams dealing with specific topics.

At the same time, the Supervisor published Provisional Directive – "Quarterly Reporting on the Measurement of Capital Adequacy", according to which the banking corporations are required to report to the Bank Supervision Department regarding capital adequacy measurement in accordance with the Basel II rules, beginning with the report relating to 31 December 2008.

Nevertheless, the actual capital adequacy requirement will continue to be in accordance with the previous regime (Basel I) during 2009.

The Supervisor intends to merge these Directives into the existing Supervision Directives with effect from 2009.

As has been described in the past, in the annual and quarterly Financial Statements published during 2007 and 2008, the Basel II directives include four parts:

Part A – Application, which specifies the manner in which the capital requirements are to be implemented in the banking group.

Part B - the first pillar, which specifies the minimum capital requirements, and specifies the manner in which the required capital is to be calculated for credit risks, market risks and operational risks. (For the first time, there is a requirement for the allocation of capital against operational risks.)

Part C - the second pillar, which outlines the expectations and principles regarding supervisory review and also includes processes for the banking corporation's risk management, including risks that are not included in the first pillar, including concentration risk, interest risk in the banking portfolio, and more.

Part D - the third pillar, which deals with disclosure and market discipline.

According to the Supervisor of Banks' instructions, banking corporations are required to operate in a manner which will ensure compliance with the requirements of the standard method of the first pillar, and with the requirements of the second and third pillars of the Basel II recommendations by the end of 2009.

At the same time, the Supervision Department is encouraging the banking corporations to prepare in a manner which will allow them to adopt in the future the advanced methods that are based on internal ratings of credit risks.

The Supervisor emphasizes the connection that must be maintained between the total capital that a banking corporation is required to hold against its risks, and the strength and efficiency of the risk management and internal control processes. The Supervisor expects that the banking corporations will develop and upgrade their risk management system, controls and corporate governance, and they must carry out an appropriate internal assessment process which combines key elements of capital planning and management and will lead to the holding of adequate capital against these risks.

In light of the current economic crisis, the Supervisor of Banks announced that he would monitor global trends and developments and would update his directives as needed.

The Leumi Group's Preparations

For some three years (2006-2008), the Leumi Group has been preparing for the implementation of the Basel II instructions through a Group-wide project in Israel and abroad. The project's management is responsible to the Senior Deputy Chief Executive Officer, who heads the project's steering committee, and it acts through designated working teams throughout the Bank.

The following actions have been taken in the context of the preparations:

1. The requirements in the Basel documents and the Bank of Israel requirements have been studied and
gap analyses prepared on their basis.

2. A detailed working program has been prepared for the Bank and Group units for closing the gaps.

3. Adjustments have been made to the infrastructure systems risk management and capital calculation systems have been purchased or upgraded, and these have been linked to the existing systems. These systems are intended to upgrade and significantly improve the Bank's ability with regard to risk-focused management.

4. Data has been collected and databases have been established as required for the assessment of risk variables.

5. Organizational and process changes have been made in the area of credit risk management.

6. Model development processes, as required for the implementation of the advanced methods regarding credit risks.

7. Surveying and mapping of operational risks as part of a three year program.

8. Commencement of the process of carrying out required adjustments in risk management policy and guidelines (credit, market and operational risk policy).

9. Measurement of the profitability of the lines of business also on the basis of the return on adjusted risk models – RORAC (Return on Risk Adjusted Capital

The Bank is preparing for the implementation, beginning at the end of 2009, of the Bank of Israel's requirements to implement the standard method set out in the first pillar with respect to credit and market risks, and of a basic method with regard to operational risks during a three year transition period, after which the standard method will be implemented for operational risks as well.

In the context of these preparations, many business adjustments and computer system adjustments are being carried out at the Bank and Group level, in order to meet the requirements of the standard method. The Bank is relying for this purpose on a centralized computer system that it has purchased for this purpose, with regard to calculating the capital requirements and of managing the credit risks. This system will serve both the Bank and the Group units. The Bank is also continuing to prepare for the advanced internal ratings-based approaches (IRB) with regard to credit risks, through the collection of data, construction of data bases, and the processes for the development of internal models for internal rating systems, calculation of the PD (probability of default) and of the severity of the LGD (loss given default). This process also involves the replacement and upgrading of the systems used to rate retail and corporate borrowers.

During the second quarter of 2008, an Internal Capital Adequacy Assessment Process – ICAAP – was initiated in the Leumi Group. This process co-ordinates compliance with the requirements of the second pillar of the Basel recommendations regarding a "Supervisory Review Process," and is necessary for the completion of the preparations for Basel II by the end of 2009, in accordance with the Bank of Israel requirements.

The process is divided into two main components:

1. Assessment of the Group's capital adequacy and an examination of the ability to bear losses in accordance with the risk appetite and the risk profile. When assessing capital adequacy, it is necessary to take into account the Group's strategic plans and its future capital needs as reflected in the three-year plan, in the light of the economic forecasts. Additionally, it is necessary to examine the planning's resilience and the changes required, in light of stress scenarios of varying severity, such as a mild or a severe recession. After the process is fully prepared, the definitions of the various levels of severity that are used for defining the severity of the risk factors are likely to change, which would, of course, lead to an updating of the risk levels.

2. An annual survey of risk management within the Group, an examination of the risk management's compliance with the standards established in the context of Basel II, the identification of strengths and weaknesses and the construction of work programs for the improvement and updating of risk management processes. The assessment of the risk management processes evaluation is closely linked to the capital adequacy assessment, since without strong and adequate risk management, a larger cushion of capital is required as protection against losses.

The results of the process will be collected in the ICAAP document. A first draft of the document is expected to be submitted to the Bank of Israel on 30 June 2009, and the annual document is expected to be submitted together with the annual report for 2009.

The Leumi Group's preparations require the investment of significant management and financial resources that have already been invested and will be invested in the coming years in order to comply with the Bank of Israel's requirements, and for the improvement and upgrading of the Group's risk management processes.

The current Directors Report and Financial Statements and the 2007 Report present for the first time 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 189-201	-
4. Quantitative credit risk disclosure	Page 189	Note 13
5. Reducing credit risk	Pages 195-196	-
6. Exposure to credit risk of counterparties	Page 200	-
7. Market risk	Pages 172-184	-
8. Position in shares	Page 100	-

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 enforced purchase of 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 2008, some NIS 187 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 the 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 9 December 2008, the Tel Aviv-Jaffa District Court approved the withdrawal of a petition for the approval of a class action, that the petitioner had filed against the Bank in June 2005 in the amount of NIS 576 million, on the ground 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

1.4 On 26 June 2008, the Tel Aviv-Jaffa District Court approved the withdrawal of a petition to approve a class action which was filed on 31 January 2007 against the Bank and two additional banks in the amount of NIS 200 million on the ground that the commissions paid by the provident funds to the Bank in respect to transactions in securities were "excessive."

1.5 On 18 January 2009, the Tel Aviv-Jaffa District Court approved the withdrawal of a petition for the approval of a class action that was filed in May 2008 against the Bank and three additional banks in the amount of some NIS 115 million, on the ground that the value date on which a customer's account in the Bank is credited for a foreign currency check drawn on an overseas bank is later than the value date on which the overseas bank account, on which the check is drawn, is charged.

1.6 On 23 February 2009, the Supreme Court rejected a petition to appeal filed by one of the third parties against whom the proceedings were to be continued according to a settlement agreement that had been signed by the parties and which was given the effect of a judgment. In 1997, a foreign company in the process of liquidation had filed a claim against the Bank, against a subsidiary of the Bank (Bartrade International Trade and Financing (83) Ltd.) and against certain of their employees, in the amount of some NIS 153 million as of the date of filing the claim. The claim related to a transfer of US$ 43.4 million by the foreign company to an account with the Bank in the name of the manager of the foreign company. The approved settlement agreement, which has in the meanwhile been carried out by the insurance company that had insured the Bank at the time of the event, remains in place.

1.7 On 10 June 2004, the Jerusalem District Court, sitting as the Standard Contracts Tribunal, gave judgment on a petition 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 would 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.

1.8 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 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, applied to 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 had 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 Partners). The respondents responded to the application and the plaintiff answered. In its ruling, handed down on 12 February 2008, the court approved the petition to amend the claim. The respondents have submitted their amended responses to the amended petition for the approval of the action as a derivative action. In the context of the suit, proceedings are being conducted against the controlling shareholder of Africa Israel with respect to the disclosure of specific documents.

2. **Other Proceedings**

2.1 In January 2008, the Tel Aviv-Jaffa Magistrate's Court approved a plea bargain that had been reached between 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.) – which are subsidiaries of the Bank – and the prosecutor's office, with respect to an indictment that was filed 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.

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. 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 asked to produce documents.

In March 2008, the Bank received a letter from the Antitrust Authority stating that the General Director was currently examining the possibility of exercising her authority according to section 43(a)(1) of the Antitrust Law, 1988, (the "Antitrust Law") 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. In September of 2008, the Bank submitted its detailed position in writing to the General Director, to the effect that there is no factual or legal basis for issuing a determination such as described above, and maintained its request that it be given the right to make oral arguments to supplement its arguments. The Antitrust Authority rejected the request for the right to make oral arguments. In January 2009, a deliberation was held between the legal representatives of all the banks and the General Director, during which the General Director suggested the banks to pay an aggregate amount of NIS 290 million (out of which NIS 80 million was to be paid by the Bank) and future rules of behaviour be laid down by a consent decree pursuant to the Antitrust Law. The Bank rejected this offer. Additional contacts took place between the Bank and the General Director, to no end. It is possible that the General Director will exercise her authority, as mentioned in her letter dated 19 March 2008.

2.3 During 2008, a routine audit by the Internal Audit Division of the Bank disclosed irregularities in the approval of loans by Mr. Menachem Friedman, while he served as manager of a branch of the Bank in Israel. The audit indicated an exceptional occurrence, but this will not affect the Bank's customers in any way. The Bank contacted the police so that they could examine matters which the Bank was unable to examine by itself, and reported the matter to the Supervisor of Banks. In light of the said exceptional occurrence, which involved a serious breach of trust vis-à-vis the Bank, Mr. Friedman was dismissed from his position.

On 2 December 2008, the Bank filed a pecuniary action against Friedman in the Tel Aviv District Court (Civil Case 2258/08) in the amount of NIS 22,873,864, in the context of which the Bank asked that Friedman be ordered to compensate the Bank for damages caused to the Bank as a result of the loans improperly made by Friedman. In parallel with the filing of the action, a petition was filed to attach the assets of Friedman and his wife. After the action was filed, Friedman and the Bank reached agreement that bank accounts owned by Friedman and his wife would be attached in favor of the Bank and that the proceedings in the Bank's action against Friedman would be stayed until the criminal proceedings against him were concluded.

2.4 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 2005 the SEC commenced a formal investigation at LISI with regard to the said matter.

In February 2009, the SEC published an order, with the consent of LISI. In the order, the SEC censured LISI and ordered LISI to cease and desist any violation of rules relating to the books and record requirements referred to in the Order. In addition, the SEC required LISI to comply with certain undertakings, including submission of a report describing a review of certain policies, procedures and systems. Customers who were harmed by the conduct of the trader were reimbursed in the amount of approximately $1.2 million.

2.5 In December 2008, the Zurich District Court ruled that Ernst Imfeld was guilty of embezzlement, falsification of documents and improper administration, with respect to the fraud he had perpetrated at Bank Leumi (Switzerland) during the 1990's, and he was sentenced to eight years in prison.

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 179.

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 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 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 of 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 regarding 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 2008, 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 of August 1987, which was extended in October 1991 until the end of 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 220 to 221.

4. An agreement of 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 of 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 Note 15 A to the Financial Statements.

7. An Agreement of May 2008 between Leumi Financial Holdings Ltd. (a wholly owned subsidiary of the Bank and the owner of all the shares of Leumi Card) and Leumi Card Ltd. ("Leumi Card") and Canit Investment and Finance Management Ltd. ("Canit"), according which shares constituting 20% of the issued and paid-up share capital of Leumi Card were allotted to Canit, for consideration of NIS 360 million which was paid to Leumi Card.
For further details, see page 146.

8. 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 2005, 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 proposed 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 was 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 should have affected the Group's tax expenses for 2008 at the rate of some NIS 47 million, net.

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 Amendment to the Law will reduce the Group's current net tax liability from 2009 by some NIS 26 million per year.

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 2004 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 2008, the number of positions in the Group increased by 546, some 4.2%, in relation to the number of positions in 2007. On a yearly average, the number of positions increased by 589 positions, some 4.7%. The increase derived mainly from an increase in the number of positions in the Bank and in its consolidated subsidiaries in Israel and abroad.

Most of the change in the number of positions in the Group in Israel derives from an increase of 320 positions at the Bank in Israel, an increase of 216 positions at the consolidated subsidiaries in Israel, of which 150 were positions at Leumi Card, and an additional increase of 10 positions at the consolidated subsidiaries abroad.

	Positions at Year's End		Yearly Average	
	2008	2007	**2008**	2007
The Bank in Israel	**9,711**	9,391	**9,548**	9,184
Consolidated subsidiaries in Israel	**2,291**	2,075	**2,145**	1,981
Group total in Israel	**12,002**	11,466	**11,693**	11,165
Overseas: Bank branches and representative offices	**65**	82	**69**	83
Consolidated subsidiaries	**1,357**	1,330	**1,346**	1,271
Group total in Israel and overseas	**13,424**	12,878	**13,108**	12,519

* "Position" – means a full time position including specific overtime, working hours of employees from temporary employment agencies and employment of external consultants.

Remuneration System and Salary Structure

In general, 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, the contribution of the employee to the Bank and the employee's managers' evaluation. Consequently, the remuneration is differential. In light of the global financial crisis, Leumi employees agreed in January 2009 to waive an annual promotion increase in the amount of 2.5% of salary, and to a 20% reduction in the 2009 budgets for employee welfare activities.

Labor and Salary Costs (at the Bank)

	2008	2007	2006
		NIS thousands	
Cost per employee position (excluding bonus)*	268.5	289.3	308.6
Cost per employee position (including bonus)*	268.5	340.9	337.8
Salary per employee position (excluding bonus)*	187.4	180.1	176.1
Salary per employee position (including bonus)	187.4	223.2	200.3

* 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 supporting the business units and the attainment of their business goals through study and training activities, which focus on improving the professional and managerial ability of the employees and managers. In this context, Leumi employees participated in 66,998 training days in 2008 (compared with 60,810 in 2007). The training activities in 2008 focused on raising the level of professionalism of the employees with emphasis being placed on core banking areas – credit, pension counseling and investment counseling, their service abilities, marketing abilities and management training, all according to the business objectives of the Bank, including comprehensive training and assimilation 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 2008. During 2008, 77% of the managers participated in professional development or skills development programs.

Also, the scope of mentoring for new managers beginning their work at the Bank and 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, professional management courses and courses developed as required for specific units.

Education

The percentage of employees with university education at the Bank has been on a continuing upward trend. This trend came to an end in 2008, due to the absorption into the Bank, in large numbers, of external workers and direct banking telephone center employees. The percentage of university graduates at the Bank was 57.6% of all employees at the end of 2008, compared to 57.9% in 2007, 55.8% in 2006 and 26% in 1995. The percentage of graduates among the managerial staff reached 91.6% in 2008. This increase in the percentage of university graduates is the result of: recruitment of employees with university education, the retirement of bank employees who are not university graduates and the acquisition of higher education by bank employees.

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.

For details, see Note 15 to the Financial Statements.

New Employees and Tenure

In 2008 the Bank recruited 403 highly qualified employees, compared with 474 in 2007. Also, in 2008, the status of some 550 external workers was changed to the status of Bank employees due to the entry into force of an amendment to the Personnel Contractors Law, 2008. In 2008, tenure was granted to 248 employees, in comparison with 209 employees in 2007.

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 of ethics was included in Leumi's social responsibility report, which was recognized internationally by the Global Reporting Initiative organization.

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. Comprehensive assimilation processes of the code of ethics among all Leumi's employees continued throughout the years 2007-2008.

During 2008, the heads of divisions at Leumi were designated as the parties responsible for assimilating the “Leumi Way” within their divisions. Similarly, the “Leumi Way” was integrated into the study program at the Leumi training center in most of the existing courses, from the absorption day for new employees of the Bank and through senior management courses.

Involvement in the Community

The Management of Leumi views the involvement of its employees in the community as a central goal in the area of corporate responsibility. Leumi encourages its employees to take an active part in volunteer projects and to be involved in community life, and provides them with frameworks for volunteering and with a variety of opportunities to contribute and to volunteer.

During the course of 2008, some 2,000 employees – from more than 80 units within the Bank - engaged in volunteer activity. It is estimated is that the employees contributed some 14,000 hours of volunteer work over the course of the year, an increase of some 30% compared with the corresponding period in 2007.

Employees from throughout the country are involved in activities helping large organizations in the collection and distribution of equipment, food and medications for the needy; making hospitals visits; assisting children and youth at-risk in residential homes, clubs and community centers; senior citizen centers and centers for the disabled, and more.

Along with these many different activities, a decision was made to link with Leumi's vision of strengthening the coming generation, by supporting the volunteers of the “year of service” and the connection with the community partners of the “Leumi Tomorrow,” and "Fair Chance for Children” organizations, and the “Adopt a Fighter” project of the Friends of the Israel Defense Forces.

Positions according to operational segments:

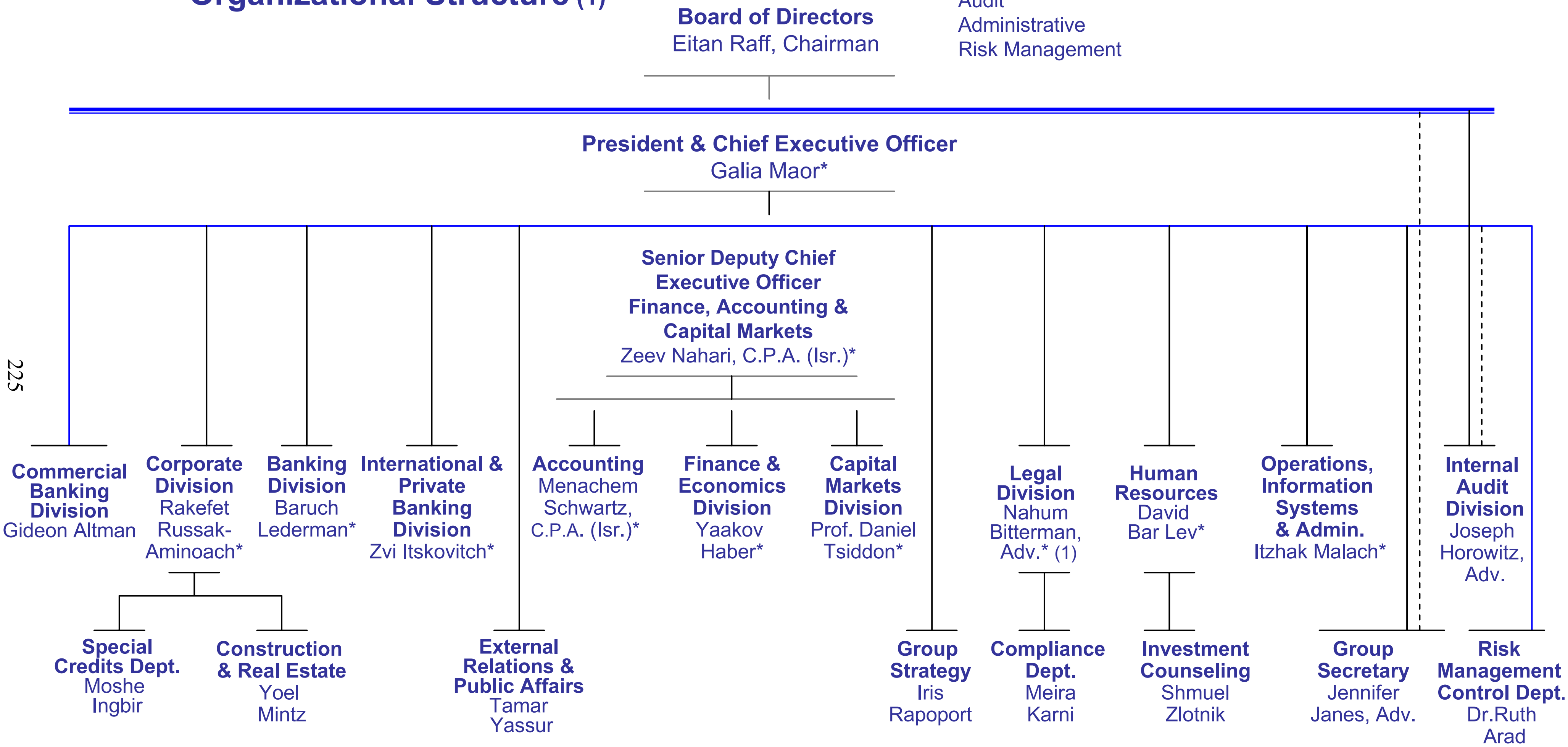
	Average positions in 2008		Average positions in 2007	
	Managerial Staff	**Clerical Staff**	Managerial Staff	Clerical Staff
Households	**1,555**	**5,398**	1,520	5,234
Small businesses	**402**	**1,293**	389	1,279
Corporate banking	**468**	**715**	413	604
Commercial banking	**662**	**1,137**	657	1,030
Private banking	**410**	**488**	379	493
Financial management – capital markets	**235**	**243**	209	152
Other	**18**	**84**	70	130
Total	**3,750**	**9,358**	3,597	8,922

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 assessments. In calculating the number of positions according to operational segments, employees of head office units, who serve all or part of the operational segments of the Bank, have also been taken into account.

Bank Leumi le-Israel B.M.

Organizational Structure (1)

Committees of the Board of Directors
Credit
Financial Statements Review
Audit
Administrative
Risk Management



(1) Until 31 March 2009

* 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.

On 1 January 2009, Yaakov Haber was appointed as Head of the Finance and Economics Division and as a member of the Bank's Management.

On 2 March 2009, Leumi announced the following changes:

Advocate Nomi Sandhaus was appointed as Chief Legal Advisor, Head of Legal Division and Manager of Legal Risks, as of 1 April 2009.

Advocate Yael (Ben Moshe) Rudnicki was appointed as Bank and Group Secretary as of 1 May 2009.

Advocate Nachum Bitterman, the Chief Legal Advisor, Head of Legal Division, Manager of Legal Risks and member of the Bank's Management, will cease to serve in these positions on 31 March 2009 and will retire, after 46 years with the Bank.

Advocate Jennifer Janes, Bank and Group Secretary, will cease to serve in these positions on 30 April 2009 and will retire, after 35 years with the Bank.

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, varied 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 purchase 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 largest 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 24 commercial branches, which are organized on a geographic basis into 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 190 branches, which are organized in 8 districts on a geographic basis and by means of a variety of technological/direct distribution channels, including the direct banking unit, which provides services to customers through the telephone and internet.

   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, the premium sector, and the business banking sector. The Division coordinates the retail operations in the Group, including those of 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. In addition, the activities of the Bank's units abroad are concentrated in this Division. The Division includes the private banking centers in Israel for residents and non-residents and is also responsible for the activity of the Bank Leumi le-Israel Trust Company Ltd. The Division's activities also include, *inter alia*, control 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 of financial entities overseas, in the context of the Group's international strategy.

5. **Capital Markets Division** is responsible for managing the Bank's financial 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 operational service for customers active in the capital and financial markets, including institutional customers.

As well as the division according to 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 preparation of the expense budget of the Bank and monitoring its implementation; coordinating the business plan of the Bank; managing profit centers and financial measurement; tax planning of the Bank and the Group and the Bank and Group insurance; 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, management of the books of account, preparation of the financial statements of the Bank and the Group and preparation of reports to the Bank of Israel. In addition, Accounting is responsible for assessing the effectiveness of the key controls of the working process for the preparation of the Financial Statements of the Bank.

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, 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. As part of its task, it co-ordinates the formulation and determination of the strategy, policy and activity regarding computers, systems, operations, technology, communications, organization and methods, information security, overseas units' operations, real-estate (including construction, procurement and maintenance), procurement (general and technologic) and security.

Investment Counseling is responsible for the Bank's policy regarding counseling on investment in securities and in financial instruments, execution of research on capital and money markets and development of systems in the investments field.

External Relations and Public Affairs is responsible for Bank and Group advertising, for the spokesperson's office and public relations, corporate responsibility, 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 assessment 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 in general, and in particular 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.

Risk Management Control Department is responsible pursuant to the framework of Proper Banking Management Directive No. 339 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 methodologies for measuring and controlling risks, including for calculating economic capital. The Department coordinates the ICAAP process as well as the independent validation of models. The department controls and coordinates the risk management policy documents, and ascertains their consistency, completeness and up-to-date condition, and carries out the loan review process. The preparations and the professional direction for the implementation of the rules of the Basel II Accord at the Group constitute a central part of the department's activity.

Strategy Department is responsible for the Group's strategic planning.

Leumi for the Community – Social Involvement

The State of Israel celebrated the 60^{th} anniversary of its independence in May 2008. Leumi for the Community held a variety of activities to mark the State's 60 years of independence.

The campaign in the South

Towards the end of 2008, a serious campaign began in Gaza. Leumi joined in the effort to help the residents and the soldiers at the front, both through the provision of financial solutions with respect to specific difficulties and through the distribution of gifts to children and soldiers, in order to lighten their daily routine.

The financial solutions that were offered to the residents included:

- Interest and commission free loans to private customers, of up to NIS 10,000
- Suspension of mortgage repayments for a period of three months, without fees
- Loans to small businesses of up to NIS 80,000, on preferential terms

In addition, during the course of the year, before the fighting commenced, Leumi provided specific assistance to the residents of Sderot and of the region adjacent to Gaza:

- At the end of June 2008, the European soccer championships – Euro 2008 - began. The matches were broadcast throughout the country on pay television channels. Leumi provided complete financing of the cost, to enable residents of Sderot and the communities adjacent to Gaza to watch the matches.

- Hebrew Book Week – like last year, the 2008 Hebrew Book Week events in Sderot were held with assistance from Leumi, which made its reinforced branch in Sderot available for the occasion, in co-operation with the 'Tzomet Books' chain of bookstores. The residents of the city and the surrounding area were able to enjoy the Book Week experience and the opportunity to purchase the best books at reduced prices (NIS 20 per book).

Since its establishment on 1902, Leumi has been taken an active role in the community in which it operates. 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 Tomorrow - The Centennial Fund for Endowing Israel’s Future Generation”

The “Leumi Tomorrow” organization, which Leumi established on the one hundredth anniversary of its establishment, is currently marking seven years of operation. The organization reflects Leumi's key values, as an organization which aspires to advance Israeli youth, and carries out its investment in the community in this area.

The activity of “Leumi Tomorrow” is focused on wide ranging educational programs and programs for the advancement of youth in all sectors of Israeli society, through long-term partnerships with non-profit organizations, umbrella-organizations and association and academic institutions throughout the country.

In 2008, some 15,000 young people took part in various educational programs which helped them to succeed in passing matriculation examinations or to be integrated into meaningful IDF service – achievements that constitute "entry tickets" into Israeli society and to integration therein. In addition, the young people enjoyed an experience of enrichment and of education for leadership; they learned values and were encouraged to turn towards higher education.

The programs and initiatives are carried out in cooperation with social organizations and academic institutions such the “Youth Leading Change” association, the “Atidim” project, Tel Aviv University, Ben Gurion University of the Negev, the Ma’aseh Center, the “Alon” non-profit organization, and others.

As it did in previous years, “Leumi Tomorrow” held a *Kamcha de’Pascha* campaign in 2008, in the context of which more than 2,000 food packages were distributed to needy families throughout the country in anticipation of the Passover holiday. The campaign was financed with a donation of NIS 300 thousand from the organization and with contributions from Leumi subsidiaries, employees and customers, in the amount of some NIS 242 thousand.

Towards the end of the year and due to the fighting in the southern part of the country, the “Leumi Tomorrow” organization sought to help those young people participating in educational initiatives located in the southern settlements. The organization helped bring the students to collective days of "time-out" during which they studied for matriculation examinations, and enlisted Leumi employees who initiated and participated in the various enrichment programs. In addition, “Leumi Tomorrow” distributed gift sets of books and games to the students, in the hope that these would make their extended stays in bomb shelters somewhat easier.

Young Israeli Entrepreneurs – Established by Leumi

As part of Leumi’s social involvement approach, the Group has participated in and supported the “Young Israeli Entrepreneurs" organization. The “Young Israeli Entrepreneurs” is part of an international initiative which involves millions of young people from more than one hundred countries throughout the world. In Israel, more than 4,000 young people - from all sectors of Israeli society – take part in the project.

In June 2008, a national competition for young entrepreneurs was held to choose Israel’s representative in the European competition which was held in Stockholm, where Israel’s winner took fourth place among the 33 participating European teams.

This year (the 2008-2009 academic year) some 200 groups of young people are taking part in the program, through which they learn about the establishment and management of a business and enjoy the experience of business entrepreneurship.

The “National Book Chart”

As part of the commemoration of the State of Israel’s sixtieth year, Leumi ran a widespread campaign together with the Tzomet Sfarim chain of bookstores, allowing members of the public to choose, through a dedicated website, the sixty best loved books representing sixty years of Israeli literature. As Independence Day approached, the public was given the opportunity to purchase the chosen books at a 60% discount. Hundreds of thousands of books were purchased by members of the public who sought to take advantage of the attractive opportunity. The campaign was extended in light of the great demand, and continued for an entire month.

Leumi for the Arts

The "Fresh Paint" Fair

As part of the Leumi Group's support for art and culture in general and for young artists in particular, and as part of its encouragement of Israeli creativity in honor of Israel’s 60th anniversary, the “Fresh Paint” Exhibition was held in March under Leumi’s lead sponsorship. More than 70 young artists exhibited their works to the general public during the Exhibition. The purpose was to bring these young artists closer to the general public, and to allow the public to purchase valued works of art. At the

Exhibition, which was held in Tel Aviv, more than 1,000 works of art of unknown young artists were exhibited alongside the works of well-known young artists, and hundreds of works were sold. In addition, at the end of the Exhibition, NIS 260,000 was contributed from the proceeds of Exhibition sales towards scholarships for art loving youth from families of limited means (NIS 160,000) and for the benefit of the "Fair Chance for Children" organization, which assists children living in residential homes (NIS 100,000). During the four days of the Exhibition, tens of thousands of art lovers and visitors came to see the works, and purchased artwork in the amount of some NIS 2.5 million.

Visitors' Center

In May 2008, Leumi inaugurated its new visitors' center in the restored Mani House on Yehuda Halevi Street in Tel Aviv. The building combines a historic restoration of the Bank and its operations, together with a gallery for temporary art exhibitions, the first of which was an exhibition of photographs by leading Israeli photographers, of various views and sites along the Israel Trail. Entry to the Visitors' Center is free of charge to the general public.

ARTLV – Tel Aviv's first biennale event - Towards the end of September 2008, ARTLV - the city's first biennale event – was held, under the chief sponsorship of Leumi. As part of the biennale, the Visitors' Center, for the first time, showed an exhibit from the Israel Museum in Jerusalem. The exhibit was put together specifically for the biennale.

The Third Secret Art Exhibition – Towards the end of December 2008, a "secret" art exhibition was held, for the third consecutive year, at the Visitors' Center and in the lobby of Leumi House in Tel Aviv. Some 240 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 being impressed purely by the art.

Some 15,000 visitors attended the exhibition over nine days, and works of art in the amount of NIS 531,000 were purchased. This entire amount was transferred directly to the artists themselves.

***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 based on their compliance with corporate responsibility criteria. The rating is based upon detailed criteria in four main areas, out of all the corporate responsibility spheres of businesses: the environment, business ethics, work environment and human rights and community involvement.

Summary of Leumi's Sponsorships and Donations in 2008

In 2008, the Leumi Group made donations and provided sponsorships for social and community purposes in the amount of some NIS 28.4 million, of which donations amounted to some NIS 23.3 million.

During the past five years (2004-2008), the Leumi Group's contributions and sponsorships for social causes amounted to some NIS 114.0 million.

Set out below is a breakdown of the total donations and sponsorships in 2008 according to various categories:

Education, children and youth	- NIS 13.2 million;
Culture and art	- NIS 7.5 million;
Community and society	- NIS 7.0 million;
Health	- NIS 0.7 million.

Decisions with regard to the designation and amount of donations are made, depending on their subject matter, by the "Leumi Tomorrow" organization and by the Bank's donations committee, the members of which 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 the Bank's donation guidelines and approved by the Board of Directors. Large donations (exceeding NIS 100,000) 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, and has considerable experience in internal auditing. His appointment was approved by the Bank's Audit Committee and Board of Directors on 7 September 1995. The Internal Auditor 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 of 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 Internal Audit Division in Israel 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 113.5 positions on annual average, as described below:

Average Positions of Auditors in the Leumi Group in Israel, including outsourcing	
The Bank	97.1
Subsidiaries in Israel	12.5
Overseas subsidiaries	3.9
Total	113.5

In addition, local auditors are employed in overseas subsidiaries in 20.2 positions.

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 2008, in NIS thousands:

2008									
Compensation for services				Other compensation		Loans given on beneficial terms			
Holding in the capital of the Bank	Salary	Social benefit provisions	Payments based on shares*	Value of the benefit	Total **	Balance as at 31 December 2008	Average period until maturity (years)	Benefit provided over the year	Loans granted on regular terms
NIS thousands									
0.0028%	**1,235**	**1,269**	**31**	**143**	**2,678**	**426**	**1.49**	**29**	**156**

* 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 make a request to 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 occasion 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 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, 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 2007 was submitted to the Audit Committee on 11 March 2008 and was discussed by it on 16 March 2008. The summarizing annual report for 2007was submitted to the Audit Committee on 17 April 2008 and discussed by it on 27 April 2008.
The annual reports of the Israeli and overseas subsidiaries were submitted on 11 May 2008 and discussed by the Audit Committee on 15 May 2008. The Chief Internal Auditor's report for the first half of 2008 was submitted to the Audit Committee on 2 October 2008 and was discussed by it on 7 October 2008.

