BANK LEUMI LE-ISRAEL B.M. AND ITS INVESTEE COMPANIES

Annual Report 2009

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 Investee Companies
Annual Report 2009

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Eitan Raff, Chairman[1]

Reuven Adler, C.P.A. (Isr.)[2]

Doron Cohen

Moshe Dovrat

Adv. Miriyam (Miri) Katz

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] Gave notice that he does not intend to submit his candidacy for re-election at the General Meeting.
[2] Elected as external director under paragraphs 239 and 245 of the Companies Law 1999 for a period of three years commencing 24 July 2009. Mr. Meir Dayan served as an external director until 23 July 2009.

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
Senior Member of Management for Finance, Accounting and Capital Markets
Manager of Market Risks

Gideon Altman
Executive Vice President, Acting Head of Commercial Banking Division

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

Yaacov (Kobi) Haber
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. Nomi Sandhaus[1]
Chief Legal Advisor, Head of Legal Division, Manager of Legal Risks

Tamar Yassur
Head of Marketing

Adv. Yael (Ben Moshe) Rudnicki[2]
Bank and Group Secretary

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

[1] Serves as Chief Legal Advisor and Head of Legal Division from 1 April 2009. Until 31 March, Adv. Nahum Bitterman served as Chief Legal Advisor, Head of Legal Division.
[2] Serves as Bank and Group Secretary since 1 May 2009. Until 30 April 2009, Adv. Jennifer Janes served as Bank and Group Secretary.

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

Directors' Report

The following is the fifty-ninth annual report of Bank Leumi le-Israel B.M. and the one hundred and eighth report of the business founded in 1902. This report will be presented to the Bank's fifty-ninth 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 108 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 equity basis, through 256 branches located throughout Israel, and through 78 branches, agencies and representative offices in 18 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 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 in five lines of business, 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 high net worth 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 expanding 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. In addition the Bank has to sell its holdings in another corporation. Following the passing of the Banking (Licensing) Law (Amendment 15) 2009, in February 2010, the Bank is allowed to retain its remaining holdings in Migdal. See further details on page 46 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).

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 2009, as published by the Bank of Israel, Leumi Group's market share in relation to the Israeli banking system was as follows:

	30.9.2009	**31.12.2008**	**31.12.2007**	**31.12.2006**	**31.12.2005**
	In percentages				
Total assets	**30.0**	29.3	30.0	30.1	30.0
Credit to the public	**28.3**	29.1	29.7	29.8	29.9
Deposits of the public	**30.2**	29.8	30.2	30.5	30.6
Operating profit before taxes	**36.7**	1.5 (1)	37.9	27.5 (2)	30.2
Operating profit after taxes	**37.8**	- (3)	38.4	25.6 (2)	30.5

(1) After neutralizing losses of Bank Hapoalim.
(2) The decrease in the Group's share arises mainly from exceptional salary expenses, some half of which was the result of the privatization.
(3) Operating loss after taxes.

The Leumi Group operates in a competitive market in all its operating segments. The main competitors are currently 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. This crisis has not yet passed, the way out is gradual and slow, and financial systems worldwide have not yet stabilized.

2009 was typified by economic changes while moving away from the world financial crisis that began in 2007 and continued until the second quarter of 2009. From mid-second quarter 2009, indications began of an improvement in world economic activity, which influenced also the acceleration of economic activity in Israel. Nevertheless, the recovery is slow and expected to be of a long duration. These changes impacted the Bank's activity also for 2009.

Total assets under management of the Group (both balance sheet and off-balance sheet*) amounted to NIS 782 billion as at 31 December 2009, as compared with NIS 651 billion at the end of 2008, an increase of some 20%, resulting primarily from the rise in the markets in Israel and throughout the world, and increased volumes of activity.

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 classified as debts under special supervision), and to large provisions for impairment in value and the realization of investments in securities and other investments, some at a loss.

Following an improvement in the worldwide and domestic economy, after the crisis in 2008, rises in the capital market and increased volumes of activity, there was an improvement in the Group results for 2009, mainly as a result of a decrease in the volume of provisions for doubtful debts and an improvement in results of investments in securities.

The net profit of the Group for 2009 totaled NIS 2,014 million, compared with a profit of NIS 92 million in 2008.

The operating profit of the Group totaled NIS 1,986 million in 2009, as compared with a loss of NIS 158 million in 2008.

The increase in the value of the securities available-for-sale portfolio amounted in 2009 to NIS 957 million, net, compared with a decrease in value of NIS 1,150 million in 2008.

For the effect of the global economic activity of Leumi Group and additional details, see pages 61-72.

Return on equity of net profit reached 10.2%%, compared with 0.5% in 2008.

The net profit per share in 2009 was NIS 1.37, compared with NIS 0.06 in 2008. No dividend was distributed for the years 2008 and 2009, compared with a dividend of NIS 1.0 per share in 2007.