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 Senior Deputy Chief Executive Officer, Chief Financial Officer, Head of Finance, Accounting and Capital Markets) 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 was 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 which were 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 Finance, Accounting and Capital Markets, 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 Finance, Accounting and Capital Markets 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 2008, no material change to the internal controls on financial reporting of the Bank occurred which had a material effect, or which could reasonably be expected to have a material effect, on the Bank's internal controls of the financial reporting.

Management's Responsibility for the Internal Control over Financial Reporting (SOX Act 404)

On 5 December 2005, the Supervisor of Banks published a circular which detailed 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 (Committee of Sponsoring Organizations of the Treadway Commission) model meets with the requirements and can be used in order to assess the internal control.

The COSO model provides defined standards for the purpose of assessing the internal control system in the organization and the ways in which it can be improved, and defines internal control as a process which is influenced by the board of directors, the management and other persons within the company.

According to the COSO model, there are five components need to be referred to:

1. The Control Environment: this component involves the examination of the management's conduct with reference to various subjects such the existence of a code of ethics, management's aggressiveness in reports, etc.

2. Risk Assessment: this component involves the examination of the relevant risks regarding each process and sub-process that are checked, which have an impact on the financial statements.

3. Control Activities: this component involves the examination of the relevant controls regarding each of the risks that were identified at the risk assessment stage.

4. Information & Communication: this component involves the examination that the information required for the Bank's activity is available, and that there is a mechanism that processes the information it received and transfers it to the appropriate parties at the Bank.

5. Monitoring: this component involves the examination of the existence of a mechanism that checks the monitoring of the correction of deficiencies. Proper supervision may be reflected in a periodic examination of the internal control system, continuous implementation of opportunities for improvements, the management's response to the internal control recommendations made by external auditors as well as the internal parties, rapid adaptation to new regulatory directives, etc.

The Bank, has been working to implement the directive in the Leumi Group, together with consultants who have been engaged for the purpose of carrying out the project.

The following work stages were defined:

1. Identification of material business processes – identification of the internal controls relevant to the risks related to financial reporting and to proper disclosure in accordance with PCAOB Auditing Standard No. 5. This stage included the mapping of material business units and of business accounts and processes that are material for the financial reporting.

2. Documentation of the processes, assessment of the existing risks and controls – mapping of risks and internal controls existing at the process and transaction level.

3. Analysis of the existing gaps against the internal control model (COSO).

4. Correction of control gaps – in accordance with the assessment of the situation according to the COSO model, schedules and orders of priorities were established for the treatment of control gaps and for the planning of corrective measures.

5. Execution of checks to assess the effectiveness of the key controls.

Key controls have been established for any process which is determined to be material to the financial reporting. The key controls are defined as controls the absence of the effective application of which could lead to errors in the financial reporting.

In accordance with the examination guidelines, an assessment is made of the effectiveness of the key controls. No material weaknesses were discovered.

Remuneration of Senior Office Holders

For the year ending 31 December 2008

Below are details of the benefits and amounts paid or in respect of which provisions were recorded in the years 2008 and 2007, to the Chairman of the Board of Directors and to the recipients of the five highest salaries among the senior office holders of the Group.

The benefits described below do not include benefits in respect of banking services that are granted to all employees, such as benefits regarding interest on deposits of monies with the Bank, discounts or exemptions from commissions for banking services provided by the Bank, and interest rate benefits on mortgages granted by Leumi Mortgage Bank. The amounts of the benefits in respect of the banking services mentioned, with respect to each recipient, are not material. Certain private banking customers, including customers who are included in arrangements between the Bank and employees groups, occasionally benefits from time to time that are similar to those granted to Bank employees and in some cases, even exceed them.

2008

Details of party receiving compensation (1)			Compensation for services				Other compensation		Loans given on beneficial terms (6)			
Name	Position	Holding in the capital of the Bank	Salary	Bonuses	Social benefit provisions (2)	Payments based on shares (3)	Value of the benefit	Total *	Balance as at 31 December 2008	Average period until maturity (years)	Benefit provided over the year	Loans granted on regular terms
		%	**NIS thousands**									
Mr. E. Raff	Chairman of the Board of Directors	**0.0082**	**1,602**	**-**	**544**	**45**	**76**	**2,267**	**583**	**1.58**	**40**	**259**
Mrs. G. Maor (4)	President and Chief Executive Officer	**0.0197**	**2,174**	**-**	**2,078**	**57**	**125**	**4,434**	**772**	**1.54**	**54**	**8**
Mr. Z. Nahari (5)	Senior Deputy Chief Executive Officer	**0.0142**	**1,481**	**-**	**997**	**37**	**155**	**2,670**	**513**	**1.56**	**35**	**1,438**
Mr. U. Rosen (5)	Chief Executive Officer, Bank Leumi USA	**0.0088**	**2,109**	**950**	**1,277**	**31**	**87**	**4,454**	**550**	**1.64**	**37**	**1**
Mr. G. Altman (5)	Acting Head of Commercial Banking Division	**0.0015**	**868**	**-**	**1,790**	**16**	**69**	**2,743**	**300**	**2.26**	**21**	**10**
Mr. B. Lederman (5)	First Executive Vice President, Head of Banking Division	**0.0027**	**1,349**	**-**	**1,126**	**31**	**97**	**2,603**	**787**	**3.70**	**42**	**666**

* Excluding salary tax.

(1) Those receiving the compensation hold full time positions (except for the position of the Chairman of the Board, which is 80%).
(2) Social benefit provisions include provisions for severance pay, provident funds, pension, supplementary training fund, vacations, jubilee benefits, and national insurance, as well as supplemental payments to the reserves for the above, due to salary changes during the accounting year.
(3) Allotment of options that were allotted to all employees.

(4) The personal employment contract of the President and Chief Executive Officer was amended such that the Bank undertook to employ the Chief Executive Officer until February 2010, in order to ensure managerial stability. At the end of the agreed period, and upon the Chief Executive Officer reaching age 67 in February 2010, the employment relations between the Bank and Chief Executive Officer will not terminate automatically, and each party will be entitled to terminate the employment relations upon nine months prior notice (which the Bank will have the right to require the Chief Executive Officer to continue in active work for the first three months of this period and that a "cooling-off" period of 6 months will apply from the date of the actual termination of the Chief Executive Officer's employment at the Bank .)
See further details, see Note 15 B(4)(a) to the Financial Statements.

(5) Senior employees of the Bank have personal and special employment contracts with the Bank.
For further details, see Note 15 B(4)(b) to the Financial Statements.
The amount of the Bank's maximum additional expense, if the employment of all said employees were terminated immediately, would amount to NIS 383 million (NIS 355 million in 2007). 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 was made, in the amount of NIS 103 million (NIS 91 million in 2007). These sums also relate to the members of Management (excluding the Chief Executive Officer).
Following the amendment to the personal contracts of the members of Management, as set forth in Note 15 B(4)(b) to the Financial Statements, a specific attribution out of the said provision was made to the members of Management, the balance whereof totaled NIS 10 million as of 31 December 2008, similar to 2007.

(6) Mainly loans granted to all the employees to purchase shares of the Bank pursuant to the 2006 outline and an extension of loans granted in the past under the 1998 and 2002 prospectuses.

(7) 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 insurance premium paid is not included in the above tables, inasmuch as it is insignificant; the total premium amounted to NIS 3,417 thousand and relates to all officers in the insured group.

For further details see Note 15 to the Financial Statements.

2007

						Loans given on beneficial terms				
	Salary including bonus	Payments 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	5,545	311	460	21	6,337	614	2.58	52	200	89
Mrs. G. Maor	8,089	397	458	111	9,055	839	2.50	72	28	139
Mr. Z. Nahari	4,912	260	447	76	5,695	557	2.52	47	1,440	148
Ms. R. Russak-Aminoach	3,378	214	415	8	4,015	733	4.49	47	272	80
Mr. D. Bar Lev	3,183	214	332	27	3,756	535	3.09	45	20	144
Mr. Z Itskovitch	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.

Auditors' Fees (1)(2)(3)

	Consolidated		Bank	
	2008	2007	**2008**	2007
	NIS thousands			
For auditing activity: (4)				
Joint auditors	**23,829***	16,133	**8,317***	4,100
Other auditors	**3,049**	3,283	**148**	85
Total	**26,878**	19,416	**8,465**	4,185
For audit related services: (5)(6)				
Joint auditors	**2,750**	2,103	**2,661**	1,998
Other auditors	**8**	-	**8**	-
For tax services: (5)				
Joint auditors	**1,749**	1,483	**559**	556
Other auditors	**382**	177	**-**	-
For other services:				
Joint auditors – SOX	**1,783**	2,970	**1,067**	2,970
Joint auditors	**5,935**	2,435	**4,223**	1,835
Other auditors	**225**	-	**-**	-
Total	**12,832**	9,168	**8,518**	7,359
Total auditors' fees	**39,710**	28,584	**16,983**	11,544
Joint auditors' fees from other engagements (7)	**-**	-	**-**	-

* The amount includes SOX audit fees in the amount of NIS 5,293 thousand, consolidated, and NIS 3,394 thousand at the Bank.

(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:

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 Partners Ltd. (formerly Leumi & Co. Investment House Ltd.) Director, 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. 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 Initiatives 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**	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, I.T.G.I. Medical Ltd., and related companies. External Director, Elron Electronic Industries Ltd., Isrotel Ltd. and Negev Ceramics Ltd. Director, Mer Telemanagement Solutions Ltd., Golden House Ltd., Renewable Resources Ltd. and related companies and Tagor Capital Ltd.

* External Director pursuant to Proper Banking Management Directive No. 301 of the Banking Supervision Department.

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., Tower Semiconductor Ltd. and Ampa Capital 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. Consultant, Ioimage Ltd. Member, Appeal Tribunal regarding Capital Investment Laws.
Adv. Miriyam (Miri) Katz Tel Aviv	Attorney, Consulting, Management and Company Director. Shareholder and CEO, Miri Katz Projects Ltd. CEO of "Ima" Foundation (Registered Non-Profit Society). External Director, Itamar Medical Ltd. Director, The Caesarea Edmond Benjamin de Rothschild Development Corporation Ltd., The Edmond and Nadine de Rothschild Israel Fund and The Caesarea Edmond Benjamin de Rothschild Fund.
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, Neve Yerak – Employees Cooperative Settlement Ltd.
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. External Director, King Ltd. Director, Aspen Building and Development Ltd. and Aspen Real Estate Ltd.

* External Director pursuant to Proper Banking Management Directive No. 301 of the Banking Supervision Department.

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. 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 Hebrew University's 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.

Pursuant to the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993 (the "Bank Shares Law") all the members of the Board of Directors comply with the definition of external director as detailed in the Companies Law, 1999 ("ED"). In addition, at least one quarter of the members of the Board are required to be External Directors, who comply with the qualification requirements of an ED (pursuant to Proper Banking Management Directive No. 301).

As detailed above, all the directors serving on the Board comply with the definition of External Director, while six directors classified as External Directors currently serve on the Board, pursuant to Directive 301, including two EDs, as required pursuant to the Companies Law.

In light of the above, the Board of Directors complies with the required criteria of the relevant laws, and therefore, no rules have been laid down in the Articles of Association regarding the number of independent directors pursuant to the Companies Law.

See the Bank's website (www.leumi.co.il) for further details about the committees of the Board of Directors and their composition.

Report on Directors with Accounting and Financial Expertise

Pursuant to the provisions of the Companies Law and its Regulations, 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 by law and the statutory documents (by-laws), 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 Law and Directive 301.

At least 3 directors who comply with the definition of a "director with accounting and financial expertise" will therefore participate in the discussions regarding the Financial Statements and their approval, such discussions being held in the Financial Statements Review Committee and 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 has 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.
7 directors currently serve on the Audit Committee, the legal quorum for its discussions being 4 directors.
6 directors currently serve on the Financial Statements Review Committee, the legal quorum for its discussions being 4 directors.
All the directors serving on the Board of Directors, the Audit Committee and the Financial Statements Review Committee, comply with the definition of a director with accounting and financial expertise, as detailed above and as follows:

Name of Director	Additional facts that qualify the Director as having Accounting and Financial Expertise
Eitan Raff (1)	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., 1989-1992; CEO of Wolfson Clore Mayer Corp. Ltd., 1987-1992, member of the Board of Directors and Financial Consultant of the company since 1992; Chairman 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, 1998-2000 and 2004 - 2006; Chairman of the Board of Directors of Migdal Insurance Company Ltd 1996-1997; 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.

(1) Member of the Financial Statements Review Committee
(2) Member of the Audit Committee

Name of Director	Facts that qualify the Director as having Accounting and Financial Expertise
Meir Dayan (1)(2)	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 (2)	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 (1)(2)	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., 1978-1998, 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 (1)(2)	External Director on the Board of Directors of the Bank. LL.B, B.A. in 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.

(1) Member of the Financial Statements Review Committee

(2) 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.) (1)	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, 2004 -2008.
Rami Avraham Guzman (2)	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.
Adv. Miriyam (Miri) Katz (2)	LL.B, The Hebrew University of Jerusalem Chairperson of the Israel Securities Authority, 1997-2002 Member of the Council of Chartered Accountants, 1997-2002 External Director and Chairperson of the Audit Committee, Bank of Jerusalem, 2003-2006 Managing Partner, Ophir Katz & Co., Law Offices 1989-1997; Advisor since 2003 External Director and director of various companies
Zvi Koren (2)	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, LL.B 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; managed the 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.
Prof. Efraim Sadka (1)(2)	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, 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. Member of the Professional Board of the Israeli Accounting Standards Board, 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. Previously, member and chairman of various boards of directors.

(1) Member of the Financial Statements Review Committee
(2) 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 chairperson or member of balance sheet and audit committees.
Moshe Vidman (2)	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; Permanent Acting Chairman of the Board of Directors and of the Audit Committee and Chairman of the Credit Committee, Maritime Bank Ltd., 1993-2003. Chairman of the Board of Directors and/or director of various companies.

(1) Member of the Financial Statements Review Committee

(2) Member of the Audit Committee

Changes to the Board of Directors

During 2008 and until the publication of the Report, the following changes have taken place in the composition of the Board of Directors:

At the Extraordinary General Meeting held on 17 January 2008, Prof. Israel Gilead was elected to serve as an External Director for an additional period of three years, as of 1 February 2008.

At the Annual General Meeting held on 5 June 2008, Adv. Miriyam (Miri) Katz, was elected as a new Director, in place of Ms. Vered Raichman who did not offer herself for re-election at the above mentioned meeting. Ms. Raichman has contributed much to the advancement of the business of the Bank and its betterment.

In addition, Messrs, Rami Avraham Guzman, Adv. Jacob Mashaal and Zvi Koren, who retired by rotation and offered themselves for re-election, were also re-elected to serve as Directors.

During 2008 the Board of Directors held 43 plenary meetings and 126 committee meetings.

Eitan Raff

Chairman of the Board of Directors

Galia Maor

30 March 2009 — President and Chief Executive Officer

Below are tables of financial information detailed by subjects, sectors and periods:

Consolidated Balance Sheet as at end of years 2004-2008

Exhibit A:

	31 December				
	2008	2007	2006	2005	2004
	Reported amounts				
	NIS millions				
Assets					
Cash and deposits with banks	**33,130**	42,329	47,609	35,381	30,033
Securities	**44,910**	47,169	46,375	47,825	43,543
Securities borrowed or purchased under agreements to resell	**201**	655	-	-	-
Credit to the public	**213,215**	198,557	183,800	180,881	174,367
Credit to governments	**520**	642	1,020	848	963
Investments in companies included on equity basis	**1,842**	1,873	1,251	2,064	1,754
Buildings and equipment	**3,445**	3,276	3,056	2,843	2,668
Other assets	**13,529**	7,650	6,230	6,277	7,203
Total assets	**310,792**	302,151	289,341	276,119	260,531
Liabilities and equity capital					
Deposits of the public	**244,783**	238,045	231,823	221,828	209,652
Deposits from banks	**3,742**	6,139	5,241	4,347	5,655
Deposits from governments	**831**	1,198	2,146	2,225	3,025
Securities loaned or sold under agreements to repurchase	**549**	231	-	-	-
Debentures, bonds and subordinated notes	**20,636**	19,248	15,622	17,253	11,256
Other liabilities	**21,334**	17,636	16,866	14,261	15,681
Total liabilities	**291,875**	282,497	271,698	259,914	245,269
Minority interest	**245**	105	152	205	276
Shareholders' equity	**18,672**	19,549	17,491	16,000	14,986
Total liabilities and equity capital	**310,792**	302,151	289,341	276,119	260,531

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

Consolidated Statement of Profit and Loss for the Years 2004-2008

Exhibit B:

	For the year ended 31 December				
	2008	2007	2006	2005	2004
	Reported amounts				
	NIS millions				
Net interest income before provision for doubtful debts	**6,380**	7,648	6,922	6,629	6,359
Provision for doubtful debts	**2,145**	407	933	1,426	1,514
Net interest income after provision for doubtful debts	**4,235**	7,241	5,989	5,203	4,845
Operating and other income					
Operating commissions	**3,362**	3,350	3,013	2,819	2,718
Profits (losses) from investments		461			
in shares, net	**(912)**	461	128	43	43
Other income	**350**	411	740	865	642
Total operating and other income	**2,800**	4,222	3,881	3,727	3,403
Operating and other expenses					
Salaries and related expenses	**4,118**	4,218	4,552	3,627	3,248
Building and equipment	**1,**				
maintenance and depreciation	**1,397**	1,274	1,220	1,168	1,079
Other expenses	**1,488**	1,445	1,495	1,285	1,161
Total operating and other expenses	**7,003**	6,937	7,267	6,080	5,488
Operating profit before taxes	**32**	4,526	2,603	2,850	2,760
Provision for taxes on operating profit	**421**	1,722	1,320	1,193	1,244
Operating profit after taxes	**(389)**	2,804	1,283	1,657	1,516
Group's equity in after-tax operating profits of companies included on equity basis, net of related tax effect	**249**	184	171	378	410
Minority interest in after-tax operating (profits) losses of subsidiaries	**(18)**	(4)	-	24	(22)
Net operating profit (loss)	**(158)**	2,984	1,454	2,059	1,904
Cumulative effect of change in accounting method at the beginning of the year	**-**	-	-	-	(32)
After-tax profit (loss) from extraordinary items	**250**	373	2,080	77	(8)
Net profit	**92**	3,357	3,534	2,136	1,864

Consolidated Statement of Profit and Loss for the Years 2004-2008 (cont'd)

Exhibit B (cont'd):

	For the year ended 31 December				
	2008	2007	2006	2005	2004
	Reported amounts				
	NIS				
Earnings per share					
Basic earnings:					
Net operating profit (loss)	**(0.11)**	2.11	1.03	1.46	1.35
Cumulative effect of change in accounting method at the beginning of the year	**-**	-	-	-	(0.02)
After-tax profit (loss) from extraordinary items	**0.17**	0.26	1.47	0.05	(0.01)
Net profit	**0.06**	2.37	2.50	1.51	1.32
Diluted earnings:					
Net operating profit (loss)	**(0.11)**	2.08	1.03	1.46	1.35
Cumulative effect of change in accounting method at the beginning of the year	**-**	-	-	-	(0.02)
After-tax profit (loss) from extraordinary items	**0.17**	0.26	1.47	0.05	(0.01)
Net profit	**0.06**	2.34	2.50	1.51	1.32

Rates of Financing Income and Expenses - on Consolidated Basis (a)
Reported amounts

Exhibit C:

	2008				2007			
			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)	**110,588**	**6,290**	**5.69**		96,072	5,755	5.99	
Effect of embedded and ALM derivatives (e)	**53,435**	**847**			35,493	579		
Total assets	**164,023**	**7,137**		**4.35**	131,565	6,334		4.82
Liabilities (d)	**109,287**	**(3,039)**	**(2.78)**		101,084	(3,010)	(2.98)	
Effect of embedded and ALM derivatives (e)	**43,647**	**(235)**			21,539	(40)		
Total liabilities	**152,934**	**(3,274)**		**(2.14)**	122,623	(3,050)		(2.49)
Interest margin			**2.91**	**2.21**			3.01	2.33
Israeli currency - linked to the CPI								
Assets (c)(d)	**60,653**	**5,626**	**9.28**		58,314	4,549	7.80	
Effect of embedded and ALM derivatives (e)	**2,154**	**109**			602	45		
Total assets	**62,807**	**5,735**		**9.13**	58,916	4,594		7.80
Liabilities (d)	**44,242**	**(3,834)**	**(8.67)**		42,793	(2,978)	(6.96)	
Effect of embedded and ALM derivatives (e)	**11,559**	**(858)**			8,202	(658)		
Total liabilities	**55,801**	**(4,692)**		**(8.41)**	50,995	(3,636)		(7.13)
Interest margin			**0.61**	**0.72**			0.84	0.67
Foreign currency – (including Israeli currency linked to foreign currency)								
Assets (c)(d)	**106,954**	**(28)**	**(0.03)**		(i) 123,998	(1,227)	(0.99)	
Effect of derivatives(e):								
Hedging derivatives	**3,033**	**7**			4,516	288		
Embedded derivatives and ALM	**81,020**	**(2,122)**			64,136	(3,911)		
Total assets	**191,007**	**(2,143)**		**(1.12)**	192,650	(4,850)		(2.52)
Liabilities (d)	**107,892**	**2,220**	**2.06**		119,327	3,500	2.93	
Effect of derivatives(e):								
Hedging derivatives	**2,864**	**8**			4,294	(273)		
Embedded derivatives and ALM	**82,011**	**1,951**			70,257	3,916		
Total liabilities	**192,767**	**4,179**		**2.17**	193,878	7,143		3.68
Interest margin			**2.03**	**1.05**			1.94	1.16

See footnotes on page 251 below.

Note - Full details of the rates of financing income and expenses in each sector, for the various balance sheet categories, are available on request.

Rates of Financing Income and Expenses - on Consolidated Basis (a) (cont'd)
Reported amounts

Exhibit C (cont'd):

	For the year ended 31 December							
	2008				2007			
			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)	**278,195**	**11,888**	**4.27**		(i)278,384	9,077	3.26	
Effect of derivatives (e):								
Hedging derivatives	**3,033**	**7**			4,516	288		
Embedded derivatives and ALM	**136,609**	**(1,166)**			100,231	(3,287)		
Total assets	**417,837**	**10,729**		**2.57**	383,131	6,078		1.59
Total monetary liabilities generating interest expenses (d)	**261,421**	**(4,653)**	**(1.78)**		263,204	(2,488)	(0.95)	
Effect of derivatives (e):								
Hedging derivatives	**2,864**	**8**			4,294	(273)		
Embedded derivatives and ALM	**137,217**	**858**			99,998	3,218		
Total liabilities	**401,502**	**(3,787)**		**(0.94)**	367,496	457		0.12
Interest margin			**2.49**	**1.63**			2.31	1.71
In respect of options		**(201)**				90		
In respect of other derivatives (excluding options, hedging derivative instruments, ALM derivative and embedded derivatives which have been separated (e))		**(97)**				(15)		
Financing commissions and other financing income (g)		**(264)**				1,038		
Net interest income before provision for doubtful debts		**(6,380)**				7,648		
Provision for doubtful debts (including general and Supplementary provision)		**2,145**				(407)		
Net interest income after provision for doubtful debts		**4,235**				7,241		
Total:								
Monetary assets generating interest income (d) (f) (i)	**278,195**				278,384			
Assets derived from derivative instruments (h)	**6,639**				4,341			
Other monetary assets (d)	**2,870**				(i) 3,845			
General provision and supplementary provision for doubtful debts	**(852)**				(989)			
Total monetary assets	**286,852**				285,581			
Total:								
Monetary liabilities generating interest expenses (d)	**261,421**				263,204			
Liabilities derived from derivative instruments (h)	**7,228**				4,161			
Other monetary liabilities (d)	**8,597**				8,355			
Total monetary liabilities	**277,246**				275,720			
Total excess of monetary assets over monetary liabilities	**9,606**				9,861			
Non-monetary assets	**10,846**				10,239			
Non-monetary liabilities	**473**				782			
Total capital resources	**19,979**				19,318			

See footnotes on next page.

Note - Full details of the rates of financing income and expenses in each sector, for the various balance sheet categories, are available on request.

Rates of Financing Income and Expenses - on 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 55 million in the unlinked Israeli currency sector (2007 – NIS 157 million), NIS 43 million in the index-linked Israeli currency sector (2007 – NIS 98 million) and NIS (952) millions in the foreign currency sector including Israeli currency linked to foreign currency (2007 – NIS (66) 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 (854) million in the various sectors for the year (2007 – NIS (189) 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) Reclassified.

Rates of Financing Income and Expenses - on Consolidated Basis (a) (cont'd)
Nominal U.S. $

Exhibit C (cont'd):

	2008				2007			
			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) (f)	**18,953**	**836**	**4.41**		(f) 19,312	1,069	5.54	
Effect of derivatives(e):								
Hedging derivatives	**845**	**7**			1,093	70		
Embedded derivatives and ALM	**22,425**	**21**			15,510	56		
Total assets	**42,223**	**864**		**2.04**	35,915	1,195		3.33
Liabilities (d)	**20,641**	**(536)**	**(2.59)**		19,045	(749)	(3.93)	
Effect of derivatives(e):								
Hedging derivatives	**797**	**(3)**			1,039	(66)		
Embedded derivatives and ALM	**22,690**	**(149)**			16,961	(67)		
Total liabilities	**44,128**	**(688)**		**(1.56)**	37,045	(882)		(2.38)
Interest margin			**1.82**	**0.48**			1.61	0.95
Foreign currency - foreign operations (integrated operations)								
Assets (c) (d)	**10,952**	**549**	**5.02**		10,620	963	9.06	
Effect of embedded and ALM derivatives (e)	**97**	**52**			52	23		
Total assets	**11,049**	**601**		**5.44**	10,672	986		9.23
Liabilities(d)	**9,476**	**(323)**	**(3.41)**		9,789	(691)	(7.06)	
Effect of embedded and ALM derivatives (e)	**123**	**-**			72	-		
Total liabilities	**9,599**	**(323)**		**(3.36)**	9,861	(691)		(7.01)
Interest margin			**1.61**	**2.08**			2.00	2.22
Total								
Monetary assets in foreign currency generating financing income (c) (d) (f)	**29,905**	**1,385**	**4.63**		(f) 29,932	2,032	6.79	
Effect of derivatives(e):								
Hedging derivatives	**845**	**7**			1,093	70		
Embedded derivatives and ALM	**22,522**	**73**			15,562	79		
Total assets	**53,272**	**1,465**		**2.75**	46,587	2,181		4.68
Monetary liabilities in foreign currency generating financing expense (d)	**30,117**	**(859)**	**(2.85)**		28,834	(1,440)	(4.99)	
Effect of derivatives(e):								
Hedging derivatives	**797**	**(3)**			1,039	(66)		
Embedded derivatives and ALM	**22,813**	**(149)**			17,033	(67)		
Total liabilities	**53,727**	**(1,011)**		**(1.88)**	46,906	(1,573)		(3.35)
Interest margin			**1.78**	**0.87**			1.80	1.33

See footnotes on next page.

Rates of Financing Income and Expenses - on Consolidated Basis (a) (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 losses from adjustments to fair value of debentures held for trading and available for sale has been added to the average balance of the assets, in the amount of US$ (265) million (2007 – US$ (16) 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.

(f) Reclassified.

Note - Full details of the rates of financing income and expenses in each sector, for the various balance sheet categories, are available on request.

Exposure to Interest Rate Fluctuations - on Consolidated Basis

Exhibit D:

	31 December 2008												31 December 2007	
	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 rate of return**	**Average maturity**	Internal rate of return	Average Maturity
	Reported amounts													
	NIS millions										**%**	**Years**	%	Years
Israeli currency - unlinked														
Total assets	**100,193**	**5,546**	**4,746**	**5,401**	**2,956**	**2,889**	**251**	**-**	**2,419**	**124,401**	**5.52**	**0.45**	6.29	0.42
Total liabilities	**92,575**	**6,478**	**11,989**	**5,798**	**2,225**	**438**	**185**	**60**	**323**	**120,071**	**3.17**	**0.36**	3.25	0.29
Difference	**7,618**	**(932)**	**(7,243)**	**(397)**	**731**	**2,451**	**66**	**(60)**	**2,096**	**4,330**	**2.37**	**0.09**	3.04	0.13
Effect of future transactions and special commitments	**6,596**	**(4,887)**	**3,819**	**2,323**	**62**	**298**	**(73)**	**-**	**-**	**8,138**				
Exposure to interest rate fluctuations in the sector	**14,214**	**(5,819)**	**(3,424)**	**1,926**	**793**	**2,749**	**(7)**	**(60)**	**2,096**	**12,468**				
Accumulated exposure in the sector	**14,214**	**8,395**	**4,971**	**6,897**	**7,690**	**10,439**	**10,432**	**10,372**	**12,468**	**12,468**				
Israeli currency – linked to the CPI														
Total assets	**2,023**	**3,262**	**13,677**	**18,464**	**9,505**	**10,299**	**2,993**	**73**	**81**	**60,377**	**4.92**	**3.33**	5.58	3.51
Total liabilities	**930**	**2,602**	**6,610**	**13,034**	**9,889**	**12,472**	**2,431**	**883**	**434**	**49,285**	**3.95**	**4.18**	4.31	3.84
Difference	**1,093**	**660**	**7,067**	**5,430**	**(384)**	**(2,173)**	**562**	**(810)**	**(353)**	**11,092**	**0.97**	**(0.85)**	1.27	(0.33)
Effect of future transactions and special commitments	**(37)**	**204**	**(2,644)**	**(3,021)**	**(1,437)**	**(1,759)**	**59**	**-**	**-**	**(8,635)**				
Exposure to interest rate fluctuations in the sector	**1,056**	**864**	**4,423**	**2,409**	**(1,821)**	**(3,932)**	**621**	**(810)**	**(353)**	**2,457**				
Accumulated exposure in the sector	**1,056**	**1,920**	**6,343**	**8,752**	**6,931**	**2,999**	**3,620**	**2,810**	**2,457**	**2,457**				
Foreign currency (b)														
Total assets	**61,762**	**25,460**	**8,644**	**8,912**	**2,419**	**2,136**	**413**	**4**	**589**	**110,339**	**4.08**	**0.55**	4.15	0.54
Total liabilities	**63,785**	**27,624**	**18,556**	**3,902**	**2,339**	**508**	**148**	**-**	**87**	**116,949**	**1.88**	**0.39**	3.14	0.35
Difference	**(2,023)**	**(2,164)**	**(9,912)**	**5,010**	**80**	**1,628**	**265**	**4**	**502**	**(6,610)**	**2.20**	**0.16**	1.01	0.19
Effect of future transactions and special commitments	**(1,380)**	**(7,506)**	**14,641**	**(3,956)**	**(350)**	**(1,061)**	**109**	**-**	**-**	**497**				
Exposure to interest rate fluctuations in the sector	**(3,403)**	**(9,670)**	**4,729**	**1,054**	**(270)**	**567**	**374**	**4**	**502**	**(6,113)**				
Accumulated exposure in the sector	**(3,403)**	**(13,073)**	**(8,344)**	**(7,290)**	**(7,560)**	**(6,993)**	**(6,619)**	**(6,615)**	**(6,113)**	**(6,113)**				

See footnotes on next page.

Exposure to Interest Rate Fluctuations - on Consolidated Basis (cont'd)

Exhibit D (cont'd):

	31 December 2008												31 December 2007	
	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 rate of return**	**Average Maturity**	Internal rate of return	Average Maturity
	Reported amounts													
	NIS millions										**%**	**Years**	**%**	**Years**
Total exposure to interest rate fluctuations														
Total assets (c)	**163,978**	**34,268**	**27,067**	**32,777**	**14,880**	**15,324**	**3,657**	**77**	**12,311**	**304,339**		**1.09**		1.14
Receivables in respect of open credit card transactions									**6,453**	**6,453**				
Total liabilities (c)	**157,290**	**36,704**	**37,155**	**22,734**	**14,453**	**13,418**	**2,764**	**943**	**1,504**	**286,965**		**1.05**		0.95
Payables in respect of open credit card transactions									**4,910**	**4,910**				
Difference	**6,688**	**(2,436)**	**(10,088)**	**10,043**	**427**	**1,906**	**893**	**(866)**	**12,350**	**18,917**		**0.04**		0.19
Effect of future transactions and special commitments	**5,179**	**(12,189)**	**15,816**	**(4,654)**	**(1,725)**	**(2,522)**	**95**	**-**	**-**	**-**				
Total exposure to interest rate fluctuations	**11,867**	**(14,625)**	**5,728**	**5,389**	**(1,298)**	**(616)**	**988**	**(866)**	**12,350**	**18,917**				
Total accumulated exposure	**11,867**	**(2,758)**	**2,970**	**8,359**	**7,061**	**6,445**	**7,433**	**6,567**	**18,917**	**18,917**				

(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 1,266 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, for 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.

Overall Credit Risk to the Public by Economic Sector - on Consolidated Basis

Exhibit E:

	31 December 2008				
	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	2,018	385	2,403	(44)	256
Industry	23,940	14,447	38,387	606	3,031
Construction and real estate	34,257	18,579	52,836	427	6,807
Electricity and water	1,203	186	1,389	1	5
Commerce	16,190	3,447	19,637	47	1,260
Hotels and restaurants	3,953	339	4,292	18	1,582
Transport and storage	4,336	1,182	5,518	21	391
Communications and computer services	4,625	1,332	5,957	12	450
Financial services	17,888	7,815	25,703	345	2,539
Other business services	5,126	1,386	6,512	29	352
Public and community services	5,539	1,804	7,343	7	330
Private individuals - loans for housing	40,904	1,742	42,646	97	979
Private individuals - other	22,374	24,169	46,543	230	1,345
Total	182,353	76,813	259,166	1,796	19,327
Credit risk included in the various economic sectors:					
Settlement movements (d)	3,120	596	3,716	(36)	928
Local authorities (e)	3,236	145	3,381	(2)	154
Activities of borrowers abroad					
Agriculture	70	28	98	-	2
Industry	10,112	3,713	13,825	35	680
Construction and real estate	6,117	1,728	7,845	3	1,056
Electricity and water	165	297	462	-	3
Commerce	7,584	3,788	11,372	159	648
Hotels and restaurants	873	110	983	2	10
Transport and storage	752	403	1,155	-	391
Communications and computer services	721	406	1,127	-	1
Financial services	12,413	4,449	16,862	27	465
Other business services	1,833	934	2,767	1	78
Public and community services	1,107	114	1,221	(1)	-
Private individuals	2,744	867	3,611	50	21
Total	44,491	16,837	61,328	276	3,355

(a) Including credit to the public in the amount of NIS 214,044 million, investments in debentures of companies in the amount of NIS 8,204 million and other assets in respect of derivative instruments which represent transactions of the public in the amount of NIS 4,596 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.

Overall Credit Risk to the Public by Economic Sector - on Consolidated Basis (cont'd)

Exhibit E (cont'd):

	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	2,656
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	1,621	38,460	50	989
Private individuals - other	21,090	22,789	43,879	165	1,187
Total	170,603	71,385	241,988	463	14,353
Credit risk included in the various economic sectors:					
Settlement movements (d)	3,296	619	3,915	(23)	531
Local authorities (e)	3,319	134	3,453	(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.

Country Exposure

Exhibit F:

Part A – Information on total country exposure and on exposure to countries whose total individual exposure exceeds 1% of total assets or exceeds 20% of equity for purposes of calculating capital ratios, whichever is the lower

2008

Balance sheet exposure

Country	Cross-Border Balance Sheet Exposure			Net Foreign-office Claims on Local Residents			Total balance sheet exposure	
	To governments	To banks	To others	Balance sheet exposure before deducting local liabilities	Deduction for local liabilities	Balance sheet exposure after deducting local liabilities		Balance of problematic debts
United States	3,516	6,466	8,801	20,504	9,367	11,137	29,920	904
England	8	6,391	967	5,253	1,812	3,441	10,807	378
France	566	1,759	521	18	5	13	2,859	33
Holland	-	1,849	1,445	-	-	-	3,294	147
Germany	-	2,195	1,177	-	-	-	3,372	36
Others	320	9,597	5,095	3,614	2,132	1,482	16,494	737
Total country exposure	4,410	28,257	18,006	29,389	13,316	16,073	66,746	2,235
Total exposure to LDC countries	264	596	1,029	1,752	1,000	752	2,642	16

Off-balance sheet exposure

Country	Total off-balance sheet exposure	Of which: Problematic off-balance sheet credit risk	Cross-Border Balance Sheet Exposure: Repayment up to one year	Repayment over one year
United States	12,599	40	7,785	10,998
England	10,758	-	5,079	2,287
France	1,698	-	1,630	1,216
Holland	846	-	2,138	1,156
Germany	661	-	2,123	1,249
Others	3,830	-	9,176	5,836
Total country exposure	30,392	40	27,931	22,742
Total exposure to LDC countries*	623	-	1,542	347

* See also page 206 in the Directors' Report

See footnotes on next page.

Country Exposure (cont'd)

Exhibit F (cont'd):

Footnotes:

In accordance with the Directive of the Supervisor of Banks, country exposure is shown on an end-risk basis, as follows:

- The accounting balance of a debt is to be dealt with as the amount of exposure to the legal country of residence of the debtor who bears the end risk.
- The accounting balance of an investment in shares is to be dealt with as the amount of exposure to the country of residence of the issuer of the security.
- Off-balance sheet credit risk is shown as an off-balance sheet exposure to the country of residence of the counterparty to the transaction.

From the aspect of determining end-risk, collateral is to be considered as follows:

- Third party guarantees according to the country of residence of the guarantor.
- Securities - The country of residence is that of the issuer of the security.
- The Directive makes it clear that real estate and debtors' balances do not represent collateral for purposes of determining end-risk.
- For purposes of determining end-risk only specific collaterals were taken into account.

Part B – The aggregate amount of balance sheet exposure to countries whose total individual exposure is between 0.75% and 1% of total consolidated assets or 15%-20% of the equity, whichever is the lower, is NIS 2,455 million and relates to Belgium only.

Quarterly Consolidated Balance Sheets – Multi-Quarter Data
Reported amounts

Exhibit G:

Year	2008				2007			
Quarter	4	3	2	1	4	3	2	1
	NIS millions				NIS millions			
Assets								
Cash and deposits with banks	**33,130**	**29,027**	**31,229**	**36,580**	42,329	45,661	45,282	45,281
Securities	**44,910**	**41,566**	**43,494**	**44,641**	47,169	46,355	45,323	47,211
Securities borrowed or purchased under agreements to resell	**201**	**483**	**742**	**864**	655	246	320	108
Credit to the public	**213,215**	**207,489**	**201,717**	**200,174**	198,557	196,327	193,944	185,848
Credit to governments	**520**	**512**	**531**	**576**	642	701	750	781
Investments in companies included on equity basis	**1,842**	**2,031**	**1,895**	**1,899**	1,873	1,855	1,765	1,781
Buildings and equipment	**3,445**	**3,368**	**3,317**	**3,331**	3,276	3,226	3,163	3,120
Other assets	**13,529**	**9,335**	**9,077**	**10,158**	7,650	7,636	6,432	6,159
Total assets	**310,792**	**293,811**	**292,002**	**298,223**	302,151	302,007	296,979	290,289
Liabilities and equity capital								
Deposits of the public	**244,783**	**225,952**	**221,752**	**228,187**	238,045	236,929	236,521	226,861
Deposits from banks	**3,742**	**6,457**	**8,966**	**6,575**	6,139	10,197	8,462	13,320
Deposits from governments	**831**	**827**	**833**	**1,128**	1,198	1,632	1,519	1,905
Securities loaned or sold under agreements to repurchase	**549**	**549**	**372**	**385**	231	185	64	116
Debentures, bonds and subordinated notes	**20,636**	**22,257**	**21,920**	**21,985**	19,248	16,872	16,618	15,803
Other liabilities	**21,334**	**17,978**	**17,506**	**20,121**	17,636	15,540	14,031	13,633
Total liabilities	**291,875**	**274,020**	**271,349**	**278,381**	282,497	281,355	277,215	271,638
Minority interest	**245**	**229**	**225**	**109**	105	121	116	152
Shareholders' equity	**18,672**	**19,562**	**20,428**	**19,733**	19,549	20,531	19,648	18,499
Total liabilities and equity capital	**310,792**	**293,811**	**292,002**	**298,223**	302,151	302,007	296,979	290,289

Quarterly Consolidated Statements of Profit and Loss – Multi-Quarter Data
Reported Amounts

Exhibit H:

Year	2008				2007			
Quarter	4	3	2	1	4	3	2	1
	NIS millions				NIS millions			
Net interest income before provision for doubtful debts	**976**	**1,491**	**1,953**	**1,960**	1,781	2,265	1,809	1,793
Provision for doubtful debts	**1,090**	**495**	**316**	**244**	279	79	38	11
Net interest income (expense) after provision for doubtful debts	**(114)**	**996**	**1,637**	**1,716**	1,502	2,186	1,771	1,782
Operating and other income								
Operating commissions	**838**	**840**	**832**	**852**	863	834	826	827
Profits (losses) from investments in shares, net	**(434)**	**(363)**	**(44)**	**(71)**	227	9	143	82
Other income	**141**	**63**	**76**	**70**	102	66	162	81
Total operating and other income	**545**	**540**	**864**	**851**	1,192	909	1,131	990
Operating and other expenses								
Salaries and related expenses	**969**	**1,043**	**975**	**1,131**	1,083	1,104	1,004	1,027
Building and equipment maintenance and depreciation	**377**	**353**	**344**	**323**	354	317	307	296
Other expenses	**455**	**350**	**343**	**340**	427	364	345	309
Total operating and other expenses	**1,801**	**1,746**	**1,662**	**1,794**	1,864	1,785	1,656	1,632
Operating profit (loss) before taxes	**(1,370)**	**(210)**	**839**	**773**	830	1,310	1,246	1,140
Provision for taxes (Tax benefit) on operating profit	**(423)**	**61**	**400**	**383**	355	471	376	520
Operating profit (loss) after taxes	**(947)**	**(271)**	**439**	**390**	475	839	870	620
Group's equity in after-tax operating profits (losses) of companies included on equity basis, net of related tax effect	**(222)**	**191**	**193**	**87**	38	62	45	39
Minority interest in after-tax operating (profits) losses of subsidiaries	**(15)**	**(5)**	**7**	**(5)**	(1)	-	(2)	(1)
Net operating profit (loss)	**(1,184)**	**(85)**	**639**	**472**	512	901	913	658
After-tax profit (loss) from extraordinary items	**1**	**1**	**250**	**(2)**	5	109	-	259
Net profit (loss) for the period	**(1,183)**	**(84)**	**889**	**470**	517	1,010	913	917

Quarterly Consolidated Statements of Profit and Loss – Multi-Quarter Data (cont'd)
Earnings per Share for Each Quarter for the Years 2007 and 2008
Reported Amounts

Exhibit H (cont'd):

Year	2008				2007			
Quarter	4	3	2	1	4	3	2	1
	NIS				NIS			
Earnings per share								
Basic earnings per share:								
Net operating profit (loss)	**(0.80)**	**(0.06)**	**0.44**	**0.33**	0.35	0.64	0.65	0.47
After-tax profit from extraordinary items	**-**	**-**	**0.17**	**-**	-	0.08	-	0.18
Net profit (loss) for the period	**(0.80)**	**(0.06)**	**0.61**	**0.33**	0.35	0.72	0.65	0.65
Diluted earnings per share:								
Net operating profit (loss)	**(0.80)**	**(0.06)**	**0.44**	**0.33**	0.34	0.62	0.65	0.47
After-tax profit from extraordinary items	**-**	**-**	**0.17**	**-**	-	0.08	-	0.18
Net profit (loss) for the period	**(0.80)**	**(0.06)**	**0.61**	**0.33**	0.34	0.70	0.65	0.65

Certification

I, Galia Maor, certify that:

1. I have reviewed the Annual Report of Bank Leumi le-Israel B.M. (the "Bank") for the year 2008 (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 that is necessary so that the statements included therein, in light of the circumstances under which such statements were included, are not misleading with reference 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 for the dates and periods covered by the Report.

4. I and the Bank's other certifying officers are responsible for establishing and maintaining controls and procedures with regard to the Bank's disclosure and internal control of financial reporting (as defined in the Public Reporting Directives concerning "The Directors' Report"), and also:

   (a) We have established such controls and procedures, or caused such controls and procedures to be determined under our supervision, so as to ensure that material information relating to the Bank, including its consolidated corporations, is made known to us by others within the Bank and in those corporations, particularly during the period of preparation of the Report;

   (b) We have established such internal control over financial reporting, or caused such internal control to be established under our supervision, so as to provide a reasonable level of confidence regarding the reliability of financial reporting and that the financial statements for external purposes are prepared in accordance with accepted accounting principles and the directives of the Supervisor of Banks and his instructions; and

   (c) We have 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

   (d) We have 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.

5. I and the Bank's other certifying officers have disclosed to the Joint Auditors, the Board of Directors and the Audit Committee of the Board of Directors of the Bank, based on our most recent evaluation of internal control over financial reporting:

   (a) All significant deficiencies and material weaknesses in the establishment 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 material or immaterial, in which Management was involved or in which other employees were involved who have a significant role in the Bank's internal control over financial reporting.

The above does not derogate from my responsibility or the responsibility of any other person, pursuant to any law.

30 March 2009

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 the year 2008 (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 that is necessary so that the statements included therein, in light of the circumstances under which such statements were included, are not misleading with reference 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 for the dates and periods covered by the Report.

4. I and the Bank's other certifying officers are responsible for establishing and maintaining controls and procedures with regard to the Bank's disclosure and internal control of financial reporting (as defined in the Public Reporting Directives concerning "The Directors' Report"), and also:

   (a) We have established such controls and procedures, or caused such controls and procedures to be determined under our supervision, so as to ensure that material information relating to the Bank, including its consolidated corporations, is made known to us by others within the Bank and in those corporations, particularly during the period of preparation of the Report;

   (b) We have established such internal control over financial reporting, or caused such internal control to be established under our supervision, so as to provide a reasonable level of confidence regarding the reliability of financial reporting and that the financial statements for external purposes are prepared in accordance with accepted accounting principles and the directives of the Supervisor of Banks and his instructions; and

   (c) We have 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

   (d) We have 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.

5. I and the Bank's other certifying officers have disclosed to the Joint Auditors, the Board of Directors and the Audit Committee of the Board of Directors of the Bank, based on our most recent evaluation of internal control over financial reporting:

   (a) All significant deficiencies and material weaknesses in the establishment 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 material or immaterial, in which Management was involved or in which other employees were involved who have a significant role in the Bank's internal control over financial reporting.

The above does not derogate from my responsibility or the responsibility of any other person, pursuant to any law.

30 March 2009

Zeev Nahari
Senior Deputy Chief Executive Officer
Chief Financial Officer,
Head of Finance, Accounting and Capital Markets

Report of the Board of Directors and Management on Internal Control over Financial Reporting

The Board of Directors and Management of Bank Leumi le-Israel B.M. (henceforth: "the Bank"), are responsible for establishing and maintaining appropriate internal control over financial reporting (as defined in the Public Reporting Directives concerning "The Directors' Report"). The internal control system of the Bank has been designed to provide a reasonable level of confidence to the Board of Directors and Management of the Bank concerning the preparation and appropriate presentation of financial statements published in accordance with accepted accounting principles and the directives of the Supervisor of Banks and his instructions. Irrespective of the quality level of their design, all internal control systems have inherent limitations. Therefore even if it is determined that they are effective, they can only provide a reasonable level of confidence with reference to the preparing and presentation of a financial statement.

The Management, under the supervision of the Board of Directors, maintain a comprehensive internal control system designed to ensure that transactions are executed in accordance with the authorizations of Management, that assets are protected, and that accounting entries are reliable. Furthermore, Management, under the supervision of the Board of Directors, takes steps to ensure that channels of information and communication are effective and monitor performance, including performance of internal control procedures.

The Management of the Bank, under the supervision of the Board of Directors, has evaluated the effectiveness of internal control of the Bank over financial reporting as at 31 December 2008, based on the criteria determined in the internal control model of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, the Management believes that as at 31 December 2008, the Bank's internal control over financial reporting is effective.

The effectiveness of the Bank's internal control over financial reporting as at 31 December 2008 was audited by the Bank's Auditors, Somekh Chaikin and Kost Forer Gabbay & Kasierer, as stated in their Report on page 267, which includes an opinion regarding the effectiveness of the Bank's internal control over financial reporting as at 31 December 2008.

Eitan Raff
Chairman of the Board of Directors

Galia Maor
President and Chief Executive Officer

Zeev Nahari
Senior Deputy Chief Executive Officer
Chief Financial Officer,
Head of Finance, Accounting and Capital Markets

30 March 2009

Report of the Joint Auditors to the Shareholders of Bank Leumi le-Israel B.M.
Internal Control Over Financial Reporting

We have audited the internal control of Bank Leumi le-Israel B.M. ("the Bank") over financial reporting as of 31 December 2008, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Bank's Board of Directors and of its Management are responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of the Board of Directors and Management on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Bank's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States) adopted by the Supervisor of Banks. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A bank's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and with the directives and guidelines of the Supervisor of Banks. A bank's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles in Israel (Israeli GAAP), and the directives and guidelines of the Supervisor of Banks, and that receipts and expenditures of the company are being made only in accordance with authorizations of Management and Directors of the Bank; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Bank's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Bank maintained, in all material respects, effective internal control over financial reporting as of 31 December 31 2008, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with generally accepted auditing standards in Israel, including standards prescribed by the Auditors (Manner of Auditor's Performance) Regulations, 1973 and certain auditing standards, of which implementation in audit of banking institutions was required in guidelines of the Supervisor of Banks, the accompanying consolidated balance sheets of the Bank and its subsidiaries as at 31 December 2008 and 2007, 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 2008 and our report of 30 March 2009 included an unqualified opinion on the consolidated financial statements.

Somekh Chaikin
Certified Public Accountants (Isr.)

Kost Forer Gabbay & Kasierer
Certified Public Accountants (Isr.)

Joint Auditors

30 March 2009

Report of the Joint Auditors to the Shareholders of Bank Leumi le-Israel B.M.
Annual Financial Statements

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 2008 and 2007, and the related consolidated statements of profit and loss, statements of changes in shareholders' equity and the consolidated statements of cash flows, for each of the three years the last of which ended 31 December 2008. 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 2008 and 2007, and whose net interest income before provision for doubtful debts included in the consolidated statements of profit and loss constitutes some 0.1%, some 2% and some 2% of the total consolidated interest income before provision for doubtful debts for the years ended 31 December 2008, 2007, and 2006, 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 included in respect of these companies, is based on the reports of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards in Israel, including standards prescribed by the Auditors (Manner of Auditor's Performance) Regulations, 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 and the reports of other auditors 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 2008 and 2007, 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 2008, in conformity with generally accepted accounting principles (Israeli GAAP). Furthermore, the above financial statements have, in our opinion, been prepared in accordance with the directives and guidelines of the Supervisor of Banks.

Without qualifying our above opinion we draw attention to that stated in Note 18.G.(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.N. and O. 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.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) adopted by the Supervisor of Banks, internal control over financial reporting of the Bank as of 31 December 2008, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report of 30 March, 2009 included an unqualified opinion thereon.

Somekh Chaikin
Certified Public Accountants (Isr.)

Kost Forer Gabbay & Kasierer
Certified Public Accountants (Isr.)

Joint Auditors

30 March 2009

Consolidated Balance Sheets as at 31 December 2008

Reported Amounts

	Note	**31 December 2008**	31 December 2007
		NIS millions	
Assets			
Cash and deposits with banks	**2**	**33,130**	42,329
Securities	**3, 14**	**44,910**	47,169
Securities borrowed or purchased under agreements to resell		**201**	655
Credit to the public	**4**	**213,215**	198,557
Credit to governments	**5**	**520**	642
Investments in companies included on equity basis	**6**	**1,842**	1,873
Buildings and equipment	**7**	**3,445**	3,276
Other assets	**8**	**13,529**	7,650
Total assets		**310,792**	302,151
Liabilities and equity capital			
Deposits of the public	**9**	**244,783**	238,045
Deposits from banks	**10**	**3,742**	6,139
Deposits from governments		**831**	1,198
Securities lent or sold under agreements to repurchase		**549**	231
Debentures, bonds and subordinated notes	**11**	**20,636**	19,248
Other liabilities	**12**	**21,334**	17,636
Total liabilities		**291,875**	282,497
Minority interest		**245**	105
Shareholders' equity	**13**	**18,672**	19,549
Total liabilities and equity capital		**310,792**	302,151

The accompanying notes are an integral part of these consolidated financial statements.

For condensed financial statements of the Bank only – 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 Chief Financial Officer, Head of Finance, Accounting and Capital Markets

Date of the signing of the financial statements: 30 March, 2009

Consolidated Statements of Profit and Loss for the year ended 31 December 2008

Reported Amounts

	Note	**2008**	2007	2005
		NIS millions		
Net interest income before provision for doubtful debts	**20**	**6,380**	7,648	6,922
Provision for doubtful debts	**4**	**2,145**	407	933
Net interest income after provision for doubtful debts		**4,235**	7,241	5,989
Operating and other income				
Operating commissions	**21**	**3,362**	3,350	3,013
Profits (losses) from investments in shares, net	**22**	**(912)**	461	128
Other income	**23**	**350**	411	740
Total operating and other income		**2,800**	4,222	3,881
Operating and other expenses				
Salaries and related expenses	**24**	**4,118**	4,218	4,552
Building and equipment maintenance and depreciation		**1,397**	1,274	1,220
Other expenses	**25**	**1,488**	1,445	1,495
Total operating and other expenses		**7,003**	6,937	7,267
Operating profit (loss) before taxes		**32**	4,526	2,603
Provision for taxes on operating profit	**26**	**421**	1,722	1,320
Operating profit after taxes		**(389)**	2,804	1,283
Group's equity in after-tax operating profits of companies included on equity basis, net of related tax effect	**6**	**249**	184	171
Minority interest in after-tax operating (profits) losses of subsidiaries		**(18)**	(4)	-
Net operating profit (loss)		**(158)**	2,984	1,454
After-tax profit from extraordinary items	**27**	**250**	373	2,080
Net profit		**92**	3,357	3,534

Earnings per share

	2008	2007	2005
Basic earnings per share			
Net operating profit (loss)	**(0.11)**	2.11	1.03
After-tax profit from extraordinary items	**0.17**	0.26	1.47
Net profit	**0.06**	2.37	2.50
Diluted earnings per share			
Net operating profit (loss)	**(0.11)**	2.08	1.03
After-tax profit from extraordinary items	**0.17**	0.26	1.47
Net profit	**0.06**	2.34	2.50
	Thousands		
Weighted average of the number of shares for calculation of basic earnings	**1,462,252**	1,414,233	1,414,233
Weighted average of the number of shares for calculation of diluted earnings	**1,470,961**	1,433,803	1,414,233

The accompanying notes are an integral part of these consolidated financial statements.

For condensed financial statements of the Bank only – see Note 30.

Statements of Changes in Shareholders' Equity for the year ended 31 December 2008

Reported amounts

					Total other overall profit (loss)					
	Share capital	Premium	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 2006	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/or shown in profit and loss (e)	-	-	-	-	(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
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/or shown in profit and loss (e)	-	-	-	-	(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

See footnotes on next page

Statements of Changes in Shareholders' Equity for the year ended 31 December 2008 (cont'd)

Reported amounts

					Total other overall profit (loss)					
	Share capital	Premium	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
Balance as at 1 January 2008	**7,000**	**-**	**610**	**7,610**	**502**	**(445)**	**(d) 12,016**	**270**	**(404)**	**19,549**
Net profit for the year	**-**	**-**	**-**	**-**	**-**	**-**	**92**	**-**	**-**	**92**
Issue of shares	**59**	**855**	**(300)**	**614**	**-**	**-**	**-**	**-**	**-**	**614**
Dividend paid (c)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(270)**	**-**	**(270)**
Benefit in respect of share-based payment transactions	**-**	**-**	**(26)**	**(26)**	**-**	**-**	**-**	**-**	**-**	**(26)**
Other overall profit in companies included on equity basis attributed directly to reserves	**-**	**-**	**-**	**-**	**-**	**-**	**(110)**	**-**	**-**	**(110)**
Adjustments in respect of presentation of securities available for sale at fair value	**-**	**-**	**-**	**-**	**(3,636)**	**-**	**-**	**-**	**-**	**(3,636)**
Losses in respect of securities available for sale that were realized and/or charged to profit and loss (e)	**-**	**-**	**-**	**-**	**1,852**	**-**	**-**	**-**	**-**	**1,852**
Related tax effect	**-**	**-**	**-**	**-**	**634**	**-**	**-**	**-**	**-**	**634**
Adjustments from translation in respect of companies included on equity basis	**-**	**-**	**-**	**-**	**-**	**(57)**	**-**	**-**		**(57)**
Loans to employees for purchase of the Bank's shares	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**30**	**30**
Balance as at 31 December 2008	**7,059**	**855**	**284**	**8,198**	**(648)**	**(502)**	**(d) 11,998**	**-**	**(374)**	**18,672**

(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 1,638 million which may not be distributed as a dividend (31 December 2007 – NIS 987 million, 31 December 2006 - NIS 1,044 million). The balance of the amount for distribution is subject to directives of Bank of Israel and to restrictions set out in Proper Conduct of Banking Business.
(e) Including provision for impairment.

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows for the year ended 31 December 2008

Reported amounts

	2008	2007	2006
	NIS millions		
Cash flows generated by operating activities:			
Net profit for the year	**92**	3,357	3,534
Adjustments required to cash flows generated by operating activities:			
Equity in undistributed profits of companies included on equity basis (a)	**(128)**	(120)	(114)
Minority interest in profits of subsidiaries	**18**	8	-
Benefit in respect of share-based payment transactions	**24**	201	356
Depreciation of buildings and equipment	**520**	460	455
Amortization	**17**	15	13
Provision for doubtful debts	**2,145**	407	933
Provision for decrease in value of assets transferred to the Group's ownership	**10**	5	-
Net gain on sale of securities available for sale	**(52)**	(354)	(30)
Realized and unrealized loss (gain) from adjustment of held for trading securities to fair value	**446**	24	(61)
Gain on receipt of shares without payment	**(27)**	-	-
After-tax gain on realization of investments in subsidiaries and companies included on equity basis	**(17)**	-	(718)
Net gain from sale of companies on the capital market	**-**	(357)	(1,361)
Net (gains) losses, after tax, on sale of buildings and equipment	**2**	(18)	(8)
Provision for impairment of debentures available for sale	**1,328**	28	-
Provision for impairment of shares available for sale	**576**	-	-
Cancellation of special provisions in connection with fixed assets	**(2)**	(5)	-
Deferred taxes in respect of operating profit, net	**33**	23	(238)
Increase (decrease) in excess of provisions for severance pay and pensions over amounts funded	**672**	(30)	307
Gain on issue of shares to third party in subsidiary	**(234)**	-	-
Other, net	**(1)**	16	3
Net cash generated by operating activities	**5,422**	3,660	3,071

(a) Net of dividend received.

The accompanying notes are an integral part of these financial statements.

For condensed financial statements of the Bank only, see Note 30.

Consolidated Statements of Cash Flows for the year ended 31 December 2008 (cont'd)

Reported amounts

	2008	2007	2006
	NIS millions		
Cash flows generated by activities in assets:			
Net decrease (increase) in deposits with banks for an initial period exceeding three months	**5,380**	(1,338)	(2,466)
Acquisition of debentures held to maturity	**(32)**	(26)	(7)
Proceeds from redemption of debentures held to maturity	**41**	973	1,114
Acquisition of securities available for sale	**(46,165)**	(37,531)	(25,014)
Proceeds from sale of securities available for sale	**5,810**	7,701	2,885
Proceeds from redemption of securities available for sale	**41,593**	29,028	23,236
Net decrease (increase) in securities held for trading	**(3,241)**	(1,091)	167
Net increase in credit to the public	**(16,615)**	(15,429)	(1,312)
Net decrease (increase) in credit to governments	**122**	378	(172)
Additional investments in shares of subsidiaries	**-**	(18)	(82)
Acquisition of a subsidiary consolidated for the first time (Appendix A)	**-**	-	84
Proceeds from sale of investment in companies included on equity basis	**29**	-	1,230
Issue of shares to third party in subsidiary	**360**	-	-
Acquisition of shares in companies included on equity basis	**(13)**	(35)	(43)
Acquisition of buildings and equipment	**(715)**	(697)	(624)
Net decrease (increase) in securities borrowed or purchased under agreements to resell	**454**	(655)	-
Proceeds from sale of buildings, after related tax	**45**	58	22
Net proceeds from sale of companies on the capital market	**-**	357	1,693
Proceeds from realization of assets transferred to Group ownership	**9**	-	-
Net increases in other assets	**(5,781)**	(1,361)	(210)
Net cash used for activities in assets	**(18,719)**	(19,686)	501
Cash flows generated by activities in liabilities and capital			
Net increase (decrease) in:			
Deposits of the public	**6,738**	6,222	8,051
Deposits from banks	**(2,397)**	898	895
Deposits from governments	**(367)**	(948)	(79)
Issue of debentures, bonds and subordinated notes	**5,089**	4,233	640
Redemption of debentures, bonds and subordinated notes	**(3,701)**	(607)	(2,103)
Net increase in other liabilities	**4,838**	1,851	343
Net increase in securities loaned or sold under agreements to repurchase	**318**	231	-
Issue of shares to employees	**614**	-	-
Dividend paid to shareholders	**(1,684)**	(2,500)	(1,103)
Dividend paid to minority shareholders by subsidiaries	**-**	(45)	(1)
Repayment of loans to employees for purchase of the Bank's shares	**30**	73	10
Loans to employees to acquire bank shares	**-**	-	(464)
Net cash generated by activities in liabilities and capital	**9,478**	9,408	6,189
Increase (decrease) in cash	**(3,819)**	(6,618)	9,761
Balance of cash at beginning of year	**34,824**	41,442	31,681
Balance of cash at end of year	**31,005**	34,824	41,442

The accompanying notes are an integral part of these financial statements.
For condensed financial statements of the Bank only - see Note 30.

Consolidated Statements of Cash Flows for the year ended 31 December 2008 (cont'd)

Reported amounts

Appendix A - Acquisition of subsidiaries consolidated for the first time:

	2008	2007	2006
	NIS millions		
Assets and liabilities of consolidated subsidiaries at date of acquisition:			
Working capital (except cash and cash equivalents)	-	-	286
Non-monetary assets	-	-	(88)
Minority interest	-	-	1
Goodwill	-	-	(115)
Cash outflow to acquire subsidiaries consolidated for the first time	-	-	84

Appendix B - Transactions not involving cash flows:
In 2008:

(1) During the year, shares were transferred from the available for sale portfolio to credit to the public, in the amount of NIS 73 million, due to loaning of securities.
(2) During the year, a capital note was received in the available for sale portfolio from a customer against credit that was repaid in the amount of NIS 73 million.
(3) During the year, fixed assets were acquired against liabilities to suppliers, in the amount of NIS 19 million.
(4) During the year, debentures were transferred in a foreign subsidiary from the redemption portfolio to the available for sale portfolio in the amount of NIS 126 million.

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 was concluded.
(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.

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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 a banking corporation.

Publication of the financial statements is on the basis of the consolidated statements only. Condensed financial statements of the Bank appear 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 items (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 items are shown 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 statements 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 difference 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 shown 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 investee companies, 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, in accordance with the terms of the transactions.

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.

- Exchange rate differences from shares in the available for sale portfolio are charged directly to capital reserve.

- 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, in accordance with the terms of the transactions.

(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		
	2008	2007	2006	**2008**	2007	2006
	NIS			%		
Exchange rate of the:						
U.S. dollar	**3.802**	3.846	4.225	**(1.1)**	(9.0)	(8.2)
Euro	**5.297**	5.659	5.564	**(6.4)**	1.7	2.2
British pound	**5.548**	7.710	8.288	**(28.0)**	(7.0)	4.4
Swiss franc	**3.565**	3.420	3.465	**4.2**	(1.3)	(0.9)
Currency basket	**4.383**	4.543	4.825	**(3.5)**	(5.8)	(5.2)
Consumer Price Index for the month of -	Points					
November – known index	**106.5**	101.9	99.1	**4.5**	2.8	(0.3)
December – actual index	**106.4**	102.5	99.1	**3.8**	3.4	(0.1)
Devaluation in real terms of NIS in relation to -						
Exchange rate of the dollar				**(4.8)**	(12.0)	(8.1)
Exchange rate of the currency basket				**(7.1)**	(8.9)	(5.1)

Note 1 - Significant Accounting Policies (cont'd)

D. Translation of financial statements of foreign subsidiaries and branches

(1) Pursuant to the directives of the Supervisor of Banks, all foreign subsidiaries of the Bank are considered as a foreign activity whose functional currency is identical to the functional currency 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. Financial statement 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.

(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:

Consolidated companies - companies of which the financial statements are directly or indirectly fully consolidated in the financial statements of the Bank.

Companies included on equity basis - Companies, other than consolidated companies, the Bank's investments in which are included in the financial statements on equity basis.

Investee companies – consolidated companies and companies included on equity basis.

See Note 6D for details of principal investee companies.

Note 1 - Significant Accounting Policies (cont'd)

E. Principles of consolidation and implementation of equity method (cont'd)

(2) Principles of consolidation

The consolidated financial statements include the audited financial statements of the Bank and of companies in which the Bank has control, 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 companies are consolidated in the financial statements of the Bank.

Intercompany balances and transactions between consolidated companies are eliminated in the consolidated financial statements.

(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) 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 an intangible asset. Pursuant to the directives of the Supervisor of Banks, positive or negative goodwill is amortized over a period of 10 years unless the Supervisor of Banks shall otherwise permit.

(5) The statement of changes in shareholders' equity includes the Bank's share in "translation adjustments" of autonomous units, held by companies included on the equity basis, namely as a foreign activity whose functional currency differs from the functional currency of the Bank.

(6) The Bank examines in each reporting period the necessity of recording impairment in companies included on equity basis - see U. below.

(7) The Bank has granted loans at preferential terms to a number of wholly-owned consolidated companies (mainly auxiliary companies). Amounts recorded in connection therewith in the capital reserves in the financial statements of these companies are included in the balance sheet of the Bank as part of the investment in them.

Note 1 - Significant Accounting Policies (cont'd)

F. Securities

(1) Securities are classified in three portfolios: 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, including on the basis of quotations by brokers and by the creators of the instruments.
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 is charged to the profit and loss statement as detailed in paragraph (2) below.
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) Impairment

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 the securities might be impaired. The criteria for determining if the impairment is not of a temporary nature are based on the following examinations:

F. Securities (cont'd)

- Intention and ability to hold the security until the forecasted recovery in full of the cost.
- The assets and collaterals backing up the security.
- The percentage of impairment from the cost of the security.
- Evaluation of repayment ability.
- A security which was sold before the publication of the report to the public.
- A security which the Bank intended to sell shortly before the publication of the report to the public.
- A debenture for which there was a significant decrease in the rating between the rating of the debenture at the date of acquisition by the banking corporation and the rating of the debenture at the date of publication of the report.
- A debenture which was classified as problematic by the banking corporation after its acquisition.
- A debenture in respect of which there was a credit failure which was not rectified within a short period of time.
- A security whose fair value was lower than the purchase value for a period of time of at least nine months before the end of the period of the financial statement, and at the end of the statement period as well as at a date shortly before publication of the report was lower by 35% or more than the cost (in the case of a debenture – the depreciated cost). In this matter an exception is possible if the Bank has concrete objective evidence and a conservative analysis of all the relevant factors, to show with a high degree of certainty that the impairment is of a temporary nature.

These principles are in accordance with the guideline issued by the Supervisor of Banks.

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)

G. Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

The Bank applies the circular of the Supervisor of Banks 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 other transfers. 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.

In view of the above, securities sold under conditions of repurchase in which the Bank did not lose control over the transferred asset are treated as secured debt: namely securities sold are not deducted from the balance sheet and are shown under "Securities", in accordance with the above-mentioned principles. As opposed to these, the deposit, for which those securities were pledged to ensure its repayment, is shown under "Securities lent or sold under agreements to repurchase".