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

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

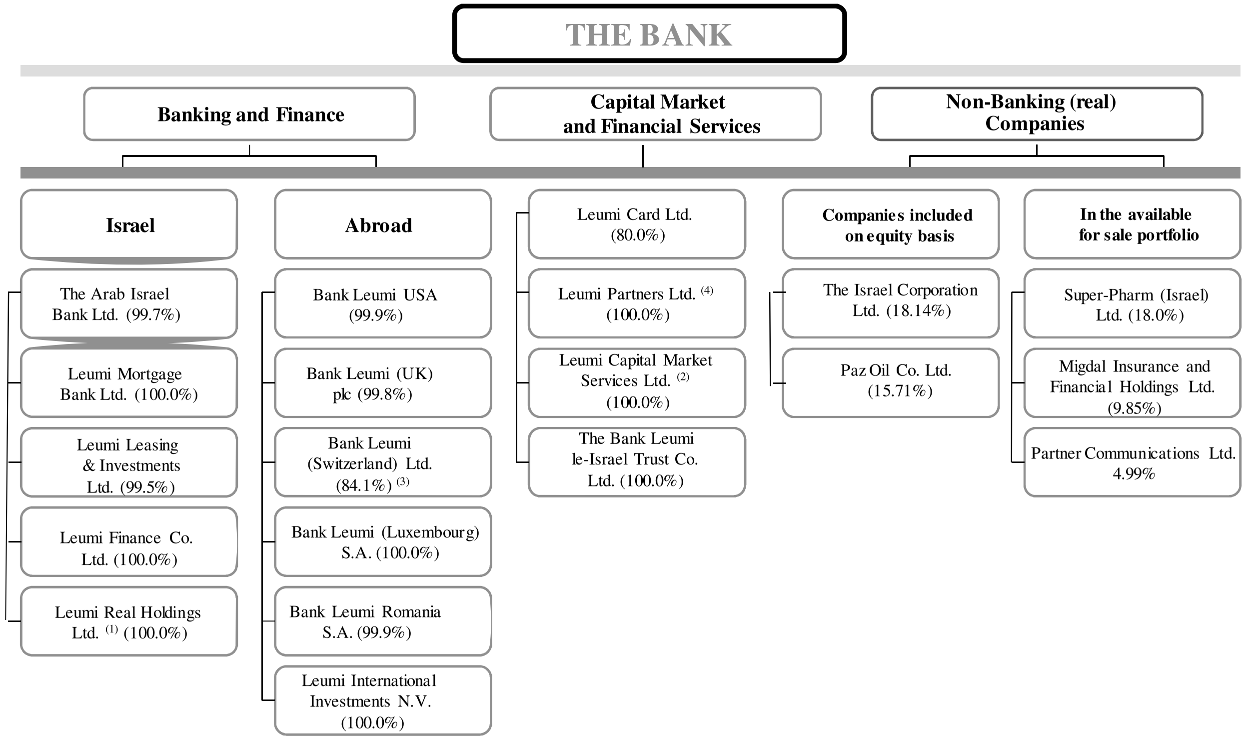
	2009			2008		
	Scope of Investment	**Contribution to Net Profit**		Scope of Investment	Contribution to Net Profit	
		(1)	**(2)**		(1)	(2)
	NIS billions	**NIS millions**		NIS billions	NIS millions	
The Bank	**9.9**	**1,251**	**1,216**	7.7	(644)	(453)
Subsidiary companies in Israel	**6.3**	**616**	**616**	5.6	432	432
Overseas subsidiary companies	**4.3**	**102**	**137**	4.1	(110)	(301)
Companies included on equity basis	**1.4**	**17**	**17**	1.3	164	164
Total	**21.9**	**1,986**	**1,986**	18.7	(158)	(158)

(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).

Commencing with the Financial Statement for 2009, the Basel II directives apply to the Bank, under a Provisional Directive of December 2008 from the Supervisor of Banks. The Basel II directives distributed to banking corporations in Israel by the Supervisor of Banks include a framework for measuring risks and calculating capital adequacy, and are based on the comprehensive working framework set in 2006 by the "Basel Committee" - BIS - (Bank for International Settlements).

Below is a chart of the major investee companies of the Bank:



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

Basel II General (Table 1 – Basel II):

A. Bank Leumi Le-Israel B.M. ("Leumi"), whose head office is located in Tel-Aviv, Israel is the parent company of the Leumi Group.

B. In the table on the previous page is a chart of principal investee companies; for further details on them see below in the section "Description of the Group's Activities" on pages 168-171 and pages 172-190.
The consolidation of consolidated companies and the recording of the equity basis of companies included on equity basis are in accordance with accepted accounting principles and Bank of Israel directives. However, in the calculation of supervisory capital, the surplus cost of investments (goodwill) and investments in the companies included on equity basis, Automatic Banking Services and the Banking Clearing Center are deducted from accounting capital.

C. The principal regulatory restrictions on transferring liquid means between Group companies in Israel and abroad are:

(1) The Bank of Israel makes no restriction on the Bank making deposits in Group companies in Israel and abroad, but has imposed restrictions on capital investments by the Bank in companies abroad. Every material investment requires Bank of Israel approval.

(2) Regulations of the authorities in the U.S. place restrictions on total exposures of any type for related companies of domestic banks. The maximum amount of exposure to a related company is 10% of the equity of the Bank in the U.S., and with regard to the group to which the Bank belongs in the U.S., the total amount is 20% of equity.

(3) Regulations of the authorities in the U.K. place restrictions on total deposits by domestic banks in any group company and jointly in total to a maximum amount of 25% of equity of the Bank in the U.K.

(4) Regulations of the authorities in Switzerland oblige the Bank in Switzerland to deduct from its equity deposits in amounts greater than 25% of equity of the Bank in the Switzerland.

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 varied exogenic factors. The worldwide and domestic market, the Israeli economy, regulation in Israel and abroad, and changes and trends in areas such as technology and the customer environment have an influence on Group activity and its resulting strategy.

The world banking system was at the epicenter of the financial crisis which broke out in 2008. Many banks worldwide were closed down, nationalized, purchased or changed the structure of their operations. Massive aid by various governments did in fact lead to stabilization of the financial system, but at the same time was a significant factor influencing the debt-to-GDP ratios of many economies, The shockwaves also reached non-banking activity. The Israeli banking system, compared with other banking systems worldwide, displayed stability and soundness, which contributed greatly to maintaining the strength of the Israeli economy.