In accordance with the directives of the Supervisor, securities lending transactions executed as "ordinary" credit transactions, in which the Bank lends securities against the collateral portfolio, and the borrower does not provide the banking corporation with a security margin relating specifically to the securities lending transaction, are shown as credit to the public according to market value and are added to the debt of the borrower. Changes in the value of the above securities on an accrual basis are shown in the profit and loss statement under income from credit to the public, and the adjustment to market value is shown under adjustments in respect of securities available for sale according to fair value.

Note 1 - Significant Accounting Policies (cont'd)

H. Buildings and equipment

(1) Recognition and measurement

Buildings and equipment are shown at cost plus direct costs of acquisition less accumulated depreciation and losses from impairment in value. Cost includes expenses which can be directly attributed to acquisition of the asset as well as an estimate of costs which will be incurred in respect of the commitment to dismantle and transfer the item and restore the site in which it was located.
When significant parts of the fixed property have a different life span they are dealt with as separate items of fixed property.
Buildings earmarked for sale are shown at the lower of cost or realizable value.
Profit or loss on the sale of fixed property is included under other income. Depreciation is calculated from the cost by the straight-line method according to estimated useful life. Estimates of useful life and residual value are reviewed periodically.

(2) Costs of software

Costs in connection with the development of computer software intended for internal use are recognized as an asset only if development costs can be measured reliably, the product can be implemented from a technical point of view, a future economic advantage is expected from the product and there are both an intention and resource to complete the development and use the product. Capitalized costs include direct costs and overhead expenses which can be attributed directly to the preparation of the software for its intended use. Other costs in respect of development costs are charged to profit and loss.
Capitalized development costs are measured in accordance with costs less accumulated depreciation and losses from impairment in value.

I. Issue expenses

Expenses of issue of debentures, bonds and subordinated notes are amortized in proportion to the balances outstanding each year.

Note 1 - Significant Accounting Policies (cont'd)

J. Basis of recognition of income and expenses

(1) Income and expenses are recognized on an 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 Ltd. are attributed to the profit and loss statement on an actual collection basis.

(4) Complementary interest received from the State Treasury, in respect of the difference in interest on loans to housing purchasers in Leumi Mortgage Bank Ltd., is attributed 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 used by the Bank in its current activity, taking into account the risks inherent in the instrument (market risk, etc). Changes in fair value of derivative instruments that are not intended for eligible 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 base interest rate in foreign currency – the Libor rate. As part of the Bank's comprehensive strategy for management of exposure to interest risk, the Bank makes use of foreign currency derivatives to exchange fixed interest for variable interest. The Bank utilizes designated eligible derivatives to hedge fair value.

The Bank carries out the following activities in the following types of derivatives: futures and option transactions on underlying assets of interest, currency, shares, commodities and others.

Activity in derivatives is carried out as follows:

(a) Derivatives designated for hedging relationships.
(b) As part of the Bank's system of management of assets and liabilities not designated for hedging relationships – asset and liability management.
(c) Brokerage transactions with responsibility between banks/brokers and customers.

Note 1 - Significant Accounting Policies (cont'd)

K. Derivative instruments and hedging activities (cont'd)

(3) The Bank may enter into a contract that is not in itself a derivative instrument but includes an embedded derivative. Regarding each contract, 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 and also that the combined instrument is not measured according to fair value through profit and loss, 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 and measured 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 risk management in creating the 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 its 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 is expected not to 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 profit or loss in the statement of profit and loss for the current period.

(6) The Bank designates certain derivatives as fair value hedges. 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 consolidated companies, of losses anticipated on credit granted, including indebtedness in off-balance sheet items.

A specific provision for doubtful debts is made in accordance with an examination of the business situation and evaluation of the ability of the borrower to continue operating and service his debt. Examining the need for calculation of the appropriate specific provision is based on the credit risk and information available on the debtor, such as: the condition of the business, the business environment, his loan repayment history and an assessment of the value of the collateral held by the Bank. Calculating the need for a provision is made on the basis of the cash flows and debt service ability of the borrower and with reference to the value of the collateral.

Specific provisions for housing loans granted by Leumi Mortgage Bank Ltd. are determined mainly as percentages of the debt according to the length of the period in arrears. These percentages have been determined by the Supervisor of Banks.

Specific and general provisions by foreign consolidated companies are made taking into consideration the practice in the countries in which they operate as agreed to by local regulatory authorities.

Note 1 - Significant Accounting Policies (cont'd)

L. Provision for doubtful debts (cont'd)

In addition, a "general provision" and a "supplementary provision" for doubtful debts are made by banking corporations 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 customer credit portfolio, according to various risk characteristics, and calculated as stipulated in the Directives of the Supervisor of Banks.

The accumulated amount of the supplementary and general provision in the consolidated balance sheet is 0.30% of the amount of risk of total credit to the public at balance sheet date (31 December 2007 – 0.29%, and 31 December 2006 - 0.37%).
Writing off 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.

M. 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. Decreases in value are charged to operating and other expenses.

N. Setting off financial instruments

Financial assets and liabilities are set-off when there exists a legally enforceable right and the intent to set-off at the dates of repayment of the amounts. In addition, deposits whose repayment to the depositor is conditional upon the amount collected from 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 this activity is included under "Operating Commissions".

Note 1 - Significant Accounting Policies (cont'd)

O. Contingent liabilities

Appropriate provisions have been made for claims which, in the opinion of Bank Management and the Managements of its consolidated companies, based on the opinions of legal counsel, will not be dismissed or canceled, notwithstanding the fact that such claims are refuted by the Bank.
In addition, legal proceedings exist whose chances cannot be estimated at this stage and therefore no provision was recorded in respect thereof.

In accordance with the Directives of the Supervisor of Banks, contingent legal claims are treated in accordance with American Accounting Standard FAS 5 and the regulations relating thereto. According to the directives, 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 have been made in the financial statements for claims whose realization is probable.

In Note 18 details are shown of the amount of the additional exposure in respect of contingent claims whose amount exceeds NIS 2 million and whose realization is not remote, as well as a description of material legal proceedings against the Bank and the consolidated companies.

P. Employees' rights

(1) There are appropriate reserves for 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 calculated by a qualified actuary, by the accrued benefit valuation method taking into account probabilities based on past experience. The capitalization rate of the reserves is determined by the Supervisor of Banks and the rate of increase in salary in the future is estimated by Management.
Regarding application of updated directives determined by the Commissioner of the Capital Market, Insurance and Savings with respect to mortality rates – see Note 15(B), below.

(2) Amounts funded in respect of severance pay are deposited in provident funds.

(3) Share-based payment transactions
Share-based payment transactions include transactions with employees that were settled with equity instruments. The fair value at the date option and share warrants were granted to employees is attributed to salary expenses concurrently with an increase in capital over the course of the period during which the employees' entitlement to option and share warrants is attained. The amount attributed as an expense is adjusted in order to show option-warrants for shares which are expected to become vested. Fair value is determined by using an acceptable costing model.

For further details on employees' rights - see Note 15.

Note 1 - Significant Accounting Policies (cont'd)

Q. Taxes on income

Taxes on income in the statement of profit and loss include current taxes and deferred taxes. Tax expenses in respect of current or deferred taxes are charged to the statement of profit and loss, except if they refer to items charged directly to equity. In these cases the effect of the tax is also charged to the item referring to equity.

The liability for current taxes is determined by using tax rates and tax laws that were passed or whose legislation has effectively been completed by the balance sheet date, as well as adjustments required in connection with the liability to pay tax for previous years.

Deferred taxes are calculated in respect of temporary differences between amounts included in the financial statements and the amounts taken into account for tax purposes, except for a small number of exceptions and in accordance with the directives of the Supervisor of Banks. Deferred taxes relating to items charged directly to equity are also charged to the items referring to equity.

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

- Amounts of adjustment to changes in the purchasing power of the new Shekel, referring mainly to buildings, according to the principles determined by the Israel Accounting Standard Board in Standard 19, see Note 26G.

- 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 investee companies which the Bank intends to hold and not to sell them.

- A deferred tax asset in respect of temporary differences where the possibility of realization of the asset is in doubt.

Deferred taxes are calculated according to the tax rates expected to be in force at the time of utilization or realization of the assets, on the basis of tax rates which have been legislated or whose legislation has effectively been completed by the balance sheet date.

Note 1 - Significant Accounting Policies (cont'd)

R. 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 calculation 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 calculation 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.

S. Statement of cash flows

In the above statement are shown the net 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 banks and other banks for an original period not exceeding three months.

T. Impairment in value of non-monetary assets

The Bank examines the necessity of recording a provision for the impairment of non-monetary assets (such as: buildings and equipment, investments in companies included on equity basis, intangible assets including goodwill) when there are signs resulting from events or changes in circumstances, which indicate that its assets in the balance sheet are shown at an amount which is in excess of their recoverable value. The recoverable value is the higher of the net selling price and the value-in-use. The value-in-use is the present value of the estimated future cash flows expected to be derived from use and realization of the asset.

When the value of the asset 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, except for impairment of value of goodwill which is not cancelled.

U. Comparative figures

Reclassified comparative figures have been indicated in the financial statements.

Note 1 - Significant Accounting Policies (cont'd)

V. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and evaluations that affect the reported amounts of assets and liabilities, the disclosure relating to contingent assets and liabilities and the amounts of income and expenses during the reporting period. It should be made clear that actual results may differ from such estimates.

W. Disclosure of effect of new Accounting Standards and Directives of the Supervisor of Banks in the period prior to their implementation

(1) 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 – the "Standard"). The Standard prescribes that entities that are subject to the Securities Law, 1968, and are required to report according to the regulations of this law, shall prepare their financial statements in accordance with IFRS for periods commencing 1 January 2008. 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 in which the Standard is to be adopted by banking corporations, the Supervisor of Banks has notified the banks as follows:

a. He intends to determine, 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 banking business.

b. In the second half of 2009 he will publish his decision regarding the date of adopting IFRS related to the core banking business. He will do this taking into account the results of the adoption of these standards in Israel on the one hand, and the progress made in the convergence process between IFRS standards and the American standards on the other hand.

Therefore, with respect to the core 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 on the basis of the American standards provided in the directives dealing with reporting to the public.

Two companies included on the equity basis implemented the Standard from January 2008.

Note 1 - Significant Accounting Policies (cont'd)

W. Disclosure of effect of new Accounting Standards and Directives of the Supervisor of Banks in the period prior to their implementation (cont'd)

(2) 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” ("Standard 23"). Standard 23 effectively replaces the main provisions of the Securities Regulations (Presentation of Transactions between a Company and its Controlling Shareholder in the Financial Statements), 1996, as adopted in the directives dealing with reporting to the public of the Supervisor of Banks. 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 recorded from the transaction shall be included in shareholders’ equity. A debit difference effectively constitutes a dividend and accordingly reduces the retained earnings. A credit difference effectively constitutes an investment by 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 alternatively, the transfer of an asset from the entity to the controlling shareholder; the assumption by the controlling shareholder of all or part of a liability of the entity to a third party, indemnification of the entity by the controlling shareholder in respect of an expense, and the waiving by the controlling shareholder of all or part of the entity’s debt to it; and loans that were granted to the controlling shareholder or loans that were received from the controlling shareholder. Standard 23 also determines the disclosure that is to be made in the financial statements regarding transactions between the entity and its controlling shareholder during the period.

In a letter from the Supervisor of Banks it is indicated that he is re-examining the rules to be applied to banking corporations and credit card companies with respect to the handling of transactions between an entity and its controlling shareholder. As at the date of publication of this Report, the Supervisor of Banks has not yet been published a final directive regarding the adoption of specific rules on this subject and on the manner of their initial implementation.

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

On 31 December 2007, the Banking Supervision Department published a circular to the banking corporations amending the directives regarding reporting to the public, 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 (FAS Standards 114 and 118), US banking regulatory provisions, and the directives of the SEC dealing with banks. It also matches the reports made by banks in the U.S. The provisions included in the circular constitute a significant 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.

The main changes included in the directive are:

a. New categories of problem loans are set out, which are defined as impaired debts, including:

- credit in respect of which the banking corporation cannot collect the entire amount due, according to the contractual terms of the loan agreement,
- a problem loan whose terms have been modified within the framework of a restructuring,
- a loan whose principal or interest has been in arrears for 90 days or more, unless such is well secured and also in the process of collection proceedings,
- a loan in a debitory or current account where the customer's account has been charged with additional excess interest and a special handling commission for a debitory or current account which has deviated from a credit line (as described in section 4(c) of Proper Banking Management Directive No. 325).
- further, credit which is insufficiently protected by the present established value and the debtor's ability to pay or by the pledged collateral, and regarding which there is a clear possibility that the banking corporation will suffer some loss if the deficiencies are not remedied, is defined as an inferior credit risk.

b. Banking corporations are required to maintain a provision for credit losses at a level which is sufficient to cover the expected credit losses relating to the banking corporation's credit portfolio, including for off-balance sheet credit risk.

The provisions for credit losses will include:

- A specific provision for credit losses for each debt whose contractual balance is above NIS 1.0 million or more, and any other debt identified for specific consideration by the banking corporation.

Note 1 - Significant Accounting Policies (cont'd)

W. Disclosure of Effect of New Accounting Standards and Directives of the Supervisor of Banks in the Period Prior to their Implementation: (cont'd)

(3) Measurement and Disclosure of Impaired Debts, Credit Risk and Provisions for Credit Losses (cont'd)

The provision will be based on the measurement of the debt's reduced value, based on the present value of the expected cash flows, discounted at the debt's effective interest rate; or where a debt is dependent on collateral or where the seizure of a property is anticipated, based on the fair value of the collateral pledged to secure such credit.

- Group provisions for credit losses – for large groups of relatively small and homogeneous debts, the fall in value of which is examined on a group basis, and for debts that have been separately examined and found not to be impaired.

  Measurement of credit losses will be carried out based on past credit loss rates for each homogeneous group. The determination of the estimates of credit losses is to be documented.

c. No interest income is to be recorded for impaired debts (this does not relate to increments for CPI linkage or foreign currency linkage which are added to the principal).

d. A change regarding the requirements for writing off debts:
   - Any part of a debt whose collection is dependent on collateral, which exceeds the collateral's fair value and is identified as uncollectible, is to be written off immediately in the accounts.
   - Generally, specific provisions are to be written off after two years.
   - Group provisions for credit losses - debts that are in arrears for over 150 days are to be written off.

e. The qualitative and quantitative disclosure requirements for financial statements with respect to problem loans have been expanded.

f. Detailed requirements have been laid down for preparing guidelines to ensure a methodical process for establishing the provisions for credit losses, which are to be consistently applied, for documentation required to support the credit process and for internal controls for the methods and processes that are established.

g. The directive will be implemented in the financial statements as from 1 January 2010. The directive will not be implemented retroactively in the financial statements for previous periods. Transitional adjustments arising from the adoption of the directive as of 1 January 2010 will be included directly in the retained earnings item in shareholders' equity. At the time of the first implementation, the following, *inter alia,* will be required:

Note 1 - Significant Accounting Policies (cont'd)

W. Disclosure of Effect of New Accounting Standards and Directives of the Supervisor of Banks in the Period Prior to their Implementation: (cont'd)

(3) Measurement and Disclosure of Impaired Debts, Credit Risk and Provisions for Credit Losses (cont'd)

- To write off in the accounts, any debt which at that date meets the conditions for being written off in the accounts.

- To classify as requiring special supervision, inferior or impaired, any debt that meets the conditions for such classification.

- To cancel all interest income which has accumulated but not been paid for any debt which at that date meets the relevant conditions.

- To examine the need for adjusting the balance for current taxes and deferred taxes to be received or paid.

A steering committee has been appointed as part of the Bank's preparations for the implementation of the above directive. The committee's members include representatives of the business divisions, and the accounting and computerization functions. Sub-committees have been set up to deal with the establishment of work methods and with the directive's requirements.

The preparations for the modification of the computer systems have begun, since material changes in the information systems are required in order to carry out the required processes.

As of the date of the publication of this Report, the design of the main component of the computerization process for managing and documenting credit losses has been completed. Writing work procedures has begun for classification of impaired debts in accordance with the new rules, and for preparing training and study programs in anticipation of 2009.
The Supervisor of Banks has not yet decided whether if, upon the directive's implementation, there will still be a requirement to make a 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 banks' existing general provision. The total general and additional provisions as at 31 December 2008 amounted to NIS 948 million, of which the Bank - NIS 661 million.

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.

Note 2 - Cash and Deposits with Banks

Reported Amounts

	31 December 2008	31 December 2007
	NIS millions	
Cash and deposits with central banks	**19,253**	8,181
Deposits with commercial banks	**13,436**	33,662
Deposits with specialized banking entities	**441**	486
Total	**33,130**	42,329
Including: Cash and deposits with central and commercial banks for original periods not exceeding three months	**31,005**	34,824

Note 3 - Securities
Reported Amounts

	31 December 2008					31 December 2007				
	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	**880**	**880**	**18**	**-**	**898**	904	904	22	(1)	925
Foreign governments	**558**	**558**	**12**	**(1)**	**569**	551	551	-	-	551
Other companies	**8**	**8**	**-**	**-**	**8**	126	126	-	(3)	123
Total debentures held to maturity	**1,446**	**1,446**	**30**	**(1)**	**1,475**	1,581	1,581	22	(4)	1,599

	31 December 2008					31 December 2007				
	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	**10,063**	**9,629**	**457**	**(23)**	**10,063**	8,875	8,855	91	(71)	8,875
Foreign governments	**336**	**327**	**9**	**-**	**336**	1,228	1,227	7	(6)	1,228
Other companies	**18,991**	**20,855**	**36**	**(1,900)**	**18,991**	22,989	23,376	43	(430)	22,989
	29,390	**30,811**	**502**	**(1,923)**	**29,390**	33,092	33,458	141	(507)	33,092
Shares of other companies and mutual funds (b) (c)	**3,219**	**2,790**	**430**	**(1)**	**3,219**	4,436	3,275	1,195	(34)	4,436
Total securities available for sale	**32,609**	**33,601**	**(c) 932**	**(c) (1,924)**	**32,609**	37,528	36,733	(c) 1,336	(c) (541)	37,528

See footnotes on next page.

Note 3 - Securities (cont'd)
Reported Amounts

	31 December 2008					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)**	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	**5,554**	**5,465**	**117**	**(28)**	**5,554**	5,014	4,992	35	(13)	5,014
Foreign governments	**3,707**	**3,674**	**44**	**(11)**	**3,707**	194	194	-	-	194
Other companies	**1,489**	**1,639**	**7**	**(157)**	**1,489**	1,933	1,924	34	(25)	1,933
	10,750	**10,778**	**168**	**(196)**	**10,750**	7,141	7,110	69	(38)	7,141
Shares of other companies and mutual funds	**105**	**457**	**-**	**(352)**	**105**	919	918	28	(27)	919
Total securities held for trading	**10,855**	**11,235**	**(d) 168**	**(d) (548)**	**10,855**	8,060	8,028	(e) 97	(e) (65)	8,060
Total securities	**44,910**	**46,282**	**1,130**	**(2,473)**	**44,939**	47,169	46,342	1,455	(610)	47,187

(a) With regard to fair value data, see Note 1(F)(1) – Significant Accounting Policies. Such quotations do not necessarily reflect the price which will be obtained upon sale of securities in large volumes.

(b) Including NIS 1,263 million with respect to shares which have no readily available fair value, which are presented at cost or as quoted by a counterparty (31 December 2007 - NIS 972 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. Also includes holding in Migdal Holdings Insurance and Finance Ltd., see Note 6 below.

(c) Regarding securities available for sale, total other income – unrealized profits (losses) are included in shareholders' equity in the item "adjustments in respect of presentation of securities available for sale according to fair value", except securities intended as hedging instruments for hedging fair value.

(d) Reported in the profit and loss statement but not yet realized.

Note: For liens – see Note 14. For details of results of investment activities in debentures – see Note 20(e). For details of results of investment activities in shares and in mutual funds – see Note 22.

Note 3 - Securities (cont'd)
Reported Amounts

	31 December 2008					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	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
	NIS millions									
4. Additional details of Asset-backed securities available for sale										
Mortgage-backed securities (MBS):										
Pass-through securities:										
Securities guaranteed by GNMA	**84**	**87**	**-**	**(3)**	**84**	119	119	-	-	119
Securities issued by FNMA and FHLMC	**1,211**	**1,226**	**10**	**(25)**	**1,211**	1,563	1,587	1	(25)	1,563
Securities issued by others	**10**	**10**	**-**	**-**	**10**	114	116	-	(2)	114
Total	**1,305**	**1,323**	**10**	**(28)**	**1,305**	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	**1,939**	**1,987**	**5**	**(53)**	**1,939**	2,324	2,343	2	(21)	2,324
Other mortgage-backed securities	**64**	**67**	**-**	**(3)**	**64**	32	34	-	(2)	32
Total	**2,003**	**2,054**	**5**	**(56)**	**2,003**	2,356	2,377	2	(23)	2,356
Total mortgage-backed securities	**3,308**	**3,377**	**15**	**(84)**	**3,308**	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	**6**	**8**	**-**	**(2)**	**6**	11	11	-	-	11
Credit for purchase of vehicle	**24**	**27**	**-**	**(3)**	**24**	175	176	-	(1)	175
Other credit to private persons	**10**	**10**	**-**	**-**	**10**	82	82	-	-	82
Credit not to private persons	**-**	**-**	**-**	**-**	**-**	1	1	-	-	1
CLO debentures	**690**	**790**	**-**	**(100)**	**690**	1,226	1,287	-	(61)	1,226
CDO debentures	**26**	**27**	**-**	**(1)**	**26**	-	-	-	-	-
SCDO debentures	**112**	**122**	**-**	**(10)**	**112**	430	491	5	(66)	430
Others	**35**	**36**	**-**	**(1)**	**35**	45	44	1	-	45
Total	**903**	**1,020**	**-**	**(117)**	**903**	2,118	2,241	6	(129)	2,118
Total Asset-backed securities available for sale	**4,211**	**4,397**	**15**	**(201)**	**4,211**	6,270	6,440	9	(179)	6,270

Note 3 - Securities (cont'd)
Reported Amounts

	31 December 2008				
	Amount in balance Sheet	Amortized Cost	Unrealized profits from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair value
	NIS millions				
5. Debentures for trading					
Pass-through securities:					
Securities issued by FNMA and FHLMC	3	3	-	-	3
Total	3	3	-	-	3
Other Mortgage-backed securities (including CMO and STRIPPED MBS)					
Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	55	54	1	-	55
Other mortgage-backed securities	111	150	-	(39)	111
Total	166	204	1	(39)	166
Asset-backed securities (ABS):					
Lines of credit for any purpose secured by dwelling	16	22	-	(6)	16
Credit for purchase of vehicle	6	6	-	-	6
Credit not to private persons	10	12	-	(2)	10
CLO debentures	3	7	-	(4)	3
Others	3	3	-	-	3
Total	38	50	-	(12)	38
Total Asset-backed securities for trading	207	257	-	(51)	207

a. 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.

b. 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.

5. The redemption portfolio includes a security issued by the FHLMC in the amount of about NIS 8 million.

Note 3 - Securities (cont'd)
Reported Amounts

	31 December 2008						31 December 2007					
	Less than 12 months		More than 12 months		Total		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	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											
7. Additional details of asset-backed securities available for sale which include unrealized losses from adjustments to fair value												
Pass-through (MBS)	**321**	**(8)**	**425**	**(20)**	**746**	**(28)**	248	(2)	1,178	(25)	1,426	(27)
Other Mortgage-Backed Securities (including REMIC, CMO and STRIPPED MBS)	**246**	**(4)**	**1,171**	**(52)**	**1,417**	**(56)**	1,239	(13)	775	(10)	2,014	(23)
Asset-backed securities (ABS)	**119**	**(14)**	**398**	**(103)**	**517**	**(117)**	1,395	(111)	497	(18)	1,892	(129)
Total	**686**	**(26)**	**1,994**	**(175)**	**2,680**	**(201)**	2,882	(126)	2,450	(53)	5,332	(179)

Note 3 - Securities (cont'd)

Definitions

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 Obligation – 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).

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

Credit Default Swap – CDS
A financial instrument which transfers 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 2008	31 December 2007
	NIS millions	
Credit	**213,490**	198,368
Customers' liabilities for acceptances	**554**	947
Total credit (a)	**214,044**	199,315
Supplementary, general and special provisions for doubtful debts (b)	**(829)**	(758)
Total	**213,215**	198,557

(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".

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 2008 was NIS 374 million (31 December 2007 – NIS 404 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 that are not local authorities or housing loans (b):

	31 December 2008	31 December 2007
	NIS millions	
a) Non-accrual loans to problematic borrowers		
In unlinked Israeli currency	**1,163**	1,006
In CPI linked Israeli currency	**168**	158
In foreign currency (a)	**675**	425
b) Restructured credit:		
(1) Loans restructured in prior years with waiver of income		
In CPI linked Israeli currency	**56**	80
In foreign currency (a)	**2**	493
(2) Loans restructured during current year without waiver of income		
In unlinked Israeli currency	**109**	137
In CPI linked Israeli currency	**172**	165
In foreign currency (a)	**66**	54
c) Credit approved for restructuring by Bank Management not yet executed		
Balance as at balance sheet date	**558**	85
d) Credit in temporary arrears		
Balance as at balance sheet date	**155**	(c) 361
Related interest income included in the statement of profit and loss	**2**	3
e) Credit under special supervision		
Balance as at balance sheet date	**13,900**	(c) 8,968
f) Credit repaid during the current year by foreclosure on assets	**73**	8

(a) Including linked to foreign currency.

(b) Problematic housing loans for which the provision is made according to the length of the arrears is shown in Note 4D.

(c) Reclassified.

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 2008	31 December 2007
	NIS millions	
Composition of credit to local authorities (a)		
Balance as at balance sheet date	**3,214**	(b) 3,294
Credit to local authorities includes:		
(a) Non-accrual loans to problematic borrowers		
In unlinked Israeli currency	**4**	6
In CPI linked Israeli currency	**2**	9
(c) Credit under special supervision		
Balance as at balance sheet date	**140**	127
(c) Credit to local authorities not included in the above problematic borrowers		
Balance as at balance sheet date	**3,068**	(b) 3,152
Related income included in the statement of profit and loss	**314**	265

(a) Including conurbations and corporations controlled by local authorities.

(b) Reclassified.

Note 4 - Credit to the Public (cont'd)

Reported amounts

C. Provision for doubtful debts

	2008				2007				2006			
	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	**7,250**	**688**	**875**	**8,813**	7,580	675	1,024	9,279	7.803	409	1,040	9,252
Classification of opening balance in subsidiary and acquisition of subsidiary	**-**	**-**	**-**	**-**	-	-	-	-	(113)	116	5	8
Provisions during the year	**2,463**	**317**	**121**	**2,901**	1,218	218	-	1,436	1,375	349	32	1,756
Decrease in provisions	**(459)**	**(220)**	**(48)**	**(727)**	(679)	(168)	(149)	(996)	(557)	(158)	(53)	(768)
Collection of past years' write-offs	**(29)**	**-**	**-**	**(29)**	(33)	-	-	(33)	(55)	-	-	(55)
Net addition charged to statement of profit and loss	**1,975**	**97**	**73**	**2,145**	506	50	(149)	407	763	191	(21)	933
Write-offs	**(979)**	**(110)**	**-**	**(1,089)**	(836)	(37)	-	(873)	(873)	(41)	-	(914)
Balance at end of year	**8,246**	**675**	**948**	**9,869**	7,250	688	875	8,813	7,580	675	1,024	9,279
Including balance of provision not deducted from credit to the public	**233**	**-**	**119**	**352**	247	-	117	364	236	-	128	364

(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 699 million (31 December 2007 - NIS 694 million; 31 December 2006 – NIS 710 million). Including a special provision of NIS 2 million.

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, 2008						
Overdue amount	**13**	**23**	**34**	**337**	**102**	**509**
Of which: interest on Overdue amount	**-**	**1**	**2**	**154**	**1**	**158**
Balance of provision for doubtful debts according to period of arrears (a)	**-**	**55**	**105**	**349**	**166**	**675**
Balance of loans less Provision	**407**	**269**	**82**	**104**	**50**	**912**
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

(a) Not including provision in respect of interest on overdue amount.

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 2008						31 December 2007					
	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	**28,338**	**659**	**282**	**470**	**-**	**470**	26,712	686	342	483	-	483
"Large" loans (a)	**6,796**	**140**	**184**	**156**	**-**	**156**	4,795	142	218	158	-	158
Other loans (c)	**6,925**	**210**	**43**	**49**	**8**	**57**	5,672	192	28	47	5	52
Total	**42,059**	**1,009**	**509**	**675**	**8**	**683**	37,179	1,020	588	688	5	693

(a) Housing loans of which each balance exceeds NIS 841 thousand (31 December 2007 – NIS 804 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 residential mortgage, of which each balance is less than NIS 841 thousand (31 December 2007 – NIS 804 thousand).
(d) Including balance of specific provision in excess of amount required according to depth of arrears in the amount of NIS 132 million (31 December 2007 – NIS 135 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 2008		
From	To	Number of borrowers (c)	Credit(a)	Off balance - sheet credit risk (b)
			NIS millions	
0	10	**694,741**	**833**	**1,339**
10	20	**270,579**	**1,542**	**2,310**
20	40	**283,761**	**3,589**	**4,469**
40	80	**249,648**	**6,751**	**7,366**
80	150	**130,741**	**8,216**	**5,824**
150	300	**79,989**	**13,644**	**3,240**
300	600	**51,148**	**19,145**	**2,168**
600	1,200	**19,988**	**13,931**	**2,457**
1,200	2,000	**5,399**	**6,848**	**1,378**
2,000	4,000	**3,973**	**9,046**	**2,204**
4,000	8,000	**2,504**	**10,598**	**3,147**
8,000	20,000	**1,943**	**18,093**	**6,012**
20,000	40,000	**808**	**17,638**	**4,477**
40,000	200,000	**805**	**37,620**	**21,236**
200,000	400,000	**90**	**16,397**	**8,711**
400,000	800,000	**41**	**17,080**	**6,016**
800,000	1,200,000	**8**	**5,051**	**2,666**
1,200,000	1,600,000	**5**	**4,096**	**2,246**
1,600,000	2,000,000	**4**	**3,788**	**3,271**
2,000,000	2,400,000	**1**	**1,876**	**436**
2,400,000	2,800,000	**1**	**1**	**2,677**
2,800,000	2,857,000	**1**	**2,857**	**-**
		1,796,178	**218,640**	**93,650**

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 4,596 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 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	(d) 3,102
300	600	48,799	18,112	(d) 2,127
600	1,200	16,739	11,643	(d) 2,129
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	90,550

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 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.
(d) Reclassified.

Note 5 - Credit to Governments

Reported amounts

	31 December 2008	31 December 2007
	NIS millions	
Credit to the government	**256**	250
Credit to foreign governments	**264**	392
Total credit to governments	**520**	642

Note 6 - Investments in Companies Included on Equity Basis

Reported amounts

A. Composition:

	31 December 2008	31 December 2007
	Companies included on equity basis	Companies included on equity basis
	NIS millions	
Total investments in shares stated on equity basis (including other assets)	**1,834**	1,858
Including shareholders' loans	**8**	15
Total investments	**1,842**	1,873
Including - post-acquisition profits	**894**	661
Post-acquisition changes in shareholders' equity:		
Translation differences	**(121)**	(64)
Details regarding goodwill and other assets:		
Amortization period	**10-20 years**	10-20 years
Original amount, net	**310**	310
Unamortized balance	**225**	248

	31 December 2008		31 December 2007	
	Book value	**Market value**	Book value	Market value
	NIS millions			
Details on book value and market value of quoted securities:				
The Israel Corporation Ltd.	**1,186**	**1,184**	1,138	5,613
Paz Oil Company Ltd	**485**	**571**	560	920
Total	**1,671**	**1,755**	1,698	6,533

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

	2008	2007	2006
	NIS millions		
Group's equity in operating profit of companies included on equity basis	**260**	205	187
Provision for deferred taxes	**(11)**	(21)	(16)
Group's equity in after-tax operating profits of companies included on equity basis	**249**	184	171

C. Details regarding sale of investee companies

1. Sale of real holding corporations (companies included on equity basis)

a. Holdings in Real (Non-banking) Holding Corporations (Conglomerates)

The Bank's holdings in real (non-banking) corporations are subject to restrictions prescribed in the Banking (Licensing) Law, 1981 (the "Banking Law"). The Banking Law prescribes, *inter alia*, in section 24A of the Law, that a banking corporation may hold a means of control in one conglomerate only (a "real (non-banking) holding corporation") (a corporation whose capital exceeds some NIS 1,901 million and that operates in more than three branches of the economy). The Bank holds 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 Paz's shareholders' equity exceeds the minimal amount of capital for the definition of a conglomerate (a real (non-banking) holding corporation).

Prior to the publication of the aforesaid financial statements, discussions had already been held between the Bank and the Bank of Israel with regard to the interpretation of the Banking Law with respect 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 pursuant to the Banking Law.

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

1. Sale of real holding corporations (companies included on equity basis) (cont'd)

a. Holdings in Real (Non-banking) Holding Corporations (Conglomerates)

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 by 30 June 2009. Following discussions in August 2007 regarding the Bank's holdings in real (non-banking) holding companies, and in light of the Bank of Israel's position (and subject to the course of the discussions still underway with the Bank of Israel in this regard, whereby the Bank disagrees with the Bank of Israel's position), the Bank intends to attempt to sell its holdings in Paz (15.73% of the share capital and voting rights – 15.31% on a fully-diluted basis); this being subject to the conditions, 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 timetable or in the position of the Bank of Israel by then.

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).

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.
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.

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

1. Sale of real holding corporations (companies included on equity basis) (cont'd)

a. (cont'd)

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, The Bank holds 9.85% of the issued and paid-up share capital of Migdal Financial and Insurance Holdings Ltd. ("Migdal Holdings"), (9.74% fully diluted), which controls the Migdal Insurance Company Ltd.