At present, financial market activity in the U.S. and in Europe, and the renewal of demand in these economies, indicate a gradual process of exiting the crisis, and stabilization. If 2008 was typified by survival and an attempt to maintain the present situation, 2009 was a year of stabilization of the system and a gradual exit from the crisis. 2010 is expected to be typified by a renewal of efforts to find growth engines and new business opportunities.

The competitive environment

Domestic banks:

After several years in which the domestic banking system reported high levels of profitability and a continuing decrease in levels of risk, in 2008 there was a dramatic change. The level of profitability fell drastically (some 98%) and the level of risk rose. Profits in the systems were impacted greatly by the financial crisis as a result of two main factors: a decrease in the value of financial assets and negative developments in the non-banking economy in Israel. On the other hand, there was a positive effect in the traditional area of intermediary activity – a return by the public to the banks.

2009 brought a year of stabilization of the banking system and a return to profitability as a result of the recovery of the capital markets and the return to growth in the economy. At present, domestic banks are working intensively to increasing their activity and focusing strategic efforts on finding areas of profitability and future growth engines.

Foreign banks

The trend of focusing post-crisis efforts on stabilization of the system and concentrating on relative advantages is expected to continue. Structural reorganization, mergers and the creation of global entities can be expected.

The activity of foreign banks in Israel focuses on private banking and capital market services: brokerage, custody of securities, and investment banking (mergers, acquisitions, underwriting).

Non-banking competitors

- The non-banking credit market – financing from the capital market and institutional investors: for the first time since 2001, the banking system supplied most of the new credit requirements of the business sector in 2008, unlike the progressive increase in non-banking credit seen in previous years. After a decrease in the volume of capital issues in 2008, there was a marked change in 2009, and the non-banking credit market began to reawaken.
  According to Bank of Israel figures, the debenture issues expanded in 2009 by about NIS 26 billion, compared with issues totaling some NIS 9.8 billion in the whole of 2008.This was despite wide scale redemptions. The increase in issues is a result of the recovery in the capital market against the backdrop of the relatively good situation of the Israeli economy, and the decrease in concerns amongst purchasers of bonds issued regarding default by companies in the economy.
  One of the prominent characteristics of the recovery of the non-banking credit market is the type of companies that make issues. As opposed to recent years, the wave of issues in 2009 was typified by the fact that most issuing companies belong to the first and second ranks of companies on the Stock Exchange; i.e. the non-banking credit market is an increasingly expanding source of competition for the banking system with regard to quality business customers (large and mid-sized).

  On the other hand, regulatory supervision of financial bodies is becoming tighter. In the light of the crisis, the view gained strength that regulation should be broad-based and encompass all financial entities. An example of the tightening of supervision is the Hodak Committee, whose aim is "to determine parameters for consideration by institutional entities providing capital by means of purchasing non-government debentures". The recommendations of the Hodak Committee, if adopted, are expected to affect the non-banking credit market. Further examples of the tightening of supervision: the requirement to appoint a risk manager, corporate governance management, minimum capital requirements, and others.

- Capital market and brokerage activity – traditionally the main competition in this area of activity was on the part of investment houses and other management entities (provident funds, supplementary training funds, insurance etc.) Competition was focused both on institutional customers, on companies and business customers and on high net-worth/private banking customers.

  However, changes have recently begun to develop in the competitive environment. On one hand, intense competition, increased in regulatory supervision (see above regarding financing by the capital market and institutional investors), and losses from the collapse at the end of 2008 are leading to small and medium-sized investment houses being heavily occupied with negotiations for their merger and acquisition.
  On the other hand, domestic and foreign banks are focusing efforts on capital market activity.

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 increase further the power of the regulator, 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 yet 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.

Increased regulation creates material pressures in terms of expenses and investments, in addition to the management inputs required for careful preparation and compliance with directives. In addition, regulation has an impact on competition and growth of the banking system in Israel, as it imposes restrictions on the banks regarding the purchase of banks and financial entities.

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 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, 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 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, *inter alia,* by attaining a level of excellence in managing the customer's experience with the Group, and expanding activity through digital channels, which is carried out with the involvement of the branches, and ensuring high levels of customer satisfaction from all channels.

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 consider the expansion of 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. In accordance with, among other things, the vision of the Bank and its work towards increasing value for its customers, leading innovation, and entrepreneurship, the Bank invests in the development of innovative services and broadening distribution channels available to customers. This investment expresses itself in improving existing infrastructures, adding functionality to direct channels, expanding activity in social networks and providing the customer with a comprehensive framework of innovative possibilities by cell phone, internet, call center or information terminals. This framework is implemented under the term "Leumi Digital" which includes all of the digital channels of the Bank.

7. Continued promotion of social responsibility to the community.

Group strategy is implemented in accordance with the risk appetite approved by the Board of Directors, alongside the use of advanced procedures and tools for managing the different types of risk, and the completion of preparations for regulatory requirements, including those of Basel II. For details of risk factors in Group activity, see pages 236-240 below.

The above-mentioned Group objectives have been adapted to the lines of business in which Leumi operates and which are described below. Each business line specializes in a particular market segment with the aim of creating a relative advantage among its target markets.

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 51 below.

Control of the Bank

The State of Israel became a shareholder of the Bank on 31 October 1993, under the Bank Shares Arrangement and the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993 (the "Bank Shares Law"). As determined in the Bank Shares Law, the transfer of the shares in the Bank to the State and the exercise of the rights by virtue of the shares under this Law do not require a permit under the Banking (Licensing) Law, 1981.

On 31 December 2009 and on 10 March 2010, the State of Israel held 11.46% of the issued share capital of the Bank and 14.20% of the voting rights in the Bank.