Pursuant to the Bank of Israel's interpretation of the Banking (Licensing) Law (an interpretation with which the Bank disagrees), the Bank must also sell its holdings in Migdal Holdings, since, according to the said law, it is considered a "real (non-banking) holding corporation."

It is noted that, pursuant to the legislation enacted following the capital market reform, the Bank may hold five percent of the capital of an insurance company, and ten percent of the capital of a corporation controlling an insurance company.

On 25 December 2008, the Bank of Israel extended the permit issued to the Bank for the holding of Migdal shares until 30 August 2009, provided that the shares are transferred to a trustee. The shares were transferred to a trustee on 4 January 2009. Pursuant to the Bank of Israel directives, if the shares held by the trustee are not sold by 30 April 2009, the trustee will sell the shares to a third party by no later than 30 August 2009. The trustee was vested all rights that the shares confer (excluding the rights vested with the Bank – the right to sell the shares to a third party or the right to distribute them as a dividend in-kind up until 30 April 2009, and the right to receive dividends).

On 19 March 2009, the Banking (Licensing) Law memorandum was distributed, pursuant to which the Ministry of Finance, with the consent of the Bank of Israel, is proposing to exclude insurance companies from the definition of a conglomerate. The Bank is holding discussions with the Bank of Israel regarding the effect of the said memorandum on the holding of the Bank in the shares of Migdal Holdings.

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

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

1. (cont'd)

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.

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, Signon (Maslulit), Central Severance Pay Fund, Illness Fund and Nidbachim provident funds, which were managed by Leumi Gemel Ltd. The consideration received amounted to NIS 418 million and the net gain amounted to about NIS 257 million.

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, was 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.

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

Reported amounts

D. Details concerning principal investee companies

(1) Consolidated 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 2008	31 December		31 December		31 December	
		2008	2007	**2008**	2007	**2008**	2007
		%	%	**%**	%	NIS millions	
In Israel							
Arab-Israel Bank Ltd.	General banking services	**99.7**	99.7	**99.7**	99.7	**334**	324
Leumi Mortgage Bank Ltd.	Provision of housing loans	**100.0**	100.0	**100.0**	100.0	**2,142**	2,015
Leumi Agricultural Development Ltd.		**100.0**	100.0	**100.0**	100.0	**59**	59
Leumi Industrial Development Ltd.		**99.6**	99.6	**99.8**	99.8	**104**	105
Leumi Partners Ltd. (c)	Business and financial services	**100.0**	100.0	**100.0**	100.0	**264**	431
Leumi Leasing and Investments Ltd. (d)	Equipment leasing and granting loans	**99.5**	99.5	**99.7**	99.7	**823**	811
Leumi Finance Company Ltd.	Raising capital by bond issues	**100.0**	100.0	**100.0**	100.0	**156**	154
Leumi Card Ltd.	Provision of credit card services	**80.0**	100.0	**80.0**	100.0	**(k) 557**	190
Leumi Securities and Investments Ltd. (e)		**100.0**	100.0	**100.0**	100.0	**45**	42
Leumi Capital Market Services Ltd. (f)	Operating services to provident funds	**100.0**	100.0	**100.0**	100.0	**23**	26
Leumi Financial Holdings Ltd.	Financial holdings	**100.0**	100.0	**100.0**	100.0	**421**	*411

See footnotes on page 325.

Note 6 - Investments in Companies Included On Equity Basis (cont'd)

Reported amounts

D. Details concerning principal investee companies (cont'd)

(1) Consolidated 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	
	2008	2007	**2008**	2007	**2008**	2007	**2008**	2007	**2008**	2007	**2008**	2007
	NIS millions		NIS millions		NIS millions		NIS millions		NIS millions		NIS millions	
In Israel												
Arab-Israel Bank Ltd.	**100**	-	**73**	88	**-**	-	**80**	90	**17**	3	**-**	-
Leumi Mortgage Bank Ltd.	**55**	68	**126**	219	**-**	-	**-**	-	**1**	6	**-**	5
Leumi Agricultural Development Ltd.	**-**	-	**1**	2	**-**	(1)	**2**	4	**-**	-	**-**	-
Leumi Industrial Development Ltd.	**-**	-	**2**	4	**-**	-	**3**	2	**-**	-	**-**	-
Leumi and Co. Investment House Ltd. (c)	**722**	722	**(46)**	128	**-**	-	**-**	-	**(121)**	92	**22**	21
Leumi Leasing and Investments Ltd. (d)	**-**	-	**48**	43	**-**	-	**-**	-	**(36)**	3	**-**	-
Leumi Finance Company Ltd.	**-**	-	**11**	10	**-**	-	**10**	8	**1**	(5)	**-**	-
Leumi Card Ltd.	**-**	* -	**116**	104	**-**	-	**-**	-	**-**	-	**4**	4
Leumi Securities and Investments Ltd. (e)	**-**	-	**3**	12	**-**	-	**-**	792	**-**	-	**-**	-
Leumi Capital Market Services Ltd. (f)	**-**	-	**(3)**	20	**-**	259	**-**	638	**-**	-	**-**	-
Leumi Financial Holdings Ltd.	**-**	-	**10**	6	**-**	-	**-**	361	**-**	-	**-**	-

See footnotes on page 325.

Note 6 - Investments in Companies Included On Equity Basis (cont'd)

Reported amounts

D. Details concerning principal investee companies (cont'd)

(1) Consolidated 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 2008	31 December		31 December		31 December	
		2008	2007	**2008**	2007	**2008**	2007
		%	%	**%**	%	NIS millions	
Abroad							
Bank Leumi le-Israel Corporation	Holding company - registered in the U.S.	**100.0**	100.0	**100.0**	100.0	**561**	558
Bank Leumi USA (g)	General banking services - registered in the U.S.	**99.9**	99.9	**99.9**	99.9	**1,776**	1,766
Bank Leumi (UK) plc	General banking services - registered in Great Britain	**99.8**	99.7	**99.7**	99.7	**545**	741
Bank Leumi le-Israel (Switzerland) (h)	General banking services - registered in Switzerland	**84.1**	84.1	**93.9**	93.9	**544**	523
Leumi Re Ltd.	Insurance	**100.0**	100.0	**100.0**	100.0	**75**	106
Bank Leumi (Luxembourg) SA	General banking services - registered in Luxembourg	**100.0**	100.0	**100.0**	100.0	**(2)**	112
Bank Leumi Romania (i)	General banking services - registered in Rumania	**99.9**	99.9	**99.9**	99.8	**438**	441
Leumi Finance Corporation (j)		**99.9**	99.9	**99.9**	99.9	**5,170**	5,084
Leumi USA Investment Corporation (i)		**99.9**	99.9	**99.9**	99.9	**3,336**	3,354

See footnotes on page 325.

Note 6 - Investments in Companies Included On Equity Basis (cont'd)

Reported amounts

D. Details concerning principal investee companies (cont'd)

(1) Consolidated 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	
	2008	2007	**2008**	2007	**2008**	2007	**2008**	2007	**2008**	2007	**2008**	2007
	NIS millions		NIS millions		NIS millions		NIS millions		NIS millions		NIS millions	
Abroad												
Bank Leumi le-Israel Corporation	**-**	-	**3**	(36)	**-**	-	**-**	-	**(1)**	(1)	**-**	-
Bank Leumi USA (g)	**-**	-	**29**	(6)	**-**	-	**-**	-	**(19)**	56	**60**	126
Bank Leumi (UK) plc	**404**	331	**(243)**	45	**-**	-	**-**	45	**(23)**	(9)	**29**	-
Bank Leumi le-Israel (Switzerland) (h)	**179**	* 172	**25**	9	**-**	-	**-**	171	**(4)**	(1)	**-**	-
Leumi Re Ltd.	**-**	-	**3**	31	**-**	-	**34**	22	**-**	-	**-**	-
Bank Leumi (Luxembourg) SA	**26**	26	**(64)**	18	**-**	-	**-**	11	**(50)**	(17)	**-**	-
Bank Leumi Romania (i)	**-**	-	**(53)**	(32)	**(1)**	3	**-**	-	**(2)**	-	**-**	-
Leumi Finance Corporation (j)	**-**	-	**82**	(250)	**-**	-	**-**	-	**-**	-	**-**	-
Leumi USA Investment Corporation (j)	**-**	-	**91**	(186)	**-**	-	**-**	-	**-**	-	**-**	-

See footnotes on next page.

Note 6 - Investments in Companies Included On Equity Basis (cont'd)

D. Details concerning principal investee companies (cont'd)

(1) Consolidated subsidiaries (a) (cont'd)

Footnotes:

(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) Formerly Leumi & Co. Investment House Ltd. The Bank's share in the capital reserve in respect of the benefit inherent in controlling shareholders' loans is NIS 40 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.

(f) Formerly Leumi Gemel Ltd.

(g) Investment in the company by Bank Leumi le-Israel Corporation.

(h) In 2008, the Bank acquired approximately 1.06% of the share capital of Bank Leumi le-Israel (Switzerland) (2007 – 2.2%). The investment includes a balance of goodwill, in the amount of NIS 35.2 million in 2008 (2007 – NIS 40 million).

(i) In 2008 the Bank purchased 2.15% of the equity of Bank Leumi Romania (in 2007 – 0.16%). In 2008 Bank Leumi Romania issued shares to its shareholders. The investment includes a balance of goodwill, in the amount of NIS 86.1 million (31 December 2007 – NIS 97.5 million).

(j) Property companies established by Bank Leumi U.S.A. and that are consolidated in 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.

(k) Including the issue of shares for Kanit Co.

* Reclassified.

Note 6 - Investments in Companies Included On Equity Basis (cont'd)

Reported amounts

D. Details concerning principal investee companies (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	
		2008	2007	**2008**	2007	**2008**	2007
		%	%	**%**	%	NIS millions	
The Israel Corporation Ltd. (b)	Holding company	**18.2**	18.3	**18.2**	18.3	**1,186**	1,138
Paz Oil Company Ltd. (c)	Supply of energy products and management of refueling and commerce areas	**15.7**	15.6	**15.7**	15.6	**485**	560

See footnotes on next page.

Note 6 - Investments in Companies Included On Equity Basis (cont'd)

Reported amounts

D. Details concerning principal investee companies (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 (d)		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	
	2008	2007	**2008**	2007	**2008**	2007	**2008**	2007	**2008**	2007
	NIS millions									
The Israel Corporation Ltd. (b)	**1,184**	5,613	**157**	110	**32**	45	**(98)**	(40)	**205**	8
Paz Oil Company Ltd. (c)	**571**	920	**82**	65	**80**	14	**(69)**	-	**191**	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 56 million (31 December 2007 - NIS 61 million).
(c) The investment includes balance of goodwill and other assets in the amount of NIS 167 million (31 December 2007 - NIS 186 million).
(d) Includes other reserves in retained earnings.

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 2007	**3,137**	**5,731**	**8,868**
Additions	**133**	**601**	**734**
Disposals	**(107)**	**(652)**	**(759)**
As at 31 December 2008	**3,163**	**5,680**	**8,843**
Accumulated Depreciation			
As at 31 December 2007	**1,560**	**4,032**	**5,592**
Current year provision	**71**	**449**	**520**
Recognized losses from impairment	**1**	**-**	**1**
Cancelled losses from impairment	**(3)**	**-**	**(3)**
Disposals	**(63)**	**(649)**	**(712)**
As at 31 December 2008	**1,566**	**3,832**	**5,398**
Balance after depreciation as at 31 December 2008	**1,597**	**1,848**	**3,445**
Balance after depreciation as at 31 December 2007	1,577	1,699	3,276

(a) Including leasehold installations and improvements.

Note 7 - Buildings and Equipment (cont'd)

Reported Amounts

B. Average depreciation rates:

	31 December 2008	31 December 2007
Buildings and real estate	**3.02%**	**2.88%**
Equipment, furniture and motor vehicles	**16.13%**	**15.42%**

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 2007 - NIS 135 million).

D. Investment property - buildings and real estate not used by the Group, mainly rental buildings, amount to NIS 29 million in the balance sheet (31 December 2007 - NIS 31 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 195 million (31 December 2007 - NIS 217 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 21 million (31 December 2007 - NIS 54 million) are shown net of a provision for anticipated losses. The fair value of the assets earmarked for sale at 31 December 2008 was NIS 66 million.

G. The balance of equipment includes capitalized costs relating to the development of computer software in the amount of NIS 93 million (31 December 2007 - NIS 90 million).

Note 8 - Other Assets
Reported Amounts

	31 December 2008	31 December 2007
	NIS millions	
Deferred tax asset, net - see Note 26I	**1,745**	1,265
Excess of deposits for severance pay over provision – see Note 15F	**2**	262
Assets transferred to ownership of the Group as a result of settlement of problematic credits	**13**	38
Investment in life insurance policies in foreign branch	**376**	369
Goodwill	**125**	142
Excess of advance tax payments over current provisions	**766**	127
Issue expenses of debentures, bonds and subordinated notes	**48**	44
Debit balances in respect of derivative instruments (except embedded derivatives)	**10,047**	4,947
Accrued income	**120**	142
Prepaid expenses	**159**	121
Other receivables and prepayments	**128**	193
Total other assets	**13,529**	7,650

Note 9 - Deposits of the Public
Reported Amounts

	31 December 2008	31 December 2007
	NIS millions	
Demand deposits	**42,593**	33,447
Time and other deposits	**196,295**	197,480
Deposits in savings plans (before the reform)	**5,895**	7,118
Total deposits of the public	**244,783**	238,045

Note 10 - Deposits from Banks
Reported Amounts

	31 December 2008	31 December 2007
	NIS millions	
Commercial banks:		
Demand deposits	**1,544**	3,129
Time deposits	**1,317**	1,874
Acceptances	**554**	947
Central banks:		
Demand deposits	**-**	10
Specialized banking entities:		
Demand deposits	**298**	179
Fixed deposits	**29**	-
Total deposits from banks	**3,742**	6,139

Note 11 - Debentures, Bonds and Subordinated Notes
Reported Amounts

	Average maturity (a)	Internal Rate of return (a)	31 December 2008	2007
	Years	%	NIS millions	
Debentures and Bonds (b)				
In Israeli currency linked to the CPI (d)	**5.11**	**4.85**	**1,196**	2,201
In unlinked Israeli currency	**0.003**	**2.72**	**32**	723
Subordinated notes (b)				
Unlinked Israeli currency	**3.95**	**6.30**	**1,862**	119
In Israeli currency:				
- linked to the CPI	**4.75**	**4.58**	**15,488**	13,620
- linked to the U.S. dollar	**(c) 0.40**	**3.29**	**344**	505
In U.S. dollars	**(c) 2.73**	**4.01**	**1,714**	2,080
Total debentures, bonds and subordinated notes			**20,636**	19,248

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 1.22 years and subordinated notes in U.S. dollars is 0.42 years.

(d) Of which, subordinated notes (non-marketable) deemed Upper Tier II capital in the amount of NIS 446 million (31 December 2007 - NIS 427 million) that, in certain circumstances, may be converted to shares. See Note 13A below.

Note 12 - Other Liabilities
Reported Amounts

	31 December 2008	31 December 2007
	NIS millions	
Deferred tax liability, net – see Note 26I	**67**	117
Excess of current provisions for taxes over advance payments	**117**	108
Excess of provisions for severance pay and pensions over amounts funded - see Note 15E	**3,085**	2,673
Provisions for unutilized vacations and long service bonus	**782**	712
Deferred income	**384**	407
Credit balances in respect of derivative instruments (except embedded derivatives)	**10,513**	4,647
Provision for doubtful debts in respect of off-balance sheet items	**272**	397
Accrued expenses in respect of salaries and related expenses	**117**	839
Proposed dividend	**-**	1,414
Payables in respect of credit cards	**4,910**	4,684
Accrued expenses	**403**	401
Market value of securities sold short	**63**	520
Other payables and credit balances	**621**	717
Total other liabilities	**21,334**	17,636

Note 13 - Shareholders' Equity and Capital Adequacy under the Directives of the Supervisor of Banks

A. Share capital

	31 December 2008		31 December 2007	
	Authorized	**Issued and paid**	Authorized	Issued and paid
	NIS	**NIS**	NIS	NIS
Ordinary shares of NIS 1.0 each	**2,215,000,000**	**(a)1,473,551,221**	1,715,000,000	1,414,232,680

(a) Also after expiry of the balance of options in February 2009. For details see Note 15D below.

All issued shares are registered in the names of the shareholders.
The shares that have been and are to be issued will be 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 138,064,517 ordinary shares of the Bank.

In February 2006, 84,853,960 option warrants were allocated free of consideration to Leumi employees, under an option plan published by the Bank, n accordance with the agreement between the State and the employees of the Bank in connection with the process of privatization of the Bank and the sale of the State's holdings of its shares.

On 14 February 2008, 41,723,516 options that were in circulation and comprised the first tranche were exercised by the employees. 17,595,025 options were exercised by 12 February 2009, the last date for exercising them. The balance of 24,062,240 options then in circulation expired on that date.

Regarding the exercising of share options by the employees – see Note 15D below.

Note 13 - Shareholders' Equity and Capital Adequacy under the Directives of the Supervisor of Banks (cont'd)

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 constitute any commitment toward any third party (including regarding dates of dividend payment or rate of dividend distribution in the future).

As a result of the global crisis, the deterioration in the condition of the economy and the uncertainty regarding the extent and depth of the crisis on the Israeli banking system (including the Bank), the Board of Directors decided on 30 March 2009 not to declare the allocation of a cash dividend for the year 2008 and thus to strengthen the capital adequacy situation and stability of the Bank.

Dividend policy for the year 2009

In view of the uncertainty prevailing in the Israeli economy regarding the extent and depth of the financial crisis on the Israeli banking system (including the Bank), the Board of Directors decided on 30 March 2009 not to decide at this stage the dividend policy for the year 2009.

Note 13 - Shareholders' Equity and Capital Adequacy under the Directives of the Supervisor of Banks (cont'd)

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 1.4 billion), 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 Annual General Meeting on 5 June 2008 approved the recommendation of the Board of Directors on 30 March 2008 for 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) and at the rate of 18.373% of the issued share capital. The dividend was paid on 30 June 2008, to the shareholders holding shares of the Bank on 17 June 2008 (the determining date). The shares were traded "ex dividend" on 18 June 2008. The dividend was at the rate of approximately 18.373 agorot for each ordinary share of NIS 1.0 par value.

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.

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Note 13 - Shareholders' Equity and Capital Adequacy under the Directives of the Supervisor of Banks (cont'd)

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 2008	31 December 2007
	NIS millions	
(1) Capital for purposes of calculating the capital ratio		
Tier I capital:		
Share capital	**7,059**	7,000
Premium	**855**	-
Capital reserves from share-based payment transactions and others	**284**	610
Unrealized losses, from adjustments to fair value of shares available for sale	**(3)**	(22)
Adjustments from translation	**(502)**	(445)
Accumulated reserves and dividend declared after balance sheet date	**11,998**	12,286
Loans to employees for purchasing shares of the Bank	**(374)**	(404)
Less goodwill	**(255)**	(288)
Minority interests in equity of consolidated companies	**245**	105
Total Tier 1 capital	**19,307**	18,842
Tier II capital:		
Upper Tier II capital (a)	**874**	855
Other Tier II capital	**9,407**	9,127
Less: investments in shares and subordinated notes of financial companies (c)	**(70)**	(87)
Total capital	**29,518**	28,737

See footnotes on page 338.

Note 13 - Shareholders' Equity and Capital Adequacy under the Directives of the Supervisor of Banks (cont'd)

C. Capital adequacy (cont'd)

31 December 2008

		Weighting percentages						
	Balances (b)	**0%**	**20%**	**50%**	**100%**	**Dedn. From equity**	**Risk balances**	**Capital require-ment**
	NIS millions							
(2) Weighted risk balances and capital requirement								
Assets								
Cash and deposits with banks	**33,130**	**19,304**	**13,808**	**-**	**18**	**-**	**2,779**	**250**
Securities	**44,910**	**20,719**	**16,117**	**-**	**8,074**	**-**	**11,298**	**1,017**
Securities borrowed or purchased under agreements to resell	**201**	**125**	**-**	**-**	**76**	**-**	**76**	**7**
Credit to the public (a)	**213,548**	**14,644**	**900**	**14,761**	**183,243**	**-**	**190,803**	**17,172**
Credit to governments	**520**	**481**	**-**	**-**	**39**	**-**	**39**	**4**
Investments in companies included on equity basis (c)	**1,842**	**-**	**-**	**-**	**1,772**	**70**	**1,772**	**159**
Buildings and equipment	**3,445**	**-**	**-**	**-**	**3,445**	**-**	**3,445**	**310**
Other assets	**13,529**	**1,361**	**5,473**	**-**	**6,440**	**255**	**7,535**	**678**
Total assets	**311,125**	**56,634**	**36,298**	**14,761**	**203,107**	**325**	**217,747**	**19,597**

			Weighting percentages					
	Balances (b)	**Balance sheet equiv.**	**0%**	**20%**	**50%**	**100%**	**Risk balances**	**Capital require-ment**
Off-balance sheet instruments								
Transactions in which the balance reflects a credit risk	**96,273**	**25,252**	**2,870**	**1,290**	**-**	**21,092**	**21,350**	**1,921**
Derivative financial instruments	**251,733**	**25,552**	**449**	**16,066**	**-**	**9,037**	**12,250**	**1,103**
Other	**1,595**	**159**	**-**	**-**	**-**	**159**	**159**	**14**
Total off-balance sheet instruments	**349,601**	**50,963**	**3,319**	**17,356**	**-**	**30,288**	**33,759**	**3,038**
Total credit risk assets							**251,506**	**22,635**
Market risk							**5,476**	**493**
Total risk assets							**256,982**	**23,128**

See footnotes on page 338.

Note 13 - Shareholders' Equity and Capital Adequacy under the Directives of the Supervisor of Banks (cont'd)

C. Capital adequacy (cont'd)

31 December 2007

	Balances (b)	Weighting percentages 0%	20%	50%	100%	Dedn. From equity	Risk balances	Capital require-ment
	NIS millions							
(2) Weighted risk balances and capital requirement								
Assets								
Cash and deposits with banks	42,329	8,253	34,073	-	3	-	6,818	614
Securities	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 (c)	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 (b)	Balance sheet equiv.	Weighting percentages 0%	20%	50%	100%	Risk balances	Capital require-ment
Off-balance sheet instruments								
Transactions in which the balance reflects a credit risk (d)	92,593	26,633	2,418	1,202	-	23,013	23,254	2,092
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	319,946	49,858	3,096	16,278	-	30,484	33,740	3,036
Total credit risk assets							242,996	21,869
Market risk							6,531	588
Total risk assets							249,527	22,457

(a) General provision for doubtful debts of NIS 428 million constituting part of the Upper Tier II capital (31 December 2007 - 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 333 million).

(b) Assets – balance sheet balances, off-balance sheet instruments – stated value weighted on the basis of credit conversion factors.

(c) 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.

(d) Reclassified

Note 13 - Shareholders' Equity and Capital Adequacy under the Directives of the Supervisor of Banks (cont'd)

C. Capital adequacy (cont'd)

(3) Below is data on market risks, in accordance with the Directives of the Supervisor of Banks:

	31 December 2008		31 December 2007	
	NIS millions			
	Risk balances	**Capital requirements**	Risk balances	Capital requirements
Interest risks	**3,704**	**333**	3,562	321
Share price risk	**38**	**4**	614	55
Exchange rate risk	**867**	**78**	1,258	113
Inflationary risk	**194**	**17**	-	-
Options	**673**	**61**	1,097	99
Total	**5,476**	**493**	6,531	588

	31 December 2008	31 December 2007
	%	%
(4) Ratio of capital to risk assets on a consolidated basis		
The ratio of Tier I capital to risk assets	**7.51**	7.55
The ratio of total capital to risk assets	**11.49**	11.52
Ratio of total minimum capital required by the Supervisor of Banks	**9.00**	9.00
(5) Capital adequacy in principal subsidiaries		
Leumi Mortgage Bank Ltd.		
The ratio of Tier I capital to risk assets	**6.15**	6.63
The ratio of total capital to risk assets	**9.24**	9.96
Ratio of total minimum capital required by the Supervisor of Banks	**9.00**	9.00
Arab-Israel Bank Ltd.		
The ratio of Tier I capital to risk assets	**13.41**	16.00
The ratio of total capital to risk assets	**17.84**	16.38
Ratio of total minimum capital required by the Supervisor of Banks	**9.00**	9.00
Bank Leumi USA		
The ratio of Tier I capital to risk assets	**9.31**	8.23
The ratio of total capital to risk assets	**12.40**	11.03
Ratio of total minimum capital required by local authorities	**10.00**	10.00

Note 14 - Liens and Restrictive Conditions

Debentures and bonds issued by Israeli subsidiaries amounting to NIS 28 million (31 December 2007 - NIS 43 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 1,384 million (31 December 2007 - NIS 1,931 million). The total liabilities in respect of which the assets were pledged amount to NIS 1,111 million (31 December 2007 - NIS 1,358 million).

The Bank made a deposit of securities, as required by the Euroclear clearing system, 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 draw downs of credit by the Bank which were not repaid, for purposes of securities transactions through the said clearing system. The credit limit against which the securities were deposited as at 31 December 2008 amounted to approximately US$ 189 million (31 December 2007 – US$ 193 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 2008 is about $ 7 million and as at 31 December 2007 about $ 22 million.

As a member of the Tel Aviv Stock Exchange, the Bank is a member of the risk fund of the Stock Exchange Clearing System. Each of the members of the risk fund pledges collateral in favor of the Stock Exchange Clearing System in the amount of its proportionate part in the fund, which secures the member's liabilities to the Clearing System and the member's share in the risk fund. Furthermore, such collateral also secures 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 provided or up to the amount of the liabilities to the Stock Exchange Clearing System, whichever is the lower. The total of debentures and deposits pledged by the Bank to the Stock Exchange Clearing System as at 31 December 2008 was NIS 151 million.

The Bank is a member of the Maof Clearing System risk fund. The Bank undertook to the Maof Clearing System to pay every charge deriving from its Maof transactions for its customers, its nostro, and for Maof transactions of a member of the TASE not clearing independently through the Maof Clearing System. The total of the bank's liabilities is included under guarantees and other liabilities.

The Bank pledges collateral in favor of the Maof Clearing System in the amount of its proportionate part in the risk fund and also in respect of its above-mentioned liabilities, which secures its liabilities to the Maof Clearing System and its share in the risk fund. Furthermore, such collateral also secures the liabilities of the other members of the risk fund: in the event that the collateral that the other member provided were not sufficient to cover all of his liabilities, the Maof Clearing System is entitled to realize the collateral provided to it by the other members of the risk fund, 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 to the Maof Clearing System, whichever is the lower.

At the date of the financial statements, the Bank's share of the Maof Clearing System risk fund was NIS 163 million (about 23% of the fund).

Note 14 - Liens and Restrictive Conditions (cont'd)

The Bank, like any other member of the Clearing System, is entitled to secure its liabilities to the Maof Clearing System risk fund by means of pledging government bonds. The total of the debentures and deposits pledged by the Bank to the Maof Clearing System as at 31 December 2008 was NIS 1,529 million.

The Bank and its consolidated companies enter into CSA (Credit Support Annex) agreements with foreign banks which are intended to reduce mutual credit risks created between the banks during trading in derivatives. Under the agreements a measurement is made on a periodic basis of the value of all derivatives transactions carried out between the parties and if the net exposure of one of the parties exceeds the predetermined limit that party is required to transfer to the other party deposits totaling the amount of exposure, until the next measurement date. At 31 December 2008 the Group made deposits in favor of foreign banks totaling NIS 1,296 million.

The Bank and its consolidated companies enter into agreements with foreign banks under which amounts are deposited in the foreign banks for purposes of carrying out marketable futures transactions in exchanges abroad for them or their customers. As at 31 December 2008 the Group had deposited an amount of US$ 65 million in the above banks.

On 23 July 2007 the Bank signed a debenture, by which the Bank pledged by way of a first floating charge, in favor of the Bank of Israel, government bonds and Makam bonds deposited in a specific account held in the Tel Aviv Stock Exchange Clearing House in the name of the Bank of Israel. The value of the bonds deposited in the account as at 31 December 2008 was about NIS 2.4 billion and on 31 December 2007, about NIS 3.2 billion.

This pledge is to secure credits that the Bank of Israel gave or will give to the Bank, with the addition of interest and linkage differences, unlimited as total amount, in accordance with the terms of the general agreement on credit from the Bank of Israel signed by the parties.

On 21 May 2008 the Bank signed a debenture, by which the Bank pledged by way of a first floating charge, in favor of the Bank of Israel, its rights to receive monetary amounts and charges in shekels, which are due or will be due to the Bank from time to time from its customers, that are corporations (which were incorporated under the laws of the State of Israel) not being in arrears in repayment to the Bank of credits received from the Bank, in respect of credits in shekels of which the duration (average life) of each credit does not exceed three years, which were given or will be given by the bank to the above customers.

This pledge is to secure credits that the Bank of Israel will grant to the Bank for purposes of the Bank's activity as a supplier of liquidity services in shekels to the CLS Bank, with the addition of interest, costs and expenses involved in realiing the pledge, up to the amount of NIS 1.1 billion, in accordance with the terms of the credit agreement signed by the parties in this matter.

Note 14 - Liens and Restrictive Conditions (cont'd)

As at 31 December 2008 and 31 December 2007, the Bank had no borrowings from the Bank of Israel. The highest balance of borrowings from the Bank of Israel in 2008 based on month-end balances amounted to NIS 4,579 million and the average balance for 2008 amounted to NIS 1,645 million (in 2007 – NIS 10,128 million and NIS 3,699 million respectively). On the other hand, the balance of deposits with the Bank of Israel amounted to NIS 13,304 million (31 December 2007 – NIS 5,773 million). The highest balance based on month-end balances amounted to NIS 13,304 million and the average balance for 2008 amounted to NIS 5,232 million.

	31 December 2008	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	**201**	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	**549**	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 confirms 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 advance payment at the rate of one month's salary for provisions on account of the annual bonus for 2005, and confirms existing group labor agreements and arrangements in the Bank, as at present, for a period of five years as from 1 January, 2006.

The employees, on their part, undertook in the agreement to refrain from disputes in connection with 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 to a pension fund. The pension plan is a comprehensive cumulative pension plan with additional insurance for disability and death. The Bank will not have any pension liability in respect of these employees other than to supplement severance pay in accordance with 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. Funds designated for liabilities for severance pay are deposited in provident funds.

Note 15 – Employees' Rights (cont'd)

B. Severance pay and pensions (cont'd)

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, of the rate of utilization of the pension benefits and the rate of withdrawal of severance and remuneration benefits (the distribution is about 64% choosing a pension and 38% 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 Israel 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 increase in salary based on past experience and varying in accordance with the age of the employee. The rates of increase range from 0.6% to 8.6%. The calculation is made under 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 includes provisions based on the higher of the liabilities for severance pay plus 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 liability calculated by an actuary, 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, in accordance with which, 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 for comment by the Commissioner of Insurance to 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, under which provisions for pension and life insurance are to be assessed on the basis of the new mortality tables.

Note 15 – Employees' Rights (cont'd)

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 legal retirement age 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 2008 amounts to approximately NIS 96 million (31 December 2007 – NIS 91 million).

(4) Early retirement for employees under personal employment contracts

(a) Under the employment contract with the Bank's President and Chief Executive Officer ("CEO") that was signed at the beginning of 1996 (and subsequently amended and signed in 2004) ("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. The rate of the CEO's pension is at the amount of 3% a year.

It was further stipulated in the contract that either side is entitled to terminate the employment by giving 9 months advance notice, and the Bank has the right to require that the CEO continues work for the first three months of this period and that there will be a cooling-off period of 6 months from the date that the CEO actually stops working in the Bank..

In the amendment to the contract the Bank undertook to continue to employ the CEO until 12 February 2010 ("the period of the commitment"), so that in the event of dismissal of the CEO, 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, and when the CEO reaches the age of 67 in February 2010, there will not be an automatic termination of employment between the CEO and the Bank, and either side will be entitled to terminate the employment by giving advance notice as described above.

Note 15 – Employees' Rights (cont'd)

B. Severance pay and pensions (cont'd)

(4) Early retirement for employees under personal employment contracts (cont'd)

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 2009 the maximum additional expense to the Bank would be NIS 1,668 thousand ("the maximum expense"). The maximum expense was calculated, as stated, for a full one-year period and decreases to zero over the period in which the CEO continues to work in the Bank, so that if the CEO continues 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.

It is also pointed out that the Board of Directors does not intend to dismiss the CEO, and as such no provision is requires regarding 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 amounts to 75, or 80 under the new contracts. 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 does not amount to 75, or 80 under the new contracts) 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 by giving advance notice 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 judged to amount 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)

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 jubilee vacation will be entitled to an additional month of advance notice. In the cooling-off period, which does not coincide with the period of advance notice, 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 immediately dismissed to NIS 383 million (including VAT on salaries payable on the pension) (2007 – NIS 355 million). Since it is not likely that all the above mentioned employees will be dismissed immediately, the Bank recorded a provision at the rate of 25% of the above amount, in the amount of NIS 103 million (including VAT on salaries) (2007 – NIS 91 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 was attributed specifically to members of Management, the balance of which at 31 December 2008 was NIS 10 million, an amount similar to the amount for 2007.

(5) The Chairman of the Board of Directors of the Bank is entitled, in the case of involuntary retirement, 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 2008, no employees retired in this framework (in 2007 - 12 employees).

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 plan published by the Bank on 24 January 2006 ("the plan"). 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).

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 2008 and 12 February 2009 the adjusted price of the option was NIS 10.555 and NIS 10.489 respectively.

The exercise date of the first tranche of the options was in mid-February 2008, and all the options included in this tranche, totaling 41,723,516 options, were exercised at an exercise price of 10.3381. From then until 31 December 2008, 17,595,025 options were exercised from the second tranche.

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 2008, the Bank recorded a reduction of about NIS 16 million in salary expenses in the profit and loss statement (2007 - about NIS 247 million, 2006 - about NIS 235 million).