On 14 June 2006, the Bank Leumi Group employees (including the Chairman of the Board of Directors) purchased 40,333,691 shares of the Bank's capital from the State. The shares are blocked until 13 June 2010. (The Chairman of the Board of Directors purchased his shares on 5 July 2006, and those shares are blocked until 4 July 2010). During the blocked period, the State has a power of attorney to vote the shares that were purchased and to use the right to appoint directors by virtue of the shares. The blocked shares constitute 2.74% of the voting rights.

The Bank Shares Law authorized the shares committee of the Bank to exercise the voting rights granted by virtue of the State's holding in the Bank in the name of the State and on its behalf.

The Bank Shares Law determines that "the use of the voting rights granted by virtue of the shares will be made by a committee functioning in the name of the State and on its behalf" (Section 3 of the Bank Shares Law).

In August 2009, the Bank received a letter from counsel for Shlomo Eliahu Holdings Ltd. ("Eliahu Holdings") according to which Eliahu Holdings is of the view that given the percentage of the State's present shareholding in the Bank, it is not possible to view the State as having control of the Bank, and under present circumstances the Bank does not in practice have a controlling shareholder as defined by law.

In light of this letter, the Bank asked M.I. Holdings Ltd. and the Bank Supervision Department for their positions on the matter. The Bank Supervision Department advised the Bank that it views the Bank as a banking corporation, in which at least one of the holders of means of control is the holder of a control permit, so long as the Board of Directors is appointed in accordance with the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993 and the regulations promulgated thereunder.

It should be noted that to the best of the Bank's knowledge, none of the holders of means of control in the Bank has been granted a control permit.

M.I. Holdings on behalf of the State of Israel replied to the Bank on 27 August 2009 as follows:

1. According to your above request and telephone conversations, the subject of the control of the Bank was raised during the preparation of the Bank's shelf prospectus. You have advised us that the Bank intends to state in the shelf prospectus, which it plans to publish in August 2009, that as long as over 50% of the Bank's directors are appointed in accordance with the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993 (the "Bank Shares Law") then according to the presumption determined in the Securities Law, the State holds control of the Bank, for the purposes of the requirement of Regulation 44C of the Securities Regulations (Details, Structure and Form of Prospectus and Draft Prospectus),1969. We have no objection to this interpretation.

2. We request you to ensure that the prospectus includes a description of the manner in which the State holds shares in the Bank, including the rules and restrictions applying to these holdings under the Bank Shares Law, including, *inter alia*, the restrictions on the State's ability to intervene in the management of the Bank's business and its decision-making process.

3. We would emphasize that nothing in the above may prevent the State from raising any claim regarding any matter concerning the State's responsibility under the securities laws or any other laws, and may not detract from or affect such claims.

All the directors serving on the Board of Directors of the Bank were appointed in accordance with the Bank Shares Law, and all the directors were proposed to the general meetings of the Bank by the Bank's shares committee, and the committee voted for them by virtue of the State's shares in the Bank. As mentioned above, under the Bank Shares Law, the committee votes at general meetings in the name of the State and on its behalf.

The Bank’s current shares committee was appointed by virtue of the Bank Shares (Arrangement Shares) (Temporary Provision) Law (Appointment of Committees and Terms of Office) Directives, 2009, which were published on 12 March 2009. The committee's appointment is valid through 31 October 2011 but will end earlier if and when one of the following events takes place: (1) no other party holds a control permit pursuant to section 34(b) of the Banking (Licensing) Law, 1981 and the State’s holding of shares in the Bank has fallen below a percentage which does not exceed 5%, or (2) there is another party who olds a control permit pursuant to section 34(b) of the Banking (Licensing) Law, 1981 and the percentage of the shares in the Bank held by the State has fallen below a percentage which does not exceed 10%.

In conclusion
The directors holding office in the Bank at present were all proposed by the shares committee and all were elected with is support by the Bank's general meeting. The shares committee acts as mentioned above in the name of the State of Israel and votes on behalf of the State at the general meetings.

From this it may be learned that as long as over 50% of the directors of the Bank are appointed in accordance with the Bank Shares Law, then the State of Israel holds over 50% of one of the means of control of the Bank and in accordance with the presumption regarding the definition of control in the Securities Law, it holds control of the Bank, subject to the restrictions determined in the Bank Shares Law. It should be noted that there exists another interpretation, as detailed above.

For further details of the subject of control of the Bank see note 19A.

On 1 March 2010, a petition by Shlomo Eliahu, Shlomo Eliahu Holdings Ltd., and Eliahu Insurance Co. Ltd., an interested party in the Bank, to the Supreme Court was received at the Bank's offices for the granting of a conditional order against the Minister of Finance, the Government of Israel, M.I. Holdings Ltd., and the Bank. On 17 March 2010, the Court received the Bank's application and removed the Bank from the petition. In this petition, the Court is requested to grant a conditional order obliging the respondents to give reasons why they should not sell immediately the shares of the Bank owner by the Government and why an immediate and defined timetable should not be set immediately for the sale of the said shares. The Court was further requested to make the order absolute if there was nothing in the respondents answer to comply with the provisions of the law and the obligation imposes on them, and to set an immediate defined and recognized time table for the sale of the shares of the Bank.

Sale of Shares in the Bank by the State

On 25 November 2009, M.I. Holdings notified the Bank it is preparing to sell the balance of the State's holdings in the Bank, but that it has no defined plan at this stage.

For details regarding the issue of options to employees see the Chapter on Capital Resources and Transactions in Shares of the Bank.

Special General Meeting for the Election of Directors of the Bank

On 11 January 2010, a letter was received from Shlomo Eliahu Holdings Ltd. ("Eliahu Holdings") an interested party in the Bank, according to which Eliahu Holdings requested, under paragraph 63(b)(2) of the Companies Law 1999, that the Board of Directors of the Bank convene a Special General Meeting of the shareholders of the Bank, to discuss a proposal for the appointment of Dr. David Klein to serve as a director of the Bank; his term of office to begin on the rotation of the directors at that time, which was expected at the Bank within the coming months.

On 24 January 2010, Mr. Eitan Raff, Chairman of the Board of Directors since 1995, announced that he did not intend to offer himself for re-election as a director of the Bank at the General Meeting. In consequence, Mrs. Galia Maor, President and CEO, announced that she had decided to offer herself as a candidate for election as a director of the Bank at the General Meeting, and that she would continue to serve as President and CEO of the Bank for as long as her appointment as a director of the Bank, if and when this occurs, has not taken effect.

On 31 January 2010 the Bank convened a Special General Meeting for 11 March 2010.

On 3 February 2010, the "Ometz" Non-Profit Association filed a petition with the High Court against the public committee appointing the Bank's shares committee, the Bank's shares committee, the Finance Minister, the Attorney-General, and Galia Maor. According to the petition, the High Court is requested to invalidate the decision of the public committee and the Bank's shares committee to propose the election of Galia Maor as director of the Bank to the General Meeting of the shareholders of the Bank. On 8 February 2010, the Movement for Quality Government in Israel filed a petition with the High Court against the public committee, the Bank's shares committee, Galia Maor, the Attorney-General, the Finance Minister, the Supervisor of Banks, and the Governor of the Bank of Israel. According to the petition, the High Court is requested, *inter alia*, to instruct the public committee to reverse its decision to include Mrs. Galia Maor in the list of candidates for the Board of Directors of the Bank, to instruct the Supervisor of Banks to give his opinion in the matter, and to instruct the public committee to disclose the names of the candidates qualified for election as directors which it sent to the Bank's shares committee.

On 15 February 2010, Mrs. Galia Maor gave notice that, in view of the circumstances created since the submission of her candidacy to serve as director of the Bank, and the approval of her candidacy by the public committee and the shares committee, she had reached a personal decision to withdraw her candidacy to serve as director of the Bank.

The petitions mentioned above were struck out by the Court on 8 March 2010 Mrs.Maor having announced that she was withdrawing her candidacy to serve as director of the Bank.

On 18 February 2010 the Board of Directors of the Bank decided to cancel the convening of the Special General Meeting since on 14 February a response had been received from the staff of the Israel Securities Authority ("the Authority") to request for a pre-ruling by the Bank, according to which the convening of the Special General Meeting should be cancelled, and a new Meeting convened, after all the shareholders have been given an appropriate opportunity to offer themselves as directors of the Bank, if in the Bank's opinion, Article 87 of the Bank's Articles of Association is in effect.

Further to the cancellation of the Special General Meeting, Eliahu Holdings and Eliahu Insurance Co. Ltd. ("Eliahu") filed an originating motion and application for a temporary injunction against the Board of Directors of the Bank and against the Bank, to invalidate the decision cancelling the Special General Meeting and to hold the Special General Meeting on 11 March 2010.

On 3 March 2010, judgment was received from the District Court rejecting Eliahu"s application to invalidate the decision of the Board of Directors of the Bank on 18 February 2010, so that the decision of the Board of Directors of the Bank to cancel the Special General Meeting convened for 11 March 2010 remains valid.

Notice of intention to convene the Annual General Meeting

On 18 March 2010, the Bank reported by Immediate Report that it intends to convene the Annual General Meeting on 2 June 2010 (the "**Annual Meeting**"), the agenda of which shall include, *inter alia*, the election of directors to the Bank's Board of Directors. For this purpose, the Bank's Secretariat would accept, up to 21 April 2010 applications from shareholders wishing to propose their own candidacy or the candidacy of another shareholder for election as a director at the Annual Meeting, all in accordance with and subject to that included in the above Immediate Report of the Bank.

Interested Persons' Transactions

Excellence Investments Ltd., The Phoenix Holdings Ltd., and the Delek Group Ltd. (" Companies of the Delek Group") notified the Bank on 6 August 2009 they had become interested persons in the Bank due to the aggregate holdings of companies in the Excellence Group, the Phoenix Group and the Delek Group. The Bank was also notified that all the above-mentioned companies are indirectly controlled by Mr. Yitzhak Sharon (Tshuva), through companies that he controls. The companies in the Delek Group advised the Bank on 4 January 2010 that they had ceased to be interested persons in the Bank on 31 December 2009.

Clal Insurance Enterprises Holdings Ltd., Clal Finance Ltd. and Epsilon Investment House Ltd. (the "Companies"), all three of which are members of the IDB Holding Corporation Ltd. Group, notified the Bank on 26 August 2009 that they had become interested persons in the Bank, by virtue of the aggregate holdings of the companies and/or their subsidiary and/or associated companies. On 31 August 2009, the companies informed the Bank that they had ceased to be interested persons in the Bank as of 30 August 2009.

Description of Operating Segments

The Bank in Israel is organized in five lines of business, 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 lines of business:

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, electronic terminals, information booths and ATM's), 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 large projects and contracting companies, 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, while involving the various units in the Leumi Group, in Israel and abroad, as necessary, so as 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 in foreign currency, interest rates, derivatives and securities. 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 relationships with overseas financial institutions and is responsible for providing services to customers active in the capital and money markets, including institutional customers.

Principal Operating Segments

Pursuant to Bank of Israel 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 operating 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 investments in non-banking (real) companies.
7. Others*	-	activities not assigned to other segments.

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 121 below and Note 28 to the Financial Statements.