The fair value valuation of the options at issue date, as prepared by an external assessor according to the Black and Scholes model, was about NIS 422 million. The calculation of value was based on the following main parameters:

- Standard deviation of the annual yield: 25%
- Risk-free rate of index-linked interest: 3.5%.
- Share price: closing price of the share of NIS 17.30 on 14 February 2006.
- Dividend distribution policy: 50% of the net profit.
- Rate of employees leaving during the vesting period of the option: 2%.

Note 15 – Employees' Rights (cont'd)

D. Issue of options to employees (cont'd)

Below are the changes in options during the years 2006-2008:

	Number of Options
Allotted in 2006	84,853,960
Canceled during the year	466,133
Total options in circulation as at 31 December 2006	84,387,827

Canceled during the year	(791,878)
Total options in circulation as at 31 December 2007	83,595,949
Exercise of first tranche	(41,723,516)
Canceled during the year	(215,168)
Partial exercise of second tranche until 31 December 2008	(17,595,025)
Total options in circulation as at 31 December 2008	24,062,240

On 12 February 2009 the balance of 24,062,240 options that were not exercised expired.

In the framework of the exercise of options in 2008 as mentioned above, 59,318,541 shares were issued to Bank employees for a consideration in the amount of NIS 614 million at an average exercise price of approximately NIS 10.35 per share. The average share price for the period was approximately NIS 14.01.

Note 15 – Employees' Rights (cont'd)

E. Data relating to provisions and designated funds
Reported amounts

The amounts of provisions and related designated funds for severance pay and pensions are included in the balance sheet as follows:

	31 December	
	2008	207
	NIS millions	
Provision for severance pay	**2,371**	(3) 2,179
Amounts funded for severance pay (1)	**(2,278)**	(2,396)
Provision for pensions	**3,099**	(3) 2,817
Amounts funded for pensions	**(109)**	(189)
Excess of provisions over deposits, net	**3,083**	2,411
Excess of provisions over deposits, net, included in "other liabilities"	**3,085**	2,673
Excess of deposits included in "other assets"	**2**	262
Excess of provisions over deposits, net (2)	**3,083**	2,411

(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.

(3) Reclassified.

(4) The total liabilities for pensions to employees who commenced work in the Bank before 1 January 1999, totaled at 31 December 2008 NIS 5,099 million. To cover this liability are severance monies deposited in Central Severance Pay Funds in the amount of NIS 2,109 million as well as provident monies deposited in provident funds in the amount of NIS 2,745 million which are managed by the management company owned by the members of these funds, as stated in section H. below. Provident monies are set off from pension liabilities and are not shown in the balance sheet and are also not detailed in the above table. The difference between the above provisions and amounts funded is provided for by the Bank and included under liabilities in the Bank's balance sheet.

Note 15 – Employees' Rights (cont'd)

F. Long service bonuses

Employees of the Bank and some employees of consolidated companies are entitled, upon their attaining 20, 30 and 40 years of employment, to a cash bonus in the amount of several monthly salaries ("jubilee grants") and to special vacation periods.

At the date of the balance sheet, there is a provision in the amount of NIS 603 million (31 December 2007 - NIS 550 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 the capitalization rate published by the Supervisor of Banks and on the assumption of a real increase in salary, estimated as stated in B(1), above.
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 under the Retirement Age Law 5764-2004.

G. Unutilized vacation pay

There is a provision of NIS 179 million under "Other Lliabilities" for unutilized vacation pay (31 December 2007 - NIS 162 million). The provision is calculated on the basis of the latest salary plus related benefits.

H. Provident funds of the employees of the Bank and Leumi Mortgage Bank

On 31 July 2008 the structural change in the provident funds of the employees of the Bank and the employees of Leumi Mortgage Bank ("employees' funds") was completed, and these funds became funds managed by a management company to be held by the members of the funds. The Bank continues to supply the management company with all the services it requires, as allowed by the legislation.

In January 2008 a further Amendment to the Provident Funds Law came into force, which cancels the possibility of continuing to deposit in provident funds. The provident funds became non-pension payment provident funds. Funds cannot be withdrawn from these funds (except for severance monies), unless they have been transferred to pension payment provident funds and subject to the conditions applying to pension payment provident funds. In addition, in the framework of this Amendment, the possibility of setting aside monies for the Central Severance Pay Funds was limited until the end of 2010. The bank is reviewing the effect of the Amendment to the Law.

Note 16 - Assets and Liabilities Classified According to Linkage Basis
Reported Amounts

31 December 2008

	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	**15,116**	**529**	**11,990**	**2,938**	**2,557**	**-**	**33,130**
Securities	**9,464**	**5,994**	**16,414**	**8,813**	**901**	**3,324**	**44,910**
Securities borrowed or purchased under agreements to resell	**125**	**-**	**76**	**-**	**-**	**-**	**201**
Credit to the public (b)	**101,569**	**53,457**	**39,959**	**7,498**	**10,732**	**-**	**213,215**
Credit to governments	**-**	**256**	**264**	**-**	**-**	**-**	**520**
Investments in companies included on equity basis	**8**	**-**	**-**	**-**	**-**	**1,834**	**1,842**
Buildings and equipment	**-**	**-**	**-**	**-**	**-**	**3,445**	**3,445**
Other assets	**4,559**	**141**	**5,109**	**1,011**	**2,090**	**619**	**13,529**
Total assets	**130,841**	**60,377**	**73,812**	**20,260**	**16,280**	**9,222**	**310,792**
Liabilities							
Deposits of the public	**111,976**	**27,522**	**74,595**	**22,161**	**8,469**	**60**	**244,783**
Deposits from banks	**1,581**	**800**	**668**	**288**	**405**	**-**	**3,742**
Deposits from governments	**53**	**592**	**175**	**11**	**-**	**-**	**831**
Securities loaned or sold under agreements to repurchase	**374**	**-**	**175**	**-**	**-**	**-**	**549**
Debentures, bonds and subordinated notes	**1,894**	**16,684**	**2,058**	**-**	**-**	**-**	**20,636**
Other liabilities	**9,090**	**3,687**	**4,224**	**1,151**	**2,582**	**600**	**21,334**
Total liabilities	**124,698**	**49,285**	**81,895**	**23,611**	**11,456**	**660**	**291,875**
Difference	**5,873**	**11,092**	**(8,083)**	**(3,351)**	**4,824**	**8,562**	**18,917**
Effect of hedging derivative instruments:							
Derivative instruments (except options)	**-**	**-**	**8**	**(8)**	**-**	**-**	**-**
Options in the money, net (in terms of underlying asset)	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Options out of the money, net (in terms of underlying asset)	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Effect of non-hedging derivative instruments:							
Derivative instruments (except options)	**8,733**	**(8,619)**	**3,956**	**1,781**	**(5,851)**	**-**	**-**
Options in the money, net (in terms of underlying asset)	**(445)**	**(5)**	**(265)**	**687**	**28**	**-**	**-**
Options out of the money, net (in terms of underlying asset)	**(150)**	**(11)**	**(180)**	**201**	**140**	**-**	**-**
Total	**14,011**	**2,457**	**(4,564)**	**(690)**	**(859)**	**8,562**	**18,917**
Options in the money, net (discounted par value)	**(1,142)**	**(9)**	**(54)**	**1,139**	**66**	**-**	**-**
Options out of the money, net (discounted par value)	**442**	**(23)**	**(1,374)**	**208**	**747**	**-**	**-**

(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 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 hedging 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 non-hedging derivative instruments:							
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 17 - Assets and Liabilities Classified According to Maturity Date and Linkage Basis (a)
Reported Amounts

31 December 2008

	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	**46,794**	**17,367**	**26,981**	**12,743**	**7,949**	**5,621**	**3,943**	**13,315**	**4,239**	**1,140**	**140,092**	**2,638**	**130,841**
Liabilities	**58,647**	**17,562**	**35,752**	**6,182**	**4,177**	**665**	**2,194**	**536**	**240**	**121**	**126,076**	**323**	**124,968**
Difference	**(11,853)**	**(195)**	**(8,771)**	**6,561**	**3,772**	**4,956**	**1,749**	**12,779**	**3,999**	**1,019**	**14,016**	**2,315**	**5,873**
Derivative instruments (except options)	**3,793**	**(943)**	**3,056**	**2,092**	**915**	**180**	**327**	**(370)**	**-**	**-**	**9,050**	**-**	**8,733**
Options (in terms of underlying asset)	**(287)**	**249**	**(552)**	**(41)**	**(74)**	**(36)**	**(35)**	**-**	**-**	**-**	**(776)**	**-**	**(595)**
Israeli currency - linked to the CPI:													
Assets	**824**	**1,728**	**8,069**	**11,496**	**7,445**	**6,790**	**5,753**	**19,369**	**14,272**	**3,288**	**79,034**	**81**	**60,377**
Liabilities	**707**	**1,962**	**4,840**	**8,080**	**4,637**	**7,776**	**4,126**	**20,329**	**6,653**	**1,547**	**60,657**	**434**	**49,285**
Difference	**117**	**(234)**	**3,229**	**3,416**	**2,808**	**(986)**	**1,627**	**(960)**	**7,619**	**1,741**	**18,377**	**(353)**	**11,092**
Derivative instruments (except options)	**(37)**	**166**	**(2,581)**	**(2,173)**	**(970)**	**(775)**	**(776)**	**(2,285)**	**(165)**	**-**	**(9,596)**	**-**	**(8,619)**
Options (in terms of underlying asset)	**-**	**(9)**	**(8)**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(17)**	**-**	**(16)**
Foreign currency- Local operations (c):													
Assets	**23,606**	**5,234**	**11,740**	**11,907**	**6,127**	**4,674**	**2,996**	**5,340**	**781**	**7**	**72,412**	**498**	**67,699**
Liabilities	**43,736**	**20,961**	**13,747**	**2,265**	**642**	**490**	**290**	**545**	**108**	**-**	**82,784**	**-**	**81,447**
Difference	**(20,130)**	**(15,727)**	**(2,007)**	**9,642**	**5,485**	**4,184**	**2,706**	**4,795**	**673**	**7**	**(10,372)**	**498**	**(13,748)**
Derivative instruments(except options)	**(3,756)**	**777**	**(475)**	**81**	**55**	**595**	**449**	**2,655**	**165**	**-**	**546**	**-**	**(114)**
Options (in terms of underlying asset)	**287**	**(240)**	**560**	**41**	**74**	**36**	**35**	**-**	**-**	**-**	**793**	**-**	**611**

See footnotes on page 356.

Note 17 - Assets and Liabilities Classified According to Maturity Date and Linkage Basis (a) (cont'd)

Reported Amounts

31 December 2008 (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	**16,499**	**4,873**	**8,496**	**3,832**	**2,317**	**3,207**	**1,174**	**2,965**	**1,816**	**867**	**46,046**	**255**	**42,653**
Liabilities	**20,331**	**5,613**	**5,208**	**750**	**1,444**	**468**	**1,897**	**381**	**2**	**-**	**36,094**	**87**	**35,515**
Difference	**(3,832)**	**(740)**	**3,288**	**3,082**	**873**	**2,739**	**(723)**	**2,584**	**1,814**	**867**	**9,952**	**168**	**7,138**
Non-monetary items:													
Assets	-	-	-	-	-	-	-	-	-	-	-	**9,222**	**9,222**
Liabilities	-	-	-	-	-	-	-	-	-	-	-	**660**	**660**
Difference	-	-	-	-	-	-	-	-	-	-	-	**8,562**	**8,562**
Total:													
Assets	**87,723**	**29,202**	**55,286**	**39,978**	**23,838**	**20,292**	**13,866**	**40,989**	**21,108**	**5,302**	**337,584**	**12,664**	**310,792**
Liabilities	**123,421**	**46,098**	**59,547**	**17,277**	**10,900**	**9,399**	**8,507**	**21,791**	**7,003**	**1,668**	**305,611**	**1,504**	**291,875**
Difference (f)	**(35,698)**	**(16,896)**	**(4,261)**	**22,701**	**12,938**	**10,893**	**5,359**	**19,198**	**14,105**	**3,634**	**31,973**	**11,190**	**18,917**

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

	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)	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 (g)	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

(a) In this Note expected contractual future cash flows in respect of assets and liabilities are shown according to linkage basis, in accordance with the remaining contractual period to maturity of each cash flow. The data is presented after deduction of provisions for doubtful debts.
(b) Including overdue amounts of NIS 1,266 million (31 December 2007 – NIS 610 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 period of the credit facility (Credit facilities of NIS 14.4 billion; 31 December 2007 - NIS 14.5 billion). Over-limit credit in the amount of NIS 0.4 billion (31 December 2007 - NIS 0.6 billion) is classified as 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 2008 (31 December 2007 - NIS 5.1 billion).

Note 18 - Contingent Liabilities and Special Commitments
Reported Amounts

	31 December 2008	31 December 2007
	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	**1,631**	2,582
Credit guarantees (a)	**6,821**	6,993
Guarantees to apartment purchasers	**8,117**	7,440
Other guarantees and liabilities	**14,454**	13,822
Unutilized credit card facilities	**16,651**	14,993
Other unutilized revolving credit facilities to the public and credit facilities on demand	**16,967**	(a) 17,327
Irrevocable commitments to provide credit which has been approved and not yet granted (b)	**19,627**	(a) 20,807
Commitments to issue guarantees	**7,361**	5,883

(a) Reclassified.

(a) Of which: credit exposures in respect of liabilities to supply liquidity to securitization structures under the auspices of other parties not utilized in the amount of NIS 380million (31 December 2007 – NIS 384 million).

B. Off-balance sheet commitments for transactions based on collection (a)		
Balance of credit from deposits on collection basis (b)		
Israeli currency unlinked	**1,520**	1,806
Israeli currency linked to the CPI	**7,535**	7,855
Foreign currency	**628**	938
Total	**9,683**	10,599

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 2008	Total 2007
	NIS millions							NIS millions
1. CPI linked sector (c)								
Flows of futures contracts	**35**	**64**	**60**	**140**	**132**	**54**	**485**	523
Expected future flows net of Management's estimate of early repayments	**38**	**66**	**58**	**138**	**118**	**49**	**467**	497
Discounted expected future flows net of Management's estimate of early repayments (d)	**38**	**61**	**49**	**99**	**68**	**21**	**336**	362
2. Unlinked shekel sector								
Flows of futures contracts	**7**	**6**	**5**	**12**	**9**	**1**	**40**	46
Expected future flows net of Management's estimate of early repayments	**7**	**6**	**5**	**12**	**9**	**1**	**40**	46
Discounted expected future flows net of Management's estimate of early repayments (d)	**7**	**5**	**5**	**9**	**5**	**-**	**31**	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 831million (31 December 2007 - NIS 1,014 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 4.36% (2007 - 4.14 %).

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

	2008	2007
	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	**201**	342
Standing loans	**7**	9
C. Other contingent liabilities and special commitments:		
(1) Long-term rental contracts - rental of buildings, equipment and motor vehicles and maintenance in respect of commitments payable in following years:		
First year	**170**	246
Second year	**132**	131
Third year	**105**	107
Fourth year	**89**	80
Fifth year	**54**	53
After five years	**117**	106
Total	**667**	723
Commitments to purchase securities	**371**	298
Commitments to invest in buildings, equipment and in other assets	**214**	219
(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	**32**	49
Total future deposits	**117**	134

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 estimating the 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 debit balances in current accounts was valued at 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 2008 by NIS 121 million.

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Note 18 - Contingent Liabilities and Special Commitments (cont'd)

D. Fair value of instruments (cont'd)

(2) Principal methods and assumptions used in estimating the fair value of financial instruments (cont'd)

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.

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.

Securities – Quoted securities at their market value. Unquoted securities, shares at cost and debentures according to a model which takes into account the present value of future cash flows discounted at the appropriate discount rate, and which also takes into account the probability of failure and market value.

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.

Other financial assets and liabilities:

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.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

D. Fair value of instruments (cont'd)

(2) Principal methods and assumptions used in estimating the fair value of financial instruments (cont'd)

Off-balance sheet financial instruments in which the balance reflects a credit risk:
The balance sheet value approximates the fair value, since the terms of transactions in the balance sheet do not differ materially from the terms of similar transactions on the reporting date.

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 2008				31 December 2007			
	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	**6,132**	**26,998**	**33,130**	**33,210**	11,271	31,058	42,329	42,334
Securities	**43,464**	**1,446**	**44,910**	**44,939**	45,588	1,581	47,169	47,187
Securities borrowed or purchased under agreements to resell	**125**	**76**	**201**	**203**	655	-	655	655
Credit to the public	**29,389**	**183,826**	**213,215**	**214,030**	33,791	164,766	198,557	199,960
Credit to governments	**-**	**520**	**520**	**516**	-	642	642	644
Other financial assets	**10,647**	**2**	**10,649**	**10,649**	5,663	8	5,671	5,670
Total financial assets	**89,757**	**212,868**	**302,625**	**303,547**	96,968	198,055	295,023	296,450
Financial liabilities								
Deposits of the public	**51,598**	**193,185**	**244,783**	**246,507**	45,824	192,221	238,045	239,100
Deposits from banks	**2,372**	**1,370**	**3,742**	**3,778**	4,484	1,655	6,139	6,168
Deposits from governments	**128**	**703**	**831**	**866**	53	1,145	1,198	1,205
Securities loaned or sold under agreements to repurchase	**376**	**173**	**549**	**558**	173	58	231	228
Debentures, bonds and subordinated notes	**34**	**20,602**	**20,636**	**21,100**	93	19,155	19,248	19,860
Other financial liabilities	**6,087**	**214**	**16,301**	**16,294**	11,905	159	12,064	12,068
Total financial liabilities	**70,595**	**216,247**	**286,842**	**289,103**	62,532	214,393	276,925	278,629
Off-balance sheet financial instruments								
Transactions in which the balance the balance reflects a credit risk	**358**	**-**	**358**	**358**	289	-	289	289

(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 to 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 2008				
	Interest contracts		Foreign currency contracts	Contracts in respect of shares	Contracts in respect of goods and Others
	Shekel – index	Other			
	NIS millions				
(1) Nominal amount of derivative instruments					
a) Hedged instruments (1)					
Swaps	**-**	**1,490**	**24**	**-**	**-**
Total	**-**	**1,490**	**24**	**-**	**-**
Of which: interest-rate swap contracts in which the banking institution agreed to pay a fixed rate of interest	**-**	**792**	**-**	**-**	**-**
b) ALM derivatives (1)(2)					
Futures contracts	**6**	**21,637**	**-**	**41**	**66**
Forward contracts	**11,223**	**15,678**	**86,549**	**-**	**949**
Exchange-traded options					
Put options	**-**	**2**	**8,847**	**4,891**	**265**
Call options	**-**	**1**	**10,296**	**4,891**	**265**
Other options					
Put options	**57**	**16,176**	**32,384**	**1,179**	**-**
Call options	**20**	**13,421**	**31,533**	**1,403**	**-**
Swaps	**1,395**	**80,052**	**8,810**	**-**	**-**
Total	**12,701**	**146,967**	**178,419**	**12,405**	**1,545**
Of which: interest-rate swap contracts in which the banking institution agreed to pay a fixed rate of interest	**-**	**13,860**	**-**	**-**	**-**
c) Other derivatives (1)					
Swaps	**-**	**-**	**-**	**-**	**-**
Total	**-**	**-**	**-**	**-**	**-**
d) Credit derivatives and foreign exchange spot contracts					
Credit derivatives in which the banking institution is a guarantor	**-**	**-**	**-**	**-**	**247**
Foreign exchange spot contracts	**-**	**-**	**7,511**	**-**	**-**
Total	**-**	**-**	**7,511**	**-**	**247**
Overall total	**12,701**	**148,457**	**185,954**	**12,405**	**1,792**

(1) Except credit derivatives and foreign exchange 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 2008				
	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	**-**	**75**	**-**	**-**	**-**
Gross negative fair value	**-**	**44**	**16**	**-**	**-**
b) ALM derivatives (1)(2)					
Gross positive fair value	**180**	**3,396**	**6,050**	**280**	**66**
Gross negative fair value	**214**	**3,438**	**6,535**	**277**	**66**
c) Other derivatives (1)					
Gross positive fair value	**-**	**-**	**-**	**-**	**-**
Gross negative fair value	**-**	**-**	**-**	**-**	**10**
d) Credit derivatives					
Credit derivatives in which the banking institution is a guarantor					
Gross positive fair value	**-**	**-**	**-**	**-**	**-**
Gross negative 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)

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				
(1) Nominal amount of derivative instruments					
a) Hedged instruments (1)					
Swaps	-	2,710	24	-	-
Total	-	2,710	24	-	-
Of which: interest-rate 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
Exchange-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: interest-rate 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 foreign exchange spot contracts					
Credit derivatives in which the banking institution is a guarantor	-	-	-	-	975
Foreign exchange 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	(3) 984	3,214	609	24
Gross negative fair value	193	(3) 899	3,254	627	23
c) Other derivatives (1)					
Gross positive fair value	-	(3) -	-	-	-
Gross negative fair value	-	(3) -	-	-	-
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.
(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)

b. Credit Risk in Respect of Derivative Instruments According to Counterparty to the Contract

	31 December 2008					
	Stock Exchanges	**Banks**	**Dealers/ brokers**	**Government s and central banks**	**Others**	**Total**
	NIS millions					
Balance sheet balances of assets derived from derivative instruments (1)	**653**	**5,058**	**18**	**1**	**4,317**	**10,047**
Off-balance sheet credit risk in respect of derivative instruments	**2,463**	**15,812**	**207**	**2**	**6,813**	**25,297**
Total credit risk in respect of derivative instruments	**3,116**	**20,870**	**225**	**3**	**11,130**	**35,344**

	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

(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 2008				
	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	**1,790**	**6,790**	**2,304**	**1,817**	**12,701**
Other	**46,812**	**28,936**	**38,128**	**34,581**	**148,457**
Foreign currency contracts	**127,772**	**44,088**	**7,231**	**6,863**	**185,954**
Contracts in respect of shares	**10,074**	**1,269**	**1,061**	**1**	**12,405**
Contracts in respect of commodities and others	**1,037**	**665**	**52**	**38**	**1,792**
Total	**187,485**	**81,748**	**48,776**	**43,300**	**361,309**

	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

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. In the regular course of business, legal claims have been filed against the Bank and certain consolidated companies, including petitions for approval of class actions.

In the opinion of the Management of the Bank and the managements of the consolidated companies, based on legal opinions regarding the chances of the claims succeeding, including the petitions for approval of class actions, appropriate provisions have been recorded in the Financial Statements, insofar as required, to cover damages resulting from the said claims.

In the opinion of the Management of the Bank and the managements of the consolidated companies, the total additional exposure arising from legal claims filed against the Bank and against the consolidated companies on various subjects, the amount of each of which exceeds NIS 2 million, and regarding which the chances of the claims succeeding are not remote, amounts to some NIS 86 million.

1. The following are details of claims in material amounts.

A. On 15 June 2000, a claim was filed against the Bank in the Tel Aviv-Jaffa District Court, together with a petition to approve the claim as a class action, in the amount of NIS 1 billion. The plaintiff alleges that the Bank, in various publications, promised depositors of shekel deposits made by self service through direct banking channels, that they would receive a preferred annual 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 could have misled the depositors into thinking that the 1% additional interest would be paid also in respect of the periods in which the deposit was automatically renewed and not only in respect of the original deposit period, as was the actual case.

Accordingly, the plaintiff is requesting that the Bank pay to him and all the relevant depositors he represents, the preferred interest also in respect of the periods in which the deposits were automatically renewed. In December 2003 the Court approved 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. The District Court granted the plaintiff's petition to cancel the stay of proceedings in the case and set a hearing for the case, although the Supreme Court has not yet rendered a decision. The Bank has petitioned the Supreme Court for a stay of the proceedings until the Supreme Court renders a decision in the appeal.

B. On 14 October 2004 a petition to approve a claim as a class action in the amount of some NIS 2 billion was filed against the Bank with the Tel Aviv-Jaffa District Court on the basis of the Banking (Service to Customer) Law, 1981 and Regulation 29 of the Civil Procedure Regulations, 1984.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. (cont'd)

1. (cont'd)

The subject of the claim was originally the allegations of the petitioner that he and all other customers of the Bank were charged fixed management fees, credit provision fees and securities deposit management fees unlawfully and contrary to the exemptions indicated beside the fees on the Bank's price list. The petitioner maintains that the Bank misled its customers and breached the disclosure duties owed to them, and breached contractual obligations to them by charging them the fees, despite the fact that according to the Bank's price list they were entitled to exemptions from the payment of such fees. The petitioner is also claiming that in this way the Bank was unlawfully enriched.

After the Bank submitted to the Court its response to the petition to approve the claim as a class action, and the petitioner submitted a reply to the Bank's response to the petition for approval of a class action, a petition was filed with the Court to amend the statement of claim, pursuant to which the petitioner requested to strike out all that part of the claim relating to the securities deposit management fee commission. The Court approved the request for such amendment and the amount of the claim was reduced to some NIS 1.12 billion. Following the amendment, the Bank submitted an amended response to the amended petition for approval of the claim as a class action and an amended reply of the petitioner was filed.

On 25 December 2007, the Tel Aviv District Court denied the petition for approval of the claim as a class action. The plaintiff filed an appeal to the Supreme Court regarding this ruling on 10 February 2008.

C. In February 2006 a petition for the approval of filing a class action was filed against the Bank by a customer of the Bank in the Tel Aviv-Jaffa District Court, in an amount estimated by the petitioner at some NIS 300 million.

According to the petitioner, in the framework of the sale of structured products to Bank customers, the Bank does not disclose the full pricing and charges a hidden "commission" that is expressed in a financial margin which inures to the benefit of the Bank in the transaction, which in the petitioner's view contradicts the duty 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 made up of all Bank customers who invested in various structured products marketed by the Bank, from January 1999 until January 2006, and to whom the Bank did not disclose what allegedly should have been disclosed. The Bank has filed its response to the petition for the approval of the claim as a class action. On 11 September 2008, the Tel Aviv District Court issued its decision denying the petition for approval of the class action. On 10 November 2008, the petitioner filed an appeal against the decision to the Supreme Court.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. (cont'd)

1. (cont'd)

D. On 12 September 2006, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, Bank Hapoalim B.M. and Israel Discount Bank Ltd. 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 petitioner, 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 petitioner is refund of the alleged over-charging to the respondents' customers, who took unlinked shekel credit or a "retroactive reduction" of the said interest and commission rates that the respondent banks collected during the past decade. The Bank has filed its response to the petition for the approval of the claim as a class action.

   On 21 January 2008, the Tel Aviv District Court granted the petition, and approved the pursuance of the claim as a class action. The Bank submitted a petition for leave to appeal the ruling to the Supreme Court. The Supreme Court's ruling of 29 May 2008 provided that the Attorney General must submit his position in writing regarding the petition. The Attorney General has notified the Supreme Court that he will take part in the proceeding regarding the petitions for leave to appeal submitted by the banks and will submit his position in writing.

E. On 23 November 2006, a claim and a petition to approve the claim as a class action were filed in the Jerusalem District Court against the Bank and against Bank Hapoalim B.M. and Israel Discount Bank Ltd. The petitioners allege that in respect to credit to the households sector, the banks collect interest at a rate that is much higher than that collected from the commercial sector and from the corporate sector, this in spite of the fact that the risk in extending credit to the households sector is significantly lower than the risk for those sectors, and that this excessive interest rate derives from the exploitation of the low level of bargaining power of the households sector and from the monopolistic power of the respondents. The petitioners allege that this is an infringement of the Restrictive Trade Practices Law, 1988, which prohibits a monopolist from abusing its position in the market, and that there is a real fear that the lack of competition among the respondents, regarding all matters concerning the households sector, is the result of a restrictive arrangement among the parties.

   The petitioners also allege that the interest rate was determined while misleading the consumers regarding the normal price for credit service to the households sector, contrary to the provisions of the Consumer Protection Law, 1981 and the Banking (Service to Customer) Law, 1981.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. (cont'd)

1. (cont'd)

The petitioners allege that the damage caused to them and the members of the group is the result of the multiple of (1) the gap between the interest rate actually collected and the fair interest rate that would have been established for loans to the households 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.

The damage alleged by them is NIS 5.6 billion according to one method, and NIS 5.2 billion according to a second method. Of this amount, the estimated damage attributed to the Bank's customers is at least NIS 1.6 billion. The Bank filed its response to the petition for the approval of the claim as a class action. The court granted a petition filed by the Bank for a stay of these proceedings and ordered they be stayed until the Supreme Court renders a decision regarding the petition for leave to appeal filed by the Bank with respect to the decision to approve as a class action the claim described in paragraph D above. The Supreme Court denied the petition for leave to appeal filed by the petitioners with respect to the District Court's above-mentioned decision to stay the proceedings in the claim.

F. On 31 January 2008, 260 identical claims were filed in the Tel Aviv-Jaffa Magistrate's Court against the Bank and receivers who had been appointed by the court. The amounts of the claims vary between some NIS 787,000 and some NIS 1,350,000. Pursuant to the Court's ruling, the proceedings for all the above-mentioned claims were combined, and they will be heard as one claim. The total amount of the claims is some NIS 270 million. The plaintiffs are the purchasers of vacation apartments in the Nofit Hotel in Eilat. According to the plaintiffs, the Bank and the receivers were negligent in supervising the project and refrained from paying for guarding it, and as a result, the plaintiffs suffered significant damages, including a decline in the value of the apartments. These claims are in addition to five other claims that have filed against the Bank on the same ground, and which are being heard separately. The total amount of all the claims in connection with this project is some NIS 288.6 million.

G. 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 units in mutual funds 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.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. (cont'd)

1. (cont'd)

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. 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 the mutual fund managers, 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.

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. The Bank has filed its response to the petition for the approval of the claim as a class action.

H. 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 charges its customers securities deposit management fee commissions which are higher than agreed. He claims that each time he carried out a low volume partial sale of a particular share for which the commission was less than the minimum, the Bank charged him 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. The Bank has filed its response to the petition for the approval of the claim as a class action.

I. On 25 September 2007, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, in the amount of some NIS 435 million, which comprises 8 different grounds for claim. Following the decision of the Court that the plaintiff was to select one and that the others would be deleted from the request, the plaintiffs notified the Court that they had selected the grounds based on the claim that the Bank charges its customers with securities management fees, when a security is sold during a particular quarter and this fee is not deducted from the minimum management fee that the bank charges the customer for that quarter. The amount which the plaintiffs relate to these grounds for the claim totals about NIS 30 million.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. (cont'd)

2. In addition, there are legal claims pending against the Bank, including petitions for approval of class actions, as detailed below. In the opinion of the Management of the Bank, based on legal opinions with regard to the chances of these legal proceedings, it is not possible at this stage to estimate the chances of the claims and therefore no provision has been recorded in respect thereof. The following are the details of the legal claims:

A. On 3 April 2008, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, Bank Hapoalim and Israel Discount Bank in an amount between NIS 35 million and NIS 84 million. The plaintiffs claim that the Banks are unjustly enriching themselves, at their customers' expense, by receiving profits from interest on the amounts of the tax they withhold at source in accordance with the provisions of Section 164 of the Income Tax Ordinance; those amounts remain with the Banks until the date fixed in the Ordinance and its regulations and are not therefore transferred to the Tax Authority on the date of actual deduction. Therefore, it is claimed in the petition, the banks have breached their duties under the Trust Law and the Custodians Law and their obligation to carry out their agreements with their customers in good faith.

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 preliminary stage to estimate the chances of the petition.

B. On 6 May 2008, a claim and a petition to approve it as a class action were filed in the Tel Aviv-Jaffa District Court. According to the plaintiff, the Bank charges its customers' accounts with the legal expenses incurred in handling such customers' debts, without obtaining the approval of any legal tribunal, and in violation of the directives of the Supervisor of Banks – "Proper Banking Management Directives – Charging Customers for Attorneys' Fees." Additionally, when the Bank charges its customers' accounts with legal expenses (both those approved by a legal tribunal and those that have not been so approved), the Bank collects interest on such expenses at the interest rate applicable to the account (which in many cases is excess interest on arrears) and not at the interest and linkage rates which the Bank is permitted to collect in accordance with the Adjudication of Interest and Linkage Law, 1961. The requested remedy is the reimbursement of all excess amounts charged by the Bank, without an indication of the amount, although it is alleged that "this is a vast amount" and that the lawsuit is filed in the name of all the Bank's customers whose accounts were charged with legal expenses during the seven years preceding the filing of the petition to approve the class action. The Bank has submitted its response to the petition for approval of the claim as a class action.

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.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. (cont'd)

2. (cont'd)

C. On 14 May 2008, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank and against Bank Hapoalim (the "Banks”). The petitioner alleges that he maintains current accounts at these banks and that no interest has been paid to him in respect of the periods during which there was a credit balance in the accounts. The petitioner further claims that it was not explained to him that there is an investment channel which can produce daily interest in respect of amounts held in credit in his accounts. The Banks’ alleged behavior constitutes, according to the petitioner, a violation of several legal provisions, including the Restrictive Trade Practices Law, the Trusts Law, the Custodians Law, the Unjust Enrichment Law, the Banking Ordinance and the Banking (Service to Customer) Law. The group in whose name the claim has been filed and which the court is being asked to approve consists of anyone who has been a customer of the Banks and who, at any time during the 7 years preceding the filing of the claim, had a credit balance in a current account with respect to which no interest was paid. The amount of the alleged class action is estimated by the petitioner at NIS 3.4 billion, while the claim does not specify the amount of damage attributed to each of the Banks. However, the opinion attached to the petition for approval, which presents the manner in which the alleged damage was calculated, indicates that the part of the damage attributed to the Bank is NIS 1.69 billion.