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

A. Business Customers:

Division/Segment	Scope of Obligo	Business Turnover of Borrower
Corporate	above NIS 80 million	above NIS 250 million
Commercial	above NIS 10 million and up to NIS 80 million (inclusive)	above NIS 30 million
Small businesses	up to NIS 10 million (inclusive)	up to NIS 30 million

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 lines of business, 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, and the financial respects in respect of the customer are recorded in the segment in which the customer's account actually operates.

C. Banking Subsidiaries have been attributed to the operating 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 lines of business 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 operating 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 lines of business 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 6,500 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 operating segments, see pages 121-167 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. In the framework of enhancing the measurement of performance of the units, a measurement is made of the Return on Risk Adjusted Capital (RORAC) for the units of the Bank, and their contribution to the Bank's profit (Economic Value Added – EVA), taking into account the cost of capital according to the multi-year return determined in the working plan.
Until the end of the allocation of risk capital to the units was done by the relevant share of each segment in total weighted risk assets of the Leumi Group in accordance with Basel I directives.
The profit of the operating segments is adjusted for the risk capital in each segment. The risk-adjusted return is calculated as the ratio between adjusted profit and the equity allocated to the segment, representing part of the allocated risk capital (Tier 1 and Tier 2).
The profit for each segment is calculated on the cost of Tier 1 and Tier 2 risk capital allocated to the segment. At the Group level, the Economic Value Added is the net profit adjusted as mentioned less the cost of equity, according to the long-term return required on the equity decided by the Board of Directors.
Beginning in 2010, the allocation of Pillar 1 capital (in respect of credit, market and operational risks) is according to the standardized approach – credit risks based on weighted risk assets of the units, operational risks according to average income of the units, and market risk according to the standardized approach.
Pillar 2 capital is allocated to the units in accordance with Bank of Israel instructions or according to models built by the Bank.

Evaluating the performance of the units

The BSC (Balanced Score Card) is a management tool for managing the performance of the Bank and its lines of business in a variety of quantitative and qualitative matters which Bank management determined to be matters under focus in the framework of the strategic map of Leumi.
The targets measured in the BSC framework belong to four main categories matching the four quadrants of the strategic map:

- Finance and risk management quadrant (targets such as return on equity and capital adequacy)
- Customer quadrant (targets such as customer satisfaction)
- Internal processes uadrant
- Capabilities and infrastructure quadrant (targets such as system availability)

The list of targets measured in the BSC framework and the weighting of each target are updated annually in accordance with emphases determined by Bank management in the framework of discussions of the work plan. Targets for the lines of business of the Bank are derived from the targets measured at Bank level.

In the framework of focusing implemented from 2010 on the subject of implementing Basel II directives, measurement of relevant targets has been enhanced and so included in the BSC framework of lines of business at Leumi are also EVA (Economic Value Added) targets. This index reflects the additional contribution of lines of business above the determined multi-year return decided, as a strategic target. This system is discussed every year by the Board of Directors and receives its approval as it is, *inter alia*, a basis for evaluation and remuneration.

Capital Resources and Transactions in the Shares of the Bank

Shareholders' Equity of the Group at 31 December 2009 amounted to NIS 21,862 million, compared with NIS 18,672 million at the end of 2008, an increase of 17.1%. The increase in shareholders' equity mainly derives from the profit for the year, the increase in value of the available-for-sale securities portfolio, from adjustments for the translation of the financial statements of the companies included on equity basis, by the adjustment in capital because of the repayment of the loans given to employees for the purchase of shares.

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.

According to Basel II principles of capital adequacy computation, the balance in respect of adjusting securities to fair value affects the capital computation for the purpose of the minimum capital ratio. It should be pointed out that according to Basel I principles adopted up to 2009, as a rule the balance in respect of adjusting securities to fair value did not affect the capital computation for the purpose of the minimum capital ratio.

In 2009 an increase in the value of the securities available-for-sale portfolio of NIS 957 million, net, was recorded in shareholders' equity, compared with a decrease in value amounting to NIS 1,150 million in 2008 (all of the amounts are net after the effect of related taxes).

Structure of Capital for purposes of calculating the capital ratio – (Table 2 Basel II):

	31 December 2009
	NIS million
Tier 1 capital:	
Shareholders' equity	**7,059**
Premium	**972**
Reserves	**14,176**
Capital reserves from share-based payment transactions and other funds	**197**
Adjustments from translation of financial statements of companies included on equity basis	**(474)**
Loans to employees for the purchase of shares of the Bank	**(377)**
Minority interest in equity of consolidated companies	**282**
Amounts deducted from Tier 1, including goodwill, investments and other intangible assets	**(357)**
Total Tier 1 capital	**21,478**
Tier 2 capital:	
45% of the amount of net profits, before the effect of relevant tax in respect of adjustments to fair value of available-for-sale securities	**208**
General provision for doubtful debts	**428**
Innovative and non-innovative hybrid capital instruments	**3,523**
Subordinated notes	**10,772**
Amounts from Tier 2 capital	**(68)**
Total Tier 2 capital	**14,863**
Total capital base for purposes of capital adequacy	**36,341**

For further details see Note 13C to the financial statements.

In accordance with Basel II directives, the elements of capital for purposes of calculating capital adequacy are divided into two tiers, Tier 1 capital and Tier 2 capital (according to Basel I "primary capital" and "secondary capital" respectively). The total of these tiers is called "the capital base for purposes of calculating capital adequacy".

The main characteristics of Tier 1 capital are as follows:

Tier 1 capital includes shareholders' equity, accumulated reserves, premium, capital reserve in respect of share-based payment transactions and others, adjustments from translation of autonomous investee companies abroad, less loans to employees for the purchase of the shares of the Bank, with the addition of minority interest and less goodwill and unrealized net losses (after tax) in respect of adjustments to fair value of securities available-for-sale. Tier 1 capital can include hybrid capital instruments. There are no hybrid capital instruments in this Tier in the Leumi Group.

Tier 1 capital without hybrid capital instruments – hereinafter "original" Tier 1 capital.

The main characteristics of Tier 2 capital are as follows:

Tier 2 capital includes 45% of the amount of unrealized profits, net (after the effect of tax) in respect of adjustments to fair value of securities available-for sale, general provision for doubtful debts, hybrid capital instruments (Upper Tier 2 capital) and subordinated notes up to the level of 50% of total Tier 1 capital (Lower Tier 2 capital). Total Tier 2 capital is limited to 100% of Tier 1 capital.

Capital instruments included in Upper Tier 2

- Non-innovative hybrid capital instruments: subordinated capital notes issued for a period of at least 49 years. The issuer (only) can make an early redemption after 5 years provided that it will be replaced by an instrument of the same or higher quality. Will be issued by Leumi or by means of issues by Leumi Finance and LII (subsidiaries of Leumi).

- Innovative hybrid capital instruments: capital notes will be considered which meet the definition of non-innovative hybrid capital instruments and in addition include a step-up mechanism, which represents a stimulus for early redemption. A step-up mechanism which determines the rate of increase of interest to investors will be used only once, after at least 10 years from the date of issue.

Capital instruments included in Lower Tier 2

- Subordinated notes will be issued for the term of at least 5 years. Leumi raises subordinated notes directly, or by means of issues by Leumi Finance and LII. The rights of the subordinated notes are subordinated to other creditors except for holders of Upper Tier 2 and Tier 1 capital instruments. In addition, Lower Tier 2 also includes non-negotiable subordinated deposits.

As well as that stated above, investments in unconsolidated banking and financial subsidiaries are deducted from both capital Tiers and also deductions connected with securitization exposures.

Shareholders' Equity relative to Total Assets at 31 December 2009 reached 6.8% in comparison with 6.0% at 31 December 2008.

Capital Adequacy Structure

Shareholders' Equity relative to Risk Assets on 31 December 2009 was as follows:

According to Basel 2 Tier 1 Total equity to risk assets 14.09%
Tier 1 to risk assets 8.33%

In addition to capital required for Pillar 1, there is a requirement under Pillar 2 of Basel II to keep "equity cushions" in respect of additional risks not taken into account in the framework of Pillar 1, and also additional capital in respect of stress scenarios. "Equity cushions" provide a response to risks such as: large borrower concentrations, group borrowers, sectorial concentrations, country risk and various market risks.

According to Basel 1 Total equity to risk assets 14.31% compared with 11.58% on 31 December 2008
Primary capital to risk assets 8.52% compared with 7.51% on 31 December 2008

The overall capital ratio is higher than the minimal rate of 9% (according to Basel I and also according to Basel II) as determined by the Supervisor of Banks.

The figure for December 2008 was reclassified in the first quarter following a change in the allocation of primary and secondary capital against exposure to market risks from an overall capital ratio of 11.49% to 11.58%, following clarification by the Bank of Israel.

Capital adequacy - (Table 3 Basel II):

	31 December 2009	
Risk assets and capital requirements in respect of credit risk deriving from exposures to:	Risk assets	Capital requirements (3)
	NIS million	
Sovereign risk	**1,356**	**122**
Debts of public sector entities	**2,315**	**208**
Debts of banking corporations	**11,845**	**1,066**
Debts of a securities company	**-**	**-**
Debts of corporations	**132,976**	**11,968**
Debts collateralized by commercial real estate	**16,554**	**1,490**
Retail exposures to individuals	**20,140**	**1,812**
Loans to small business	**10,586**	**953**
Housing loans	**22,479**	**2,023**
Securitization	**592**	**53**
Other assets	**10,708**	**964**
Total in respect of credit risk (1)	**229,551**	**20,659**
Risk assets and capital requirements in respect of market risk (1)	**7,418**	**668**
Risk assets and capital requirements in respect of operational risk (1) (2)	**20,928**	**1,884**
Total risk assets and capital requirements	**257,897**	**23,211**
Total capital base for capital adequacy	**36,341**	
Total capital ratio	**14.09%**	
Tier 1 capital ratio	**8.33%**	

(1) According to the standardized approach.
(2) According to the basic indicator approach.
(3) Acceding to the 9% minimum requirement.

Below is the capital adequacy ratio on consolidated basis and for principal subsidiaries according to Basel II Tier 1 compared to Basel 1 on 31 December 2009:

	Basel II	Basel I
Leumi – on consolidated basis (1)	**14.09**	**14.31**
Leumi Mortgage Bank (2)	**16.32**	**9.66**
Arab Israel Bank (3)	**15.91**	**19.18**
Leumi Card (4)	**14.8**	**20.7**
Bank Leumi U.S.A. (5)	**-**	**14.44**

(1) The difference derives mainly from an increase in risk assets under Basel II as a result of the addition of operational risks which were partially offset by the reduction in capital requirement in respect of credit risks in the retail segment, housing loans and derivatives.
(2) The improvement derived mainly from the large component of housing loans.
(3) The difference derives mainly from the addition of operational risks partially offset by retail credit.
(4) The difference derives mainly from the addition of capital requirements in respect of credit facilities (not required in Basel I)
(5) Not required to be reported under Basel II principles.

For further details in connection with risk components, risk assets and the capital ratio of significant banking subsidiaries see Note 13C to the Financial Statements.