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. On 30 June 2008, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, Israel Discount Bank and Bank Hapoalim, (the "Banks”). The claim relates to the commissions charged by the Banks for various banking services provided by them to their private customers (“operating” commissions, as distinguished from commissions for the allocation, granting and handling of credit, which are not part of the claim). It is claimed that the Banks had agreed among themselves regarding the increase or reduction of the rates of the commissions, and that it is suspected that agreements were also reached regarding the creation of new commissions. It is claimed that in so doing , the Banks maintained an illegal restrictive arrangement regarding the rates of the commissions they collect from their customers, they abused their monopolistic power (the Banks constituting, it is argued, an oligopoly), and that they unjustly enriched themselves at the expense of their customers. The petition claims that because of these said restrictive arrangements, the Banks’ customers paid an unfair rate for the commissions, higher than would have been paid were it not for the existence of the cartel that prevented free competition. The calculation of the amount claimed is presented as being derived from the Banks’ income from commissions paid by households and those resulting from private banking. It is claimed, as an estimation, that half of this income was collected following the coordination of rates as a result of the restrictive practices, and had the rates not been coordinated between the Banks, the commissions would have been significantly lower, by at least 25%.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. (cont'd)

2. (cont'd)

Therefore, in accordance with the various assumptions indicated in the petition, the total aggregated amount of the damage is estimated in the amount of NIS 3.5 billion, while the petition's caption indicates that the amount of the claim is NIS 3 billion. No specific attribution has been made of the damage claimed to each of the Banks, but the petition mentions that the Bank's relative share of banking activity in Israel is estimated at some 30%.

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.

E. On 4 August 2008, a claim and a petition to approve it as a class action were filed in the Jerusalem District Court against the Bank, Israel Discount Bank, "Kahal" Supplementary Training Funds Management (1996) Ltd. ("Kahal") and the Supervisor of the Capital Market, Insurance and Savings (as a formal defendant). According to the petitioner, Kahal had transferred, in accordance with the Intensification of Competition and Reduction of Concentration and Conflicts of Interest in the Israeli Capital Market (Legislative Amendments) Law, 2005, and at the banks' instruction, the control of the assets of the provident funds controlled by Kahal to a "different management company" and that the banks allegedly illegally assumed and appropriated to themselves the consideration amounts that they received from the other management company, for "the transfer of the control of the assets of the provident funds as well as their management and the trusteeship of them," since a management company and a management company's controlling shareholder may not receive any benefit whatsoever, directly or indirectly, in connection with the management of a provident fund, other than expenses and management fees. It is claimed that the consideration amounts received for the said transfer of control of the provident funds are proceeds produced by the assets of the provident funds, and their source is the members' rights stemming from such assets, and that this is a profit which therefore belongs to the members of the provident funds and not to any of the defendants. It is claimed that the consideration received by the banks amounts to some NIS 260 million, with the Bank's share in this amount being to NIS 149.5 million.

The petitioner bases the claim on, *inter alia*, violation of the Control of Financial Service (Provident Funds) Law, 2005, the Joint Investments Trusts Law, 1994, the Unjust Enrichment Law, the Contracts Law, the Banking (Licensing) Law, the Agency Law and the Trusts Law. The group in whose name the approval of the class action is sought is composed of: all members of all the provident funds whose assets were controlled and managed by each of the trust managers (apparently referring to Kahal) that were owned and/or controlled by the respondent bank, and transferred to their replacements.

The petitioner added the Supervisor of the Capital Market, Insurance and Savings to the claim and to the petition for approval since, according to the petitioner, the Supervisor is charged with licensing, control and implementation of the provisions of the Provident Funds Law, and it is therefore appropriate that he, in terms of the public interest, present his position, and since this would assist in clarifying and deciding the questions raised in the class action.

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.

F. On 4 August 2008, a claim and a petition to approve it as a class action were filed in the Jerusalem District Court against the Bank, Leumi Gemel Ltd. and the Supervisor of the Capital Market, Insurance and Savings (as a formal defendant). According to the petitioner, Leumi Gemel transferred, in accordance with the Intensification of Competition and Reduction of Concentration and Conflicts of Interest in the Israeli Capital Market (Legislative Amendments) Law, 2005, and at the Bank's instruction, the control of the assets of the provident funds controlled by Leumi Gemel to "different management companies." According to the petitioner, the Bank allegedly illegally assumed and appropriated to itself the consideration amounts that it received from the other management companies, for "the transfer of the control and management of the assets of the provident funds and the trusteeship thereof," since according to the petitioner, a management company, and a management company's controlling shareholder may not receive any benefit whatsoever, directly or indirectly, in connection with the management of a provident fund, other than expenses and management fees. It is claimed that the consideration amounts received for the said transfer of control of the provident funds are proceeds arising from the assets of the provident funds, and their source is the provident funds' members' rights stemming from such assets, and that this is therefore a profit which belongs to the members of the provident funds and not to any of the respondents. The amount being claimed amounts to NIS 1.0016 billion, which constitutes, according to the petitioner, the consideration received by the Bank from the sale. The petitioner bases the claim on, *inter alia*, violation of the Control of Financial Service (Provident Funds) Law, 2005, the Joint Investments Trusts Law, 1994, the Unjust Enrichment Law, the Contracts Law, the Banking (Licensing) Law, the Agency Law and the Trusts Law. The group in whose name the approval of the class action is sought is composed of: all members of all the provident funds whose assets were controlled and managed by each of the trust managers (apparently referring to Leumi Gemel) that were owned and/or controlled by the respondent bank, and transferred to their replacements. The petitioner added the Supervisor of the Capital Market, Insurance and Savings to the claim and to the petition for approval since, according to the petitioner, the Supervisor is charged with licensing, control and implementation of the provisions of the Provident Funds Law, and it is therefore appropriate that he, in terms of the public interest, present his position, and since this would assist in clarifying and deciding the questions raised in the class action.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. (cont'd)

2. (cont'd)

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.

G. On 4 August 2008, a claim and a petition to approve it as a class action were filed in the Jerusalem District Court against the Bank, Leumi Pia Trust Management Company Ltd., Psagot Managers of Mutual Funds - Leumi Ltd., Kesselman & Kesselman Trust Company (1971) Ltd., and the Israel Securities Authority (as a formal defendant). According to the petitioner, each manager transferred the control and management of the mutual funds it owned to "different management companies," in accordance with the Intensification of Competition and Reduction of Concentration and Conflicts of Interest in the Israeli Capital Market (Legislative Amendments) Law, 2005, and the Bank allegedly illegally obtained the consideration amounts that it received from the other management companies, for "the transfer of the control and management of the assets of the mutual funds." According to the petitioner, a management company, trustee and a management company's controlling shareholder may not receive any benefit whatsoever, in connection with the management of mutual funds, other than expenses and management fees, and it is therefore claimed that the consideration amounts received for the said transfer of control of the mutual funds are proceeds arising from the assets of the mutual funds, and their source is the rights stemming from such assets, and that this is a profit which belongs to the funds and to the owners of the units thereof, and not to any of the respondents. According to the petitioner, the consideration received by the Bank amounts to some NIS 1.885 billion, and this is the amount claimed by the petitioner for the members of the group. The petitioner bases the claim on, *inter alia*, violation of the Joint Investments Trusts Law, 1994, the Unjust Enrichment Law, the Contracts Law, the Banking (Licensing) Law, the Agency Law and the Trusts Law. The group in whose name the approval of the class action is sought is composed of: all owners of units in all the mutual funds whose assets were controlled and managed by each of the managers who were controlled by the Bank, and were transferred to their replacements. The petitioner added the Israel Securities Authority to the complaint and to the petition for approval since, according to the petitioner, the Authority is charged with licensing, control and implementation of the provisions of the Joint Investments Trusts Law and it is therefore appropriate that it, in terms of the public interest, present its position, and since this would assist in clarifying and deciding the questions raised in the class action.

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.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. (cont'd)

2. (cont'd)

H. On 28 September 2008, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, Bank Hapoalim, Israel Discount Bank and the Bank Otzar Hachayal the amount of some NIS 672 million. According to the allegations, the Bank secretly collects an illegal commission from customers engaged in continuous trading of options on the Tel Aviv 25 stock index (such options consisting of a right to buy or sell the basket of shares comprising the Tel Aviv 25 Index at a given time and at a given price); the banks take advantage of the fact that the amounts pass from the stock exchange to those holding the options through the Banks, and an exercise commission of 0.5% is collected from the amounts received by customers who are the holders of expiring options which entitle their holders to a payment; the calculation of the amount due to the option holder is not simple because the expiration index is not an exact amount and is not published in any official publication and therefore the customer does not know exactly what amount is due to him and cannot know that a commission has been deducted from the amount that he receives. The ground for the action is based on the fact that the Banks did not announce that they collect an exercise commission, did not include this commission in their agreements with the customers and they made a false representation to the customers according to which the only commission that they collect is the sale and purchase commission. The banks do specify the commission that is collected in a separate notice that they send at later stages, after the transactions are carried out, but according to the plaintiffs, customers like them do not follow these notices and are not capable of analyzing them. The defined group consists of customers who contracted with portfolio managers in connection with the trading of Tel Aviv 25 Index options. According to the plaintiffs they used a narrow definition of this group of customers in order to argue that it is easier to hide the charging of commissions from this group (relative to the group of customers who do not trade through portfolio managers). The relief requested is the damage which is common to all the customers of the banks in respect of the amount of the exercise commissions collected during the past seven years.

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.

I. On 26 November 2008, a claim and a petition to approve it as a class action were filed in the Tel Aviv District Court against the Bank, the First International Bank of Israel Ltd., Union Bank of Israel Ltd. and Bank Mizrahi Tfahot Ltd. The claim is based on damages claimed in the amount of about NIS 68,125,000 (according to the plaintiff's calculations), caused to all the customers of the banks from whose profits tax was deducted at source from interest in respect of bonds and/or dividends in respect on shares, this from 1 January 2003 until the day the claim was filed. According to the claim, the banks over-deducted tax, by deducting tax at source in respect of commissions collected from the income received. According to the plaintiff's calculation, the banks should have deducted the commissions from the income on which tax was deducted at course, and only then carried out the deduction at source.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. (cont'd)

2. (cont'd)

The plaintiff bases his claim on Section 17 of the Income Tax Ordinance, which classifies commissions as an expense incurred in the production of income during the tax year, which is to be taken into account in the calculation of taxable income.

According to the plaintiff's claim, by acting as stated the banks violated their duties of caution, trust and fair disclosure towards the group, which applies to them under the Banking Law, the Consumer Protection Law and the Damages Ordinance, as well as the duty of good faith applying to them. It was also claimed that the banks caused the group damage and monetary loss and that their behavior is tantamount to negligence, violation of statutory duties and unjust enrichment.

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.

J. With regard to a further demand in the matter of the victims of the Holocaust, see section M. below.

3. The following are details of petitions for approval of class actions in material amounts that were filed against Leumi Mortgage Bank Ltd. ("Leumi Mortgage Bank"). In the opinion of the Management of the Bank, and in reliance on the opinion of the management of Leumi Mortgage Bank, which is based on the opinion of Leumi Mortgage Bank's legal advisers 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. On 21 June 2000, a petition for approval of a class action was filed against Leumi Mortgage Bank in the Tel Aviv-Jaffa District Court based on the Banking (Service to Customer) Law, 1981, Regulation 29 of the Civil Procedure Regulations, 1984, and the Supervision of Insurance Practices Law, 1981. The amount of the claim for which approval as a class action has been requested is estimated by the petitioners at some NIS 100 million.

The petitioners, who took out loans from Leumi Mortgage Bank, are making claims regarding the value of buildings for purposes of property insurance in the framework of loans taken from Leumi Mortgage Bank. According to the petitioners, Leumi Mortgage Bank or its representative prepared an excessive valuation of the buildings, resulting in overpayment of premiums by Leumi Mortgage Bank customers. The petitioners contend that this was also done in their case. In accordance with the decision of the District Court, the hearing on the claim has been stayed until the appeals regarding the matter reviewed in Note 4A below are decided. The petitioners have nevertheless made a request for renewal of the proceedings.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. (cont'd)

3. (cont'd)

B. On 2 December 2006, a petition to approve a class action was filed in the Tel Aviv – Jaffa District Court against Leumi Mortgage Bank and against the Migdal Insurance Company Ltd. ("Migdal") regarding the partial payment of life insurance compensation. The estimated amount for the class action, as claimed by the petitioner, is NIS 150 million.

The petitioner and her deceased spouse took out a loan from Leumi Mortgage Bank. According to what is alleged in the request: borrowers who took out loans from Leumi Mortgage Bank were able to join a life insurance arrangement for borrowers, in which the insurer was Migdal; numbered among the borrowers who joined the said 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 had promised to pay such insured-borrower parties, "insurance compensation at the level of the loan balance due or at the level of the amount of insurance (the lower of them)" - so alleges the petitioner. On 18 January 2009 the Court issued a decision ordering the application of proceedings laid down in the law for approving a settlement agreement signed by the parties.

C. On 10 June 2003, a petition for approval of a class action was filed with the Tel Aviv-Jaffa District Court against Leumi Mortgage Bank regarding alleged over-charging of borrowers who took out loans at variable interest. Although the petition and the attached claim are stated unclearly, it appears that (at least partial) overlapping exists regarding the arguments underlying another case concerning the approval of a class action which was filed against Leumi Mortgage Bank and which was dismissed by the court, regarding the requested relief and the group of petitioners to be represented.

The amount of the class action whose approval is requested is estimated by the petitioners at some NIS 90 million.

In light of the (at least partial) overlapping between the petition for approval of the class action reviewed here and the other petition for approval of a class action mentioned above, it was agreed between the parties to stay the proceedings in the claim until after clarification of the appeal filed against the dismissal of the petition for the approval of the other claim. The Court was informed of this agreement and, accordingly, a response has not yet been submitted to the petition for approval of the class action.
The appeal in the petition for approval of the other class action was dismissed, and for this reason, *inter alia,* the petitioners sought to withdraw from the proceeding. On 25 September 2008, a decision was rendered approving the petition for withdrawal and rejecting the petitioners' action.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. (cont'd)

4. In addition, the petitions for approval of class actions set out below are pending against Leumi Mortgage Bank. In the opinion of the Management of the Bank, in reliance on the opinion of the management of Leumi Mortgage Bank, which is based on the opinion of the legal advisors of Leumi Mortgage Bank with regard to the chances of these legal proceedings, it is not possible at this stage to estimate their chances and therefore no provision has been recorded..

The following are details of the legal proceedings:

A. On 17 July 1997 a petition for approval of a class action in an amount exceeding NIS 1 billion was filed with the Tel Aviv-Jaffa District Court against Leumi Mortgage Bank and against other mortgage banks in connection with collection of borrowers' life insurance and property insurance commissions. Each of the petitioners took out a loan from one of the respondent mortgage banks. According to the petitioners, in the context of taking out the loan, they were included in life insurance or property insurance policies taken out through the respondent banks and, according to their assertions, part of the insurance premiums illegally reached the respondent banks.

On 17 November 1997 the Court ruled that the claim could not be heard as a class action according to the Banking (Service to Customer) Law, 1981, and the Restrictive Trade Practices Law, 1988. Accordingly, the Court struck off the monetary claim.

Nevertheless, the Court decided that the claim could be heard in the framework of Regulation 29 of the Civil Procedure Regulations, 1984, but only with regard to the claim for declaratory relief relating to causes of action that had arisen before 10 May 1996. The Court ruled that the causes of action that could be heard in this framework related to the "restrictive arrangement and various insurance issues."

Appeals to the Supreme Court submitted against this decision by Leumi Mortgage Bank, all the other respondent mortgage banks and the petitioners are pending. Pursuant to the decision of the Supreme Court, implementation of the District Court's decision was stayed. Accordingly, the claim will not be determined until the Supreme Court rules with regard to all the appeals.

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 was not appropriate at that time, mainly because of the legislative procedures underway in the field of class actions; and on 12 March 2006 the Class Actions Law was published. On 25 September 2008 the Court approved the withdrawal of one of the plaintiffs from the claim. A hearing on the request to add another plaintiff instead of the one who withdrew has not yet been held.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. (cont'd)

4. (cont'd)

In the opinion of the Management of the Bank, based on the opinion of management of Leumi Mortgage Bank, which is based on the opinion of its legal advisors, it is not possible at this stage to estimate the chances of the appeals.

B. On 19 August 2007, a petition to approve a class action was filed in the Jerusalem District Court against Leumi Mortgage Bank, together with a statement of class action claim regarding the joining of an "additional borrower" to a portion of the 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 Leumi Mortgage 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 joined as 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 people who were classified as "additional borrowers" by Leumi Mortgage Bank, who have no rights to the pledged property and who, in connection with the loan, were required to take out life insurance and pay insurance premiums in respect thereof, either directly or through the principal borrowers, during the seven years prior to the filing of the petition.

The petitioners are requesting the reimbursement of 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.

With the consent of the class action plaintiff, it was agreed that the date for Leumi Mortgage Bank's submission of its response to the petition would be deferred until a decision is rendered in another case which deals with a similar issue, such that at this stage the deliberation of the case is effectively stayed.

According to Management of the Bank, in reliance on the opinion of management of Leumi Mortgage Bank, based on the opinion of its legal advisors, it is not possible at this early stage to estimate the chances of the claim.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

H. 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 2008, amounted in nominal values to NIS 1,092 million (31 December 2007 - NIS 3,451 million). The value of the assets of the aforesaid funds as of 31 December 2008, amounted to NIS 960 million. 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 127 thousand as of 31 December 2008. The fair value of the above liabilities as of 31 December 2008 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.

I. 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.

J. 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).

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

J. Letters of indemnity (cont'd)

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 2008, 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 indemnify 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 2009 to its directors and officers as well as to the lawyers of the issues, 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 in connection with the prospectuses, and in respect of reasonable litigation expenses. The maximum indemnification for issues carried out is NIS 12.57 billion.

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.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

J. Letters of indemnity (cont'd)

(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.

(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.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

J. Letters of indemnity (cont'd)

(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 has undertaken 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.

(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 (4) above.

(9) The Bank has undertaken 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).

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

J. Letters of indemnity (cont'd)

(10) The Bank has undertaken to indemnify Goldman Sachs International ("Goldman Sachs") 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 has undertaken in advance to indemnify the underwriters to the Group's insurance policy (including banking, responsibility, directors and other officers 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).

(12) The Bank has undertaken to indemnify Tali Basket Certificates Ltd. (formerly Ofek Leumi Financial Instruments Ltd.) and Tali 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.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

J. Letters of indemnity (cont'd))

(13) The Bank has undertaken 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 has undertaken 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.

(14) The Bank has undertaken 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 has undertaken to indemnify Harel Mutual Funds Management Ltd. ("Harel"), 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 connection with an investigation by the Israel Securities Authority, and in connection with the Bank's debts and liabilities to the tax authorities.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

J. Letters of indemnity (cont'd)

(16) The Bank has undertaken 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 has undertaken to indemnify Visa International (Europe) and Mastercard in respect of carrying out the liabilities of Bank Leumi Romania S.A. concerning "Visa" and "Mastercard" credit card activity, whichever applicable (no maximum indemnification has been decided).

(18) The Bank has undertaken to indemnify Visa Europe regarding the execution of the liability of Leumi Card Ltd. in connection with opening new accounts by Leumi Card Ltd. for purposes of multi-currency clearing.

(19) 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.

(20) The Bank has undertaken 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).

(21) The Bank has undertaken 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.

(22) From time to time, and in accordance with the normal terms and circumstances for banking transactions, it is the Bank's practice to provide letters of indemnity both limited and unlimited as to amount and period, all of which 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.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

J. Letters of indemnity (cont'd))

(23) From time to time, it is the Bank's practice to provide letters of indemnity both limited and unlimited as to amount and period to subsidiary companies, 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.

K. Union Bank of Israel Ltd.

On 17 November 2003, concurrently with the exercise of the put option for the sale of one third of the shares of Union Bank to Shlomo Eliahu Holdings Ltd. ("Eliahu), an agreement was signed between the Bank, Sherodar Assets Ltd. ("Sherodar") and Yeshayu Landau Holdings (1993) Ltd.("Landau") (hereinafter – "the extension agreement"), under whose terms the period of the put option and call option granted to the parties in the agreement dated 18 November 1999 signed between the said parties and Eliahu ("the agreement") regarding the balance of Union Bank shares held by the Bank ("the balance of the shares") was extended until 17 November 2010, at the price and under the terms stipulated in the extension agreement.

It was stipulated in the extension agreement that 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 in accordance with the reviewed financial statements of Union Bank for the period ending 30 June 2003, with the addition of linkage differences and index-linked interest at the rate of 2% per annum from 1 July 2003 until the date of the financial statements published before the exercise of the option ("the determining statements") and with the addition of linkage differences and index-linked interest at the rate of 5% per annum from the end of the period to which the determining statements relate until the date of exercise of the put option, and subject to certain adjustments and deductions.

In addition, the extension agreement states that the exercise price of the call option regarding the balance of the shares will be equal 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 of Union Bank, various adjustments will be made in respect of the 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.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

L. Credit Cards

(1) In the separation agreement for ownership of Israel Credit Cards Ltd. (hereinafter - "ICC") 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 and payment thereof is subject to various conditions.

(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 9 july 2009.

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)

L. 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. On 31 October 2007, the Tribunal decided to give a temporary permit for the arrangement after a provisional permit for the arrangement had been previously granted.

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.
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.

Following the decision of the Tribunal, Dr. Yossi Bachar was appointed as examining expert and on 1 January 2009 his opinion was submitted to the Tribunal and to the parties. The Tribunal has to fix a date for the examination of the expert regarding his opinion.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

L. Credit Cards (cont'd)

Total issuer's commissions received by the Bank in 2008 amounted to NIS 73 million, compared with NIS 68 million during the corresponding period in the prior year.

(3) The Bank has undertaken with regard to Visa International to take full responsibility for the proper execution by Leumi Card of all the provisions and requirements included in the Articles of Visa International as in effect from time to time, to perform all actions necessary in order to fulfill this commitment and to notify Visa International immediately in writing regarding any material change in the agreement between the Bank and Leumi Card.

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.
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.

Following the decision of the Tribunal, Dr. Yossi Bachar was appointed as examining expert and on 1 January 2009 his opinion was submitted to the Tribunal and to the parties. The Tribunal has to fix a date for the examination of the expert regarding his opinion.

(4) The Bank has undertaken with regard to World MasterCard and to all other Mastercard members to take full responsibility for the carrying out all Leumi Card'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 Leumi Card's aforesaid obligations.

(5) During the normal course of business, legal claims have been submitted against Leumi Card including a request for approval of a class action. In the view of management of the Bank, based on the view of management of Leumi Card, which is based on the opinion 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 where required to cover damages resulting from such claims.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

M. 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 a revaluation be made of the funds, 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.

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 and 18 September 2008, the Bank received two requests from the Company for payment of amounts which the Company claimed that the Bank is required to transfer to it according to the Law. The amount of the two requests, after having been reduced by the company and revalued to 31 December 2008, is some NIS 186 million. The Bank responded to these two requests while rejecting the claim that it has any financial liability with respect to the majority of the assets included in the requests.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

M. (cont'd)

The Bank appointed the Honorable Supreme Court Justice (ret'd) Theodore Orr as an external examiner to carry out an independent and impartial investigation 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. In the report that he delivered to the Bank, the examiner reinforced the Bank's position with regard to the main points of disagreement between the Bank and the Company. The examiner refers to the dormant accounts, details of which were published by the Bank in 2000 on its website, in coordination with the Administrator General, as "unclaimed accounts". The examiner states that the legal obligation to prove whether these funds belong to Holocaust victims is borne by the Company, and that it will be difficult to prove this. The examiner recommends that the Bank grant the Company a certain amount, as a gesture of goodwill, such to be estimated by the Bank in the future, following the submission of all the Company's requests. The examiner mentions the amount already transferred by the Bank, as referred to above, and that such amount may constitute all or part of this grant. Following submission of all the Company's requests, and once it has all the relevant data, a discussion will be held by the Board of Directors, while taking into account this recommendation.

At this stage, the Bank estimates that no additional provision in respect of the above-mentioned requests or in respect of the contents of the examiner's report is necessary.

On 11 February 2009, the Bank received an additional request from the Company, for the payment of a revalued amount of some NIS 120 million. The Bank is examining this request. At this stage, it is not yet possible to evaluate the factual and legal basis for this request.

N. 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 infrastructure 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 2008.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

O. 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 2008.

P. In March 2008, the Bank received a letter from the Antitrust Authority stating that the General Director was currently examining the possibility of exercising her authority according to section 43(a)(1) of the Antitrust Law, 1988, (the "Antitrust Law") 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.

In September of 2008, the Bank submitted its detailed position in writing to the General Director, to the effect that there is no factual or legal basis for issuing a determination such as described above, and maintained its request that it be given the right to make oral arguments to supplement its arguments. The Antitrust Authority rejected the request for the right to make oral arguments. In January 2009, a deliberation was held between the legal representatives of all the banks and the General Director, during which the General Director suggested the banks to pay an aggregate amount of NIS 290 million (out of which NIS 80 million was to be paid by the Bank) and future rules of behaviour be laid down by a consent decree pursuant to the Antitrust Law. The Bank rejected this offer. Additional contacts took place between the Bank and the General Director, to no end. It is possible that the General Director will exercise her authority, as mentioned in her letter dated 19 March 2008.

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 2008 the State of Israel held 11.46% of the Bank's issued share capital (11.28% fully diluted) and 14.20% of the voting rights in the Bank (13.97% fully diluted). On 1 March 2009 (after the expiry of the balance of the options held in 14 February 2009), the State held 11.46% of the Bank's issued share capital and 14.20% of the voting rights in the Bank.

In accordance with the Bank Shares Law in the Arrangement (Interim Regulation), 1993, in order to avoid government involvement in the routine management of the business of the banks (in the period up to the sale of the shares) but at the same time safeguarding the property interests of the State in the shares, committees were formed for each of the banks in the Share Arrangement whose function was to participate in general meetings of the shareholders of the bank and to vote in them by virtue of the shares held by the State. The term of the shares committee in the Bank ended in October 2008. On 12 March 2009, the Bank Shares in the Arrangement (Interim Regulation) (Appointment of Other Committees and their Period of Office) Regulations, 1993, were published, according to which other committees will be appointed concerning the shares of the relevant banks, including the Bank, for a period of another three years (subject to the possibility of the period of office being shortened, as detailed in the said Regulations).

Sale of Shares in the Bank by the State

Further to the procedure for the sale of up to 20% of the State's shares in the Bank, published by the Accountant General in the Ministry of Finance and M.I. Holdings Ltd. ("MIH") in 2005, Barnea Investments B.V. ("Barnea") purchased 9.99% of the Bank's share capital in November 2005.

The government also granted Barnea an option to purchase a further 10.01% of the capital of the Bank. The option expired on 24 May 2007. According to the conditions of the sale procedure, Barnea was required to sell at least 4.99% of the shares of the Bank (of the 9.99% that it purchased) within a year of said date. Consequently, on 18 May 2008, Barnea notified the Bank that on 15 May 2008 it had transferred 70,570,211 ordinary shares of the Bank to Gabriel Capital Corporation or its affiliates (together, "Gabriel Funds") in consideration for the interest of Gabriel Funds in Barnea S.a.r.l (the parent company of Barnea), and an undertaking of Gabriel Funds to make future payments to Barnea, subject to certain conditions and circumstances. In addition, Barnea notified the Bank that, following the above transaction, Mr. Ezra Merkin and the Gabriel Funds controlled by him do not hold any interest, directly or indirectly, in Barnea, which is now wholly controlled by Mr. Stephen Feinberg, through the Cerberus private investment fund group.

In January 2009 M.I. Holdings notified the Bank that M.I. Holdings did not have any defined plan for the sale of the Bank's shares.

On 31 December 2008 Shlomo Eliahu Holdings Ltd. and its subsidiaries and related parties ("the Eliahu Group") held 9.59% of the Bank's issued capital and voting rights, (9.44% fully diluted), and as of 10 March 2009, 9.59%.

On 31 December 2007 the Eliahu Group held 9.9969% of the Bank's issued share capital.

Note 19 - Interested and Related Parties of the Bank and its Subsidiaries (cont'd)

A. General (cont'd)

On 3 September 2007, Otzar Hityashvuth Hayehudim Ltd., together with J.C.T. Trust Ltd., 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 2008

	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)	**-**	**-**	**-**	**-**	**101**	**104**	**-**	**-**	**257**	**655**
Credit to the public	**-**	**250**	**2**	**3**	**-**	**-**	**436**	**1,489**	**5,112**	**5,114**
Investments in companies included on equity basis (d)	**-**	**-**	**-**	**-**	**-**	**-**	**1,842**	**2,031**	**-**	**-**
Other assets	**-**	**3**	**-**	**-**	**8**	**8**	**32**	**57**	**36**	**61**
Liabilities										
Deposits of the public	**56**	**80**	**8**	**14**	**-**	**-**	**932**	**932**	**533**	**926**
Deposits from banks	**-**	**-**	**-**	**-**	**25**	**25**	**-**	**-**	**-**	**-**
Debentures, bonds and subordinated notes	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**5**
Other liabilities	**-**	**6**	**-**	**-**	**-**	**27**	**258**	**314**	**63**	**131**
Credit risk in off-balance sheet items (e)	**-**	**4**	**3**	**3**	**118**	**153**	**410**	**679**	**2,045**	**2,973**

(a) Including their spouses and minor children and companies controlled by them.
(b) As at 31 December 2008 the directors and the CEO held Bank shares with a par value of NIS 411,441 and 61,322 options exercisable into the 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.

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 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)(d)
	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 the 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

	2008				
	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)	**(3)**	**-**	**(4)**	**12**	**240**
Operating and other income	**-**	**-**	**47**	**10**	**176**
Including management and service fees	**-**	**-**	**-**	**-**	**134**
Operating and other expenses (b)	**-**	**(19)**	**-**	**(17)**	**(33)**
Total	**(3)**	**(19)**	**43**	**5**	**383**

	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

(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

	2008		2007	
	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)	**7**	**2**	15	2
Directors not employed in the Bank or on its behalf (a)	**(c) 9**	**14**	(c) 5	14

(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 3,417 thousand (2007 - NIS 5,781 thousand).

(b) Does not include VAT on salaries.

(c) The amounts: NIS 8,972 thousand in 2008 compared with NIS 4,751 thousand in 2007.

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

	2008		2007		2006	
	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	**259**	**21**	336	68	285	27
b) Expenses on liabilities						
Deposits of the public	**(55)**	**41**	(62)	(31)	(74)	(11)
Deposit with banks	**(4)**	**-**	(3)	-	-	-
Debentures and subordinated notes	**-**	**-**	(5)	-	(14)	(1)
c) Income on derivative financial instruments						
Net income (expenses) in respect of ALM derivatives	**42**	**32**	(95)	5	(102)	(5)
d) Other						
Financing commissions	**4**	**-**	3	-	3	-
Other financing Expenses	**(1)**	**-**	(1)	-	(10)	-
Net interest income before provision for doubtful debts	**245**	**12**	173	42	88	10

Note 20 - Net Interest Income before Provision for Doubtful Debts

Reported Amounts

	2008	2007	2006
	NIS millions		
A. Income on assets (a)			
Credit to the public	**11,483**	9,145	7,863
Credit to governments	**24**	3	(8)
Deposits with Bank of Israel and cash	**535**	(154)	(34)
Deposits with banks	**(1,110)**	(604)	(464)
Debentures	**(e) 914**	(e) 667	417
Interest income from securities borrowed or purchased under agreement to resell	**31**	14	-
Total income on assets	**11,877**	9,071	7,774
B. Expenses on liabilities (a)			
Deposits of the public	**(2,536)**	(1,322)	(2,087)
Deposits from governments	**(40)**	(66)	(42)
Deposits from Bank of Israel	**(55)**	(137)	(44)
Deposits from banks	**(287)**	11	(84)
Debentures, bonds and subordinated notes	**(1,682)**	(957)	(476)
Interest expense from securities loaned or sold under agreement to repurchase	**(27)**	1	-
Total expenses on liabilities	**(4,627)**	(2,470)	(2,733)
C. Income on derivative financial instruments			
Ineffective part of hedge ratio (b)	**-**	3	(1)
Net income (expenses) in respect of ALM derivatives (c)	**(509)**	21	1,077
Net income in respect of other derivatives	**(97)**	(15)	(12)
Total from derivatives and hedging activities	**(606)**	9	1,064
D. Other			
Financing commissions	**337**	308	282
Other financing income (d)	**(601)**	730	535
Total other	**(264)**	1,038	817
Total net interest income before provision for doubtful debts	**6,380**	7,648	6,922
Including net exchange rate linkage differences	**(2)**	16	32

(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 1K.

(d) Including interest collected in respect of doubtful debts in the amount of NIS 507 million (2007 - NIS 461 million, 2006 - NIS 325 million).

(e) Including negative interest and exchange difference in respect of mortgage-backed bonds (MBS) in the amount of about NIS 24 million (2007 - NIS 216 million).

Note 20 - Net Interest Income before Provision for Doubtful Debts (cont'd)

Reported Amounts

	2008	2007	2006
	NIS millions		
E. Details of operating results of investments in debentures			
Interest on debentures, on accrual basis:			
Held to maturity	**66**	72	123
Available for sale	**565**	247	110
Held for trading	**283**	348	184
Total, included in interest income on assets	**914**	667	417
Other financing income (expenses)			
Gain on sale of debentures available for sale	**59**	138	32
Losses on sale of debentures available for sale and provisions for impairment	**(1,396)**	(30)	(3)
Realized and unrealized profits from adjustments of held for trading debentures to fair value, net (a)	**82**	(22)	73
Total, included in other financing income (expenses)	**(1,255)**	86	102
Total from investments in debentures	**(341)**	753	519

F. Net effect of hedged derivatives on income from financing activity

	2008	2007	2006
	NIS millions		
Interest income (expenses) in respect of assets	**(11)**	(6)	9
Interest income (expenses) in respect of liabilities	**26**	18	(39)

(a) Of which part of the profit related to traded debentures still held as of balance sheet date in the amount of NIS (23) million (2007 - NIS (60) million, 2006 - 14 million).

Note 21 - Operating Commissions

Reported Amounts

	2008	2007	2006
	NIS millions		
Ledger fees (a)	**239**	255	254
Payment transfer services (a)	**901**	830	764
Handling of credit and preparing agreements	**364**	377	318
Computerized services, information and confirmations	**26**	38	38
Foreign trade transactions and special foreign currency services	**125**	138	132
Income from securities transactions	**782**	866	733
Income from credit cards (a)	**765**	672	595
Interest margin and collection commission on deposits and credit from deposits on collection basis:			
Collection commissions on credit out of treasury funds	**40**	43	44
Other commissions and interest margins	**14**	19	19
Management fees and commissions on life assurance and on housing insurance	**45**	48	50
Other	**61**	64	66
Total operating commissions	**3,362**	3,350	3,013

(a) In respect of the decline in account management fees, compensatory commissions in the accounts payments' system services and credit card income.

Note 22 – Profits (Losses) from Investments in Shares (a), net

Reported Amounts

	2008	2007	2006
	NIS millions		
Gains on sale of shares available for sale	**141**	250	7
Losses on sale of shares available for sale and provisions for impairment	**(656)**	(32)	(6)
Realized and unrealized losses from adjustments of held for trading shares to fair value, net (b)	**(528)**	(2)	(12)
Dividend on shares available for sale and on held for trading shares	**131**	245	139
Total from investments on shares	**(912)**	461	128

(a) Including mutual funds.

(b) Of which the part of the gains (losses) relating to traded shares still held as at balance sheet date is NIS (326) million (2007 - NIS (1) million; 2006 - NIS (1) million).

Note 23 - Other Income
Reported Amounts

	2008	2007	2006
	NIS millions		
Income from provident funds (a)	**4**	29	245
Income from mutual funds (a)	**123**	165	391
Profits from severance pay funds	**-**	63	23
Provident funds operation fees	**49**	43	-
Other, net (b)	**174**	111	81
Total other income	**350**	411	740

(a) From 2007 only distribution commissions.
(b) Including income from Visa International in the amount of NIS 91 million.

Note 24 - Salaries and Related Expenses
Reported Amounts

	2008	2007	2006
	NIS millions		
Salaries	**2,474**	2,788	2,485
Severance pay, provident fund, continuing education fund, pension, vacation and long service bonus	**589**	445	718
Expense deriving from share-based payment transactions settled with capital instruments	**(65)**	250	452
National insurance and VAT on salaries	**339**	524	489
Other related expenses	**171**	162	148
Adjustment of provisions for related expenses as a result of current changes in salaries in the current year	**607**	49	85
Voluntary retirement	**3**	-	175
Total salaries and related expenses (a)	**4,118**	4,218	4,552
The above includes:			
Salaries and related expenses abroad	**525**	514	445

Note 25 - Other Expenses

Reported Amounts

	2008	2007	2006
	NIS millions		
Marketing and advertising	**271**	265	267
Legal, audit and professional consultancy	**287**	270	292
Communications - postage, telephone, delivery services, etc.	**158**	152	149
Computers (a)	**232**	219	224
Office expenses	**92**	92	92
Insurance	**29**	26	45
Training	**32**	36	18
Amortization of goodwill	**17**	15	13
Other (b)	**370**	370	395
Total other expenses	**1,488**	1,445	1,495

(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.

Note 26 - Provision for Taxes on Operating Profit

Reported Amounts

A. Composition

	2008	2007	2006
	NIS millions		
Current taxes -			
In respect of current year	**342**	1,660	1,560
In respect of prior years	**46**	39	(2)
Total current taxes	**388**	1,699	1,558
Add (deduct) changes in deferred taxes -			
In respect of current year	**29**	9	(265)
In respect of prior years	**4**	14	27
Total deferred taxes	**33**	23	(238)
Total provision for taxes	**421**	1,722	1,320
Includes provision for foreign taxes	**(27)**	166	130

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:

	2008	2007	2006
Statutory tax rate applying to a bank in Israel	**36.80%**	38.53%	40.65%
	NIS millions		
Tax at the statutory tax rate	**12**	1,744	1,059
Tax (tax saving) resulting from:			
General and supplementary provisions for doubtful debts	**27**	(51)	12
Other non-deductible expenses (a)	**143**	26	99
Income of foreign subsidiaries	**88**	(b) 142	(b) 85
Income of Israeli subsidiaries	**(33)**	(44)	(23)
Inflationary depreciation adjustments	**1**	(22)	(2)
Inflationary addition (deduction)	**-**	(140)	16
Tax exempt and preferred income	**(22)**	(39)	(19)
Timing differences for which deferred taxes have not been provided	**43**	1	2
Profit tax on VAT on salaries, net	**(32)**	35	33
Change in deferred taxes due to change in tax rates	**21**	4	27
Taxes in respect of prior years (c)	**50**	53	25
Other	**(d) 123**	13	6
Provision for taxes on operating profit	**421**	1,722	1,320

(a) Includes in 2008 cancellation of deferred tax receivable due to the impairment in the value of the benefit to employees and non-deductible expenses deriving from the issuance of options and sale of options to employees in the amount of NIS 105 million (2007 – NIS (1) million, 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.

(d) Effect of losses transferred for tax purposes which are not recognized for purposes of profits tax.

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 Order 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, 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 tax expenses of the Group in 2008. In 2007 the discount for inflation reduced taxes by the amount of about NIS 140 million and in 2006 the addition for inflation increased taxes by the amount of about NIS 16 million.

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.

The Amendment to the Law will reduce the net tax liability of the Group from 2009 by about NIS 26 million per year. In addition deferred taxes were 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 36 million.

E. Final assessments have been issued to the Bank for all years up to and including the 2004 tax year. Principal consolidated companies have final assessments for the years up to and including 2002.

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 view of this, 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 manner presentation of the securities in the financial statements of the financial institutions.

In coordination 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 future tax purposes, and in respect of which it has been determined that no reserve for deferred taxes is to be made, is as follows:

	December 31		
	2008	2007	2006
	NIS millions		
Balance at the beginning of the year	**203**	217	230
Change in the current year (a)	**(13)**	(14)	(13)
Balance at the end of the year	**190**	203	217

(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 other deductions which were claimed for tax purposes and in respect of which no deferred tax asset was created, amounting in the consolidated companies to approximately NIS 26 million (31 December 2007 - approximately NIS 56 million). These amounts will be realizable in the future provided that the subsidiaries for 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 **2008**	31 December 2007	31 December **2008**	31 December 2007
	NIS millions		Average tax rate %	
Deferred tax assets				
From specific provision for doubtful debts	**173**	246	**40%**	38%
From provision for unutilized vacations and long service bonus	**273**	242	**35%**	34%
From excess of provision for severance pay and pension over amounts funded	**1,006**	725	**35%**	34%
From interest not credited to current income	**59**	56	**38%**	38%
From tax loss carry forward	**366**	3	**26%**	42%
From activity abroad	**11**	9	**36%**	35%
From adjustment of depreciable non-monetary assets	**34**	31	**44%**	37%
Other – from monetary assets	**-**	1	**-**	37%
Other – from non-monetary assets	**39**	27	**24%**	31%
Share-based payment transactions	**2**	270	**27%**	33%
Total	**1,963**	1,610		
Reserve for deferred taxes				
From securities	**(26)**	(254)	**34%**	34%
From investments in investee companies	**(137)**	(129)	**12%**	12%
Adjustment of depreciable non-monetary assets	**(89)**	(64)	**31%**	28%
Other – from monetary assets	**(12)**	(3)	**36%**	37%
Other – from non-monetary assets	**(21)**	(12)	**27%**	26%
Total	**(285)**	(462)		
Deferred taxes receivable, net	**1,678**	1,148		
Deferred taxes included: (a)				
In "Other assets"	**1,745**	1,265		
In "Other liabilities"	**(67)**	(117)		
Deferred tax assets, net	**1,678**	1,148		

(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.

J. Deferred taxes have been calculated at the statutory tax rate applying to the companies at the time of utilization.

K. Changes in deferred taxes amounting to NIS 634 million (2007 - NIS 89 million; 2006 - NIS (299) million) derive from securities available 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 to employees and others) have been charged to equity in the amount of NIS (50) million (2006 - NIS 4 million).

Note 26 - Provision for Taxes on Operating Profit (cont'd)
Reported Amounts

L. Under an arrangement with the tax authorities from 14 April 2005, the Bank is entitled as from 2004 to set off, against 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, 2008 is about $54 million. Utilization of these amounts in the future will be possible 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 after Taxes from Extraordinary Items

Reported amounts

	2008	2007	2006
	NIS millions		
Net gain on realization of investments in investee companies and sale of activities	**258**	564	3,434
Elimination of extraordinary provisions (extraordinary provisions) in connection with fixed assets	**1**	7	-
Net gain (loss) from sale of buildings	**(2)**	28	12
Net profit (loss) before taxes	**257**	599	3,446
Provision for taxes on profit (loss) from extraordinary items:			
Current taxes	**7**	222	1,502
Deferred taxes	**-**	-	(136)
After-tax profit (loss) from extraordinary items	**250**	377	2,080
Share of profits of minority shareholders of consolidated companies, net of extraordinary items after taxes	**-**	(4)	-
After-tax profit (loss) from extraordinary items	**250**	373	2,080

(a) In 2008 the profit derives mainly from the allocation of 20% of the equity of Leumi Card to the Kanit Co. As a result of the above allocation the net profit of the Bank was about NIS 234 million. Regarding profits in 2007 and 2006 see Note 6C – Details regarding sale of investee companies.

Note 28 – Activity Sectors and Geographical Distribution

The Bank in Israel is organized into five business lines, operated though five 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 business line in accordance with 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)

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.

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

Until 2007 the Construction and Real-estate segment was shown separately. From 2008 the segment was reallocated between the other segments and shown as a product in each of the segments in which there is the above activity.

Allocation to a specific operational segment is carried out according to additional quantitative criteria and criteria such as: size of obligo with regard to business customers, and financial wealth with regard to private customers. Criteria such as the nature of a corporation's business operations and the volume of its business, such as activity volume, international trade volume, complex and special transactions, complex projects and construction financing, can change the segmental allocation of a specific customer.

As mentioned above, the Bank is organized into five business lines, and its policy is to allocate, as best as possible, the customers to the business line/activity sector appropriate for them, in accordance with their characteristics and activities. It should be emphasized however that segmental allocation 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, i.e. as long as the customer does not receive service from the segment to which he should be allocated under the above criteria, the segmental classification does not change.

Financial Measurement System

To provide administrative support for the operations according to segments, a profit-center operating and administrative system exists in the Bank according to business lines and additional cross-sections (the "Bachan" system).

The objectives of the system are:

- Measurement of the profitability of the various profit centers;
- Measurement of the business activity volume of the various profit centers according to various classifications;
- Measurement of 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.

Note 28 - Activity Sectors and Geographical Distribution (cont'd)

Financial Measurement System (cont'd)

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 Bachan system as explained below, while the data for the segments 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.

Note 28 - Activity Sectors and Geographical Distribution (cont'd)

Financial Measurement System (cont'd)

Operating Income

All the operating income (commissions and other operating income) that the Bank charges its customers and/or its subsidiaries for 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 in accordance with the volume of activity (number of operations of the profit center).

Costing is activity based – the system calculates the cost per transaction after considering the transaction type, line of business and distribution channel. The system costs some 6,400 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.

Measuring Return on Equity

For every activity segment a calculation is made of the segment's risk assets and in accordance with the results of the calculation Tier I and Tier II capital are allocated to the segment. In accordance with results the yield on equity is calculated for the 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 2008

	Households	Private Banking	Small Businesses	Commercial Banking	Corporate Banking	Financial management	Other	Total consolidated
	NIS millions							
Net interest income (loss) before provision for doubtful debts								
From outside entities -	300	1,208	3,905	2,295	(597)	(732)	1	6,380
Intersegmental -	2,337	(302)	(2,022)	(906)	959	(51)	(15)	-
Total	2,637	906	1,883	1,389	362	(783)	(14)	6,380
Operating and other income:								
From outside entities -	1,689	434	335	402	397	(624)	167	2,800
Intersegmental -	237	(26)	(164)	(32)	15	2	(32)	-
Total	1,926	408	171	370	412	(622)	135	2,800
Total income	4,563	1,314	2,054	1,759	774	(1,405)	121	9,180
Provision for doubtful debts	340	182	1,070	485	10	58	-	2,145
Operating and other expenses	3,158	708	512	858	580	1,145	42	7,003
Operating profit (loss) before taxes	1,065	424	472	416	184	(2,608)	79	72
Provision for taxes(benefit) on operating profit	436	190	178	172	72	(890)	263	421
Operating profit (loss) after taxes	629	234	294	244	112	(1,718)	(184)	(389)
Equity in after-tax operating profits (losses) of companies included on equity basis, net of related tax effect	-	-	-	1	-	252	(4)	249
Minority interest in after- tax operating profits of subsidiaries	(13)	-	-	-	(2)	(3)	-	(18)
Net operating profit (loss)	616	234	294	245	110	(1,469)	(188)	(158)
After-tax profit (loss) from extraordinary items	202	18	2	26	3	-	(1)	250
Net profit (loss)	818	252	296	271	113	(1,469)	(189)	92
Return on capital (percentage of profit from the proportionate capital according to share of sector in risk assets)	19.7	20.7	4.5	6.9	19.0	(47.6)	(44.3)	0.5

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 2008

	Households	Private Banking	Small Businesses	Commercial Banking	Corporate Banking	Financial management	Other	Total consolidated
	NIS millions							
Average balance of assets	**60,319**	**18,027**	**72,320**	**50,852**	**10,170**	**81,636**	**6,070**	**299,394**
Including: investments in companies included on equity basis	**8**	**-**	**-**	**4**	**-**	**1,829**	**66**	**1,907**
Average balance of liabilities	**121,917**	**14,421**	**29,524**	**30,533**	**39,170**	**41,793**	**2,266**	**279,624**
Average balance of risk assets	**52,202**	**15,348**	**83,285**	**49,190**	**7,496**	**38,870**	**5,380**	**251,771**
Average balance of assets of mutual funds	**32,689**	**1,346**	**746**	**2,833**	**4,627**	**339**	**-**	**42,580**
Average balance of securities	**42,523**	**3,345**	**70,602**	**39,222**	**62,122**	**105,053**	**-**	**322,867**
Average balance of other managed assets	**8,077**	**464**	**290**	**963**	**292**	**-**	**122**	**10,208**
Margin of credit activities	**1,051**	**635**	**1,275**	**929**	**50**	**6,382**	**(12)**	**10,310**
Margin of deposit activities	**1,353**	**166**	**80**	**257**	**275**	**(6,093)**	**(16)**	**(3,978)**
Other	**233**	**105**	**528**	**203**	**37**	**(1,072)**	**14**	**48**
Total interest income (loss) before provision for doubtful debts	**2,637**	**906**	**1,883**	**1,389**	**362**	**(783)**	**(14)**	**6,380**

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 2007

	Households	Private Banking	Small Businesses	Commercial Banking	Corporate Banking	Financial management	Other	Total consolidated
	NIS millions							
Net interest income (loss) before provision for doubtful debts								
From outside entities -	(674)	1,040	3,436	2,127	(1,290)	2,987	22	7,648
Intercompany operations -	3,243	(172)	(1,728)	(688)	1,767	(2,357)	(65)	-
Total	2,569	868	1,708	1,439	477	630	(43)	7,648
Operating and other income:								
From outside entities -	1,676	442	530	427	461	370	316	4,222
Intersegmental -	226	(27)	(152)	(31)	16	2	(34)	-
Total	1,902	415	378	396	477	372	282	4,222
Total income	4,471	1,283	2,086	1,835	954	1,002	239	11,870
Provision for doubtful debts	178	139	(71)	180	-	(19)	-	407
Operating and other expenses	3,456	893	525	899	687	435	42	6,937
Operating profit before taxes	837	251	1,632	756	267	586	197	4,526
Provision for taxes on operating profit	269	105	613	275	76	356	28	1,722
Operating profit after taxes	568	146	1,019	481	191	230	169	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 (profits) of subsidiaries	-	-	-	-	(5)	2	(1)	(4)
Net operating profit	568	146	1,019	486	186	411	168	2,984
After-tax profit from extraordinary items	278	29	18	16	6	-	26	373
Net profit	846	175	1,037	502	192	411	194	3,357
Return on capital (percentage of profit from the proportionate capital according to share of sector in risk assets)	22.1	15.4	16.5	12.2	33.4	14.0	41.9	17.4

(a) Reclassified

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 2007

	Households	Private Banking	Small Businesses	Commercial Banking	Corporate Banking	Financial management	Other	Total consolidated
	NIS millions							
Average balance of assets	54,162	17,237	67,040	50,632	10,257	91,189	5,636	296,153
Including: investments in companies included on equity basis	4	-	-	10	-	1,634	56	1,704
Average balance of liabilities	121,861	14,276	28,540	33,486	42,577	33,243	2,898	276,881
Average balance of risk assets	46,307	13,776	76,142	49,754	6,959	35,592	5,616	234,146
Average balance of assets of mutual funds	34,899	1,242	459	2,744	5,635	245	-	45,224
Average balance of securities	42,959	4,797	78,929	41,463	65,051	109,874	758	343,831
Average balance of other managed assets	8,381	475	558	1,222	417	-	-	11,053
Margin of credit activities	932	572	1,151	891	83	4,335	(62)	7,902
Margin of deposit activities	1,367	173	109	231	454	(4,369)	52	(1,983)
Other	270	123	448	317	(60)	664	(33)	1,729
Total interest income (loss) before provision for doubtful debts	2,569	868	1,708	1,439	477	630	(43)	7,648

(a) Reclassified

Note 28 - Activity Sectors and Geographical Distribution (cont'd)

A. Information on activity by banking sectors (cont'd)

Statement of profit and loss for the year ended 31 December 2006

	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:									
From outside entities -	1,470	388	346	405	413	47	126	686	3,881
Intersegmental -	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 (loss) 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 (loss) after taxes	123	86	108	368	563	217	(152)	(30)	1,283
Equity in after-tax operating profits of companies included on equity basis, net of related tax effect	-	-	-	-	-	-	174	(3)	171
Minority interest in after- tax operating losses (profit) of subsidiaries	-	(2)	-	-	-	-	2	-	-
Net operating profit	123	84	108	368	563	217	24	(33)	1,454
After-tax profit from extraordinary items	1,127	76	54	74	32	1	718	(2)	2,080
Net profit	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%

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 2006 (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	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, supplementary training 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 (loss) before provision for doubtful debts	2,324	354	724	1,177	1,461	580	300	2	6,922

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 2008

	Israel	United States	Great Britain	Switzerland	Luxembourg	Romania	Others	Total outside of Israel	Total consolidated
	NIS millions								
Total income (b)	**8,571**	**638**	**26**	**296**	**(452)**	**106**	**(5)**	**609**	**9,180**
Net profit (loss)	**516**	**31**	**(243)**	**25**	**(192)**	**(54)**	**9**	**(424)**	**92**
Total assets	**268,792**	**22,033**	**8,760**	**3,453**	**5,312**	**1,874**	**568**	**42,000**	**310,792**
Credit to the public	**189,208**	**13,810**	**6,457**	**1,977**	**111**	**1,204**	**448**	**24,007**	**213,215**
Deposits of the public	**212,923**	**15,971**	**5,901**	**1,408**	**7,111**	**979**	**490**	**31,860**	**244,783**

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)	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

(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.

Note 29 - Earmarked Deposits, Credit and Deposits from Earmarked Deposits

Reported Amounts

	31 December 2008	31 December 2007
	NIS millions	
Credit and deposits from earmarked deposits		
Total credit to the public	**432**	636
Earmarked deposits		
Deposits of the public	**16**	20
Deposits from banks	**29**	-
Deposits from the Government	**677**	873
Total	**722**	893

Note 30 - Condensed Financial Statements of the Bank

Reported Amounts

A. Balance sheets of the Bank as at 31 December 2008

	31 December 2008	31 December 2007
	NIS millions	
Assets		
Cash and deposits with banks	**58,355**	62,488
Securities	**37,056**	35,723
Securities borrowed or purchased under agreement to resell	**125**	655
Credit to the public	**144,574**	133,729
Credit to governments	**520**	642
Investments in subsidiaries and companies included on equity basis	**12,518**	12,258
Buildings and equipment	**3,011**	2,807
Other assets	**11,547**	6,179
Total assets	**267,706**	254,481
Liabilities and equity capital		
Deposits of the public	**221,409**	208,422
Deposits from banks	**3,481**	5,457
Deposits from governments	**733**	936
Securities loaned or sold under agreement to repurchase	**374**	173
Subordinated notes	**4,637**	4,542
Other liabilities	**18,400**	15,402
Total liabilities	**249,034**	234,932
Shareholders' equity	**18,672**	19,549
Total liabilities and equity capital	**267,706**	254,481

Note 30 - Condensed Financial Statements of the Bank (cont'd)

Reported Amounts

B. Statements of profit and loss for the year ended 31 December 2008

	For the year ended 31 December		
	2008	2007	2006
	NIS millions		
Net interest income before provision for doubtful debts	**4,972**	6,602	5,533
Provision for doubtful debts	**1,751**	318	734
Net interest income after provision for doubtful debts	**3,221**	5,744	4,799
Operating and other income	**1,628**	2,756	2,389
Operating and other expenses	**5,085**	5,059	5,388
Operating profit (loss) before taxes	**(236)**	3,441	1,800
Provision for taxes on operating profit	**217**	1,314	943
Operating profit (loss) after taxes	**(453)**	2,127	857
Bank's equity in after-tax operating profits of subsidiaries and companies included on equity basis, net of related tax effect	**295**	857	597
Net operating profit (loss)	**(158)**	2,984	1,454
Cumulative effect of change in accounting method			
After-tax profit (loss) from extraordinary items	**250**	373	2,080
Net profit	**92**	3,357	3,534

Note 30 - Condensed Financial Statements of the Bank (cont'd)

Reported Amounts

C. Statements of cash flows for the year ended 31 December 2008

	For the year ended 31 December		
	2008	2007	2006
	NIS millions		
Cash flows generated by operating activities:			
Net profit for the year	**92**	3,357	3,534
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)
Equity of Bank in undistributed losses (profits) of subsidiaries and companies included on equity basis	**(324)**	1,078	(1,557)
Other, net (including provisions for doubtful debts and impairment of securities)	**4,999**	633	1,370
Net cash inflow generated by operating activities	**4,767**	5,068	2,681
Cash flows generated by activities in assets:			
Additional investments in shares of subsidiaries	**(123)**	(219)	(366)
Proceeds from sale of investments in investee companies and sale of activities	**-**	-	1,100
Other	**(24,201)**	(21,966)	(4,708)
Net cash outflow generated by activities in assets	**(24,324)**	(22,185)	(3,974)
Cash flows generated by activities in liabilities and capital			
Issue of debentures and subordinated notes	**917**	134	-
Dividend paid to shareholders	**(1,684)**	(2,500)	(1,103)
Issue of shares to employees	**614**	-	-
Other	**14,312**	12,316	11,536
Net cash inflow (outflow) generated by activities in liabilities and capital	**14,159**	9,950	10,433
Increase (decrease) in cash	**(5,398)**	(7,167)	9,140
Balance of cash at beginning of year	**32,988**	40,155	31,015
Balance of cash at end of year	**27,590**	32,988	40,155

D. Information on the basis of nominal values for tax

	31 December **2008**	31 December 2007
	NIS millions	
Total assets	**266,175**	253,016
Total liabilities	**248,984**	234,890
Shareholders equity	**17,191**	18,126
Net profit for the year ended (a)	**(69)**	3,288

(a) Not including income of companies included on equity basis as required by generally accepted accounting principles.

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 2008
(U.S. $ millions)

	2008	2007
Assets		
Cash and deposits with banks	**743**	137
Securities	**1,147**	1,948
Loans	**3,582**	3,453
Buildings and equipment	**18**	19
Other assets	**270**	257
Total assets	**5,760**	5,814
Liabilities and Equity Capital		
Deposits	**4,871**	4,888
Other liabilities	**335**	371
Capital notes	**90**	100
Capital resources	**464**	455
Total liabilities and capital resources	**5,760**	5,814

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2008
(U.S. $ millions)

	2008	2007
Income from financing operations before provision for doubtful debts	**127**	110
Provision for doubtful debts	**15**	2
Income from financing operations after provision for doubtful debts	**112**	108
Operating and other income	**44**	49
Operating and other expenses	**133**	108
Operating profit before taxes	**23**	49
Provision for taxes	**4**	18
Net profit	**19**	31

Bank Leumi (Switzerland) ltd.

Chairman of the Board: G. Maor
General Manager: A. Zaindenberg *

Condensed Consolidated Balance Sheet as at 31 December 2008
(CHF millions)

	2008	2007
Assets		
Cash and deposits with banks	**253**	89
Loans	**555**	635
Securities	**188**	184
Other assets	**74**	48
Total assets	**1,070**	956
Total Customers' Investments (off-balance sheet)	4,878	6,398
Liabilities and Equity Capital		
Deposits from banks	**383**	512
Deposits and other accounts	**470**	227
Subordinated capital notes	**50**	50
Capital resources and reserves	**167**	167
Total liabilities and capital resources	**1,070**	956

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2008
(CHF millions)

	2008	2007
Net interest income	**15**	20
Other operating income	**39**	49
Expenses	**49**	55
Operating profit before taxes	**5**	14
Provision for taxes	**1**	3
Net profit	**4**	11

* Until November 2007, Mr. S. Oren served as General Manager.

Bank Leumi (UK) plc

Chairman of the Board: E. Raff
Director and General Manager: L. Weiss *

Condensed Consolidated Balance Sheet as at 31 December 2008
(Pounds sterling millions)

	2008	2007
Assets		
Cash and deposits with banks	**235**	275
Loans	**1,151**	1,007
Securities	**103**	114
Equipment and buildings	**4**	4
Other assets	**80**	23
Total assets	**1,573**	1,423
Liabilities and Equity Capital		
Deposits	**1,086**	1,190
Deposits from banks	**231**	73
Subordinated capital notes	**73**	43
Other liabilities	**87**	22
Capital resources	**96**	95
Total liabilities and capital resources	**1,573**	1,423

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2008
(Pounds sterling millions)

	2008	2007
Net interest income before provision for doubtful debts	**31**	28
Recoveries of doubtful debts	**24**	3
Net interest income after provision for doubtful debts	**7**	25
Operating and other income	**8**	12
Operating and other expenses	**21**	20
Operating profit (loss) before taxes	**(6)**	17
Provision for taxes (benefit)	**(2)**	5
Net profit (loss)	**(4)**	12
Dividend paid	**-**	6

* Until October 2007, Mr. B. Lederman served as General Manager.Until June 2008 Mr. M.Friedman 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 2008
(Euro millions)

	2008	2007
Assets		
Cash and deposits with banks	**534**	295
Securities	**173**	217
Credit to the public	**21**	24
Other assets	**12**	11
Total assets	**740**	547
Liabilities and Shareholders' Equity		
Deposits of the public	**498**	505
Deposits from banks	**212**	7
Other liabilities	**10**	6
Total liabilities	**720**	518
Shareholders' equity	**20**	29
Total liabilities and shareholders' equity	**740**	547

Condensed Statement of Profit and Loss for the Year Ended 31 December 2007
(Euro millions)

	2008	2007
Net Interest income	**5.0**	3.3
Operating and other income	**4.5**	4.2
Operating and other expenses	**23.6**	4.6
Operating profit (loss) before taxes	**(14.1)**	2.9
Provision for taxes	**-**	0.6
Net profit	**(14.1)**	2.3

Leumi Mortgage Bank Ltd.

Chairman of the Board: A. Zeldman
General Manager: J. Burshtein*

Condensed Balance Sheet as at 31 December 2008
Reported amounts (NIS millions)

	2008	2007
Assets		
Cash and deposits with banks	**11**	5
Credit to the public	**39,783**	35,790
Buildings and equipment	**57**	46
Other assets	**219**	191
Total assets	**40,070**	36,032
Liabilities and Shareholders' Equity		
Deposits of the public	**6,980**	7,591
Deposits from banks	**26,795**	22,326
Deposits from the government	**33**	29
Debentures	**63**	83
Subordinated notes	**3,803**	3,731
Other liabilities	**246**	248
Total liabilities	**37,920**	34,008
Shareholders' equity	**2,150**	2,024
Total liabilities and shareholders' equity	**40,070**	36,032

Condensed Statement of Profit and Loss for the Year Ended 31 December 2008
Reported amounts (NIS millions)

	2008	2007
Net interest income before provision for doubtful debts	**430**	456
Provision for doubtful debts	**103**	43
Net interest income after provision for doubtful debts	**327**	413
Operating and other income	**121**	127
Operating and other expenses	**241**	241
Operating profit before taxes	**207**	299
Provision for taxes on operating profit	**81**	80
Net profit	**126**	219

* Until march 2008, Mr. Y. Gavish served as General Manager.

The Arab Israel Bank Ltd.

Chairman of the Board: S. Sussman
General Manager: Y. Eyal

Condensed Balance Sheet as at 31 December 2008
Reported amounts (NIS millions)

	2008	2007
Assets		
Cash and deposits with banks	**1,003**	939
Securities	**794**	529
Credit to the public	**2,885**	2,663
Buildings and equipment	**50**	47
Other assets	**40**	39
Total assets	**4,772**	4,217
Liabilities and Shareholders' Equity		
Deposits of the public	**3,217**	3,160
Deposits from banks	**931**	568
Subordinated notes	**100**	-
Other liabilities	**180**	155
Total liabilities	**4,428**	3,883
Shareholders' equity	**344**	334
Total liabilities and shareholders' equity	**4,772**	4,217

Condensed Statement of Profit and Loss for the Year Ended 31 December 2008
Reported amounts (NIS millions)

	2008	2007
Net interest income before provision for doubtful debts	**235**	216
Provision for doubtful debts	**27**	12
Net interest income after provision for doubtful debts	**208**	204
Operating and other income	**102**	97
Operating and other expenses	**188**	160
Operating profit before taxes	**122**	141
Provision for taxes on operating profit	**48**	52
Net profit	**74**	89
Dividend Paid	**80**	90

Leumi Card Ltd.

Acting Chairman of the Board: B. Lederman *
General Manager: D. Cohen

Condensed Consolidated Balance Sheet as at 31 December 2008
Reported amounts (NIS millions)

	2008	2007
Assets		
Cash and deposits with banks	**31**	18
Receivable in respect of credit card activity	**6,456**	** 5,821
Investment in companies included on the equity basis	**9**	17
Equipment	**122**	113
Other assets	**24**	** 24
Total assets	**6,642**	5,993
Liabilities and Shareholders' Equity		
Credit from banks	**853**	750
Payables in respect of credit card activity	**4,977**	** 4,727
Capital notes	**-**	230
Other liabilities	**116**	** 93
Total liabilities	**5,946**	5,800
Right of outside shareholders	**-**	3
Shareholders' equity	**696**	190
Total liabilities and shareholders' equity	**6,642**	5,993

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2008
Reported amounts (NIS millions)

	2008	2007
Income from credit card transaction	**679**	** 619
Net interest income before provision for doubtful debts	**109**	** 65
Other income	**1**	** 1
Provision for doubtful debts	**26**	16
Operating and other expenses	**584**	532
Net operating profit before taxes	**179**	137
Provision for taxes on operating profit	**51**	37
Net operating profit after taxes	**128**	100
Company’s equity in the net profit of companies included on the equity basis	**1**	4
Net profit from unregular action	**17**	-
Net profit	**146**	104

* The Late Mr. A. Heilweil served as general manager until October 30, 2008

** Reclassified

Leumi Partners Ltd.(formerly Leumi & Co. Investment House Ltd.)

Chairman of the Board: E. Raff
General Manager: A. Zeldman

Condensed Consolidated Balance Sheet as at 31 December 2008
Reported amounts (NIS millions)

	2008	2007
Assets		
Cash and deposits with banks	**412**	274
Securities	**550**	912
Credit to the public	**-**	-
Investment in companies included on the equity basis	**57**	62
Fixed assets	**4**	1
Other assets	**4**	4
Total assets	**1,027**	1,253

Liabilities and Shareholders' Equity

	2008	2007
Other liabilities	**33**	89
Subordinated notes	**672**	672
Shareholders’ equity	**322**	492
Total liabilities and shareholders' equity	**1,027**	1,253

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2008
Reported amounts (NIS millions)

	2008	2007
Net interest income	**-**	(6)
Operating and other income (expenses)	**(3)**	220
Operating and other expenses	**25**	31
Operating profit (loss) before taxes	**(28)**	183
Provision for taxes on operating profit	**16**	50
Net operating profit (loss) after taxes	**(44)**	133
Company’s equity in the net profit (loss) of companies included on the equity basis	**(4)**	1
Net profit (loss)	**(48)**	134

Leumi Finance Company Ltd.

Chairman of the Board: M. Eisenthal
General Manager: T. B. Davidovitch

Condensed Balance Sheet as at 31 December 2008
Reported amounts (NIS millions)

	2008	2007
Assets		
Cash and deposits with banks	**10,792**	9,685
Other assets	**-**	2
Total assets	**10,792**	9,687
Liabilities and Shareholders' Equity		
Debentures and subordinated notes	**10,633**	9,529
Other liabilities	**2**	1
Total liabilities	**10,635**	9,530
Shareholders' equity	**157**	157
Total liabilities and shareholders' equity	**10,792**	9,687

Condensed Statement of Profit and Loss for the Year Ended 31 December 2008
Reported amounts (NIS millions)

	2008	2007
Net interest income	**19**	16
Operating and other expenses	**2**	3
Operating profit before taxes on income	**17**	13
Provision for taxes on income	**6**	3
Net profit	**11**	10
Dividend Paid	**10**	8

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 2008
Reported amounts (NIS millions)

	2008	2007
Assets		
Cash and deposits with banks	**84**	57
Investments	**27**	30
Credit to the public	**948**	976
Other assets	**3**	8
Total assets	**1,062**	1,071
Liabilities and Shareholders' Equity		
Deposits from banks	**236**	300
Other liabilities	**10**	3
Total liabilities	**246**	303
Shareholders’ equity	**816**	768
Total liabilities and shareholders' equity	**1,062**	1,071

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2008
Reported amounts (NIS millions)

	2008	2007
Net interest income before provision for doubtful debts	**80**	58
Other income	**2**	2
Impairment of investment	**5**	-
Net income before provision for doubtful debts	**77**	60
Provision for doubtful debts	**1**	-
Net income after provision for doubtful debts	**76**	60
Operating expenses	**9**	9
Operating profit before taxes	**67**	51
Provision for taxes on operating profit	**18**	7
Net profit	**49**	44

* Until May 2007, Mr. J. Burshtein as served chairman of the board .