The main differences between Basel II Pillar I and Basel I in the weighting of risk assets in the standardized approach are as follows:

- Indebtedness of governments and banks are weighted according to country rating, instead of "0%" for countries and 20% for banks under Basel I.
- Indebtedness of small businesses (indebtedness up to NIS 5 million) and indebtedness of retailers are weighted at a rate of 75% instead of 100% under Basel I.
- Debt under collateral of a private dwelling, when the level of the loan is up to 75% of the value of the apartment is weighted at a rate of 35%. Under Basel I, the weighting was at a rate of 50%, when the loan was up to 60% of the value of the apartment.
- Loans in arrears when the provision was less than 20% are weighted at a rate of 150% instead of 100% under Basel I, and when the provision is above 20%, the loans are weighted at a rate of 100%.
- Investments in venture capital funds and private equity funds are weighted at a rate of 150% instead of 100% under Basel I.
- Liabilities for the granting of credit or a guarantee up to one year are weighted at a rate of 20%, compared with 0% under Basel I.
- Change in relationship of weighting of derivatives between 0% and 10% compared with 10% on all derivatives under Basel I.
- Reference to pledging of all types of securities for purposes of reducing risk under Basel II and not just for government debentures under Basel I.
- Capital requirements in respect of operational risks were not required under Basel I.

Pursuant to the directive of the Supervisor of Banks at the Bank of Israel, the overall capital ratio will not be less than 8% in respect of Pillar I and 1% in respect of Pillar II, a total minimal capital ratio of 9%. The capital requirement is calculated at the rate of 9% of total weighted risk assets.

However, the Supervisor of Banks expects that as a result of the Internal Capital Adequacy Assessment Process – ICAAP in the framework of the second pillar of Basel II, every bank will determine on an individual basis the total "risk capital" required in respect of this pillar and for the purposes of meeting stress scenarios.

For purposes of calculating the risk bearing ability, an analysis is made of the coverage of risks on two levels:

Capital for the purpose of maintaining a going concern – in order to examine the stability of the Group after the occurrence of a stress scenario as a going concern, which continues to carry on its business without external assistance with minimum damage as far as possible to the goodwill of the Bank.

Capital for the purposes of liquidation – is intended to serve as security against claims by creditors of the banking corporation. For the purpose of meeting these risks, it is necessary for the actual capital of the corporation to be higher than the "risk capital" required (Pillar I and additional cushions for Pillar II).

In the framework of the ICAAP process that the Group undertook, "cushions" were estimated in respect of risks not included in the framework of Pillar I. These "equity cushions" provide a response to risks, such as: large borrower concentrations, group borrowers, sectorial concentrations, country risk, and various market risks.

Risk assets are calculated in the Leumi Group under the first pillar in the Basel II directives, which includes credit risks, market risks and operational risks. Risk assets in respect of credit are calculated according to the standardized approach. Operational risk is calculated according to the basic indicator approach.

Capital planning in the Leumi Group reflects a forward-looking view of risk appetite and the capital adequacy required as a consequence of this. Risk factors are further checked under strict assumptions of stress tests.

Capital planning includes inter alia reference to the risk appetite of the Group, to the dividend allocation policy, and to the optimal capital structure.

Capital Adequacy Target

The policy of the Bank approved by the Board of Directors is to hold a level of capital adequacy higher than the floor determined from time to time y the Bank of Israel, and generally higher in relation to the banking system in Israel and in similar relation to the average in OECD countries in the long term.

Group policy, which expresses its risk appetite, in accordance with that mentioned above, includes a target of total capital ratio of 14.0%-14.5% and an “original” Tier 1 capital ratio at a rate of 8.0%-8.5%. IN addition, the Group has determined a target of maintaining an “original” Tier 1 capital ratio in a stress scenario (for purposes of maintaining a going concern) of not less than 6.0%.

The above capital adequacy policy refers to future activities of the Bank, and is defined as “forward-looking information”. For the meaning of this term, see the section “Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report on page 51

Issue of Subordinated Capital Notes and Subordinated Notes

During April – May 2009, the Bank raised NIS 1.0 billion through private placings of subordinated capital notes with institutional investors, which have been recognized by the Bank of Israel to as upper Tier II capital.

In May 2009, Leumi Finance Company issued subordinated capital notes (Series J) in the amount of some NIS 1.5 billion.

In August 2009, in accordance with a permit received from the Israel Securities Authority, Leumi Finance published a shelf prospectus allowing it to issue debentures, subordinated capital notes (Tier II capital) and other subordinated capital notes (upper Tier II capital). Unlisted subordinated capital notes were also issued, pursuant to the prospectus, to the shareholders of Dan Public Transportation Company Ltd., in the amount of some NIS 341 million, and listed subordinated capital notes in the amount of some NIS 2 billion were issued to the public and to institutional investors, pursuant to a shelf offering report which was published pursuant to the prospectus. The subordinated capital notes were approved by the Bank of Israel as upper Tier II capital.

On 27 August 2009, in accordance with a permit received from the Israel Securities Authority, the Bank published a shelf prospectus allowing it to issue up to 6 series of debentures (series 400 to 405), up to 11 series of subordinated capital notes (series 250 to 256 and series 300 to 303) and up to 6 series of subordinated capital notes (series 200 to 205). The maximum amount of debentures and capital notes which the Bank may issue under this shelf prospectus is NIS 4 billion par value of each of the above series. The prospectus will remain valid for two years from the date of its publication.

In February 2010 the Bank issued subordinated capital notes (series 200 and 201) of some NIS 2.3 billion, under the above shelf prospectus. The capital notes are repayable after 50 years (February 2060), with Series 200 being in the amount of NIS 1,250 million linked to the index and bearing interest of 4.0%. Capital Notes Series 201 in the amount of NIS 950 million are unlinked and bear variable interest at the Makam (T-Bill) rate plus a margin of 1.4 %. The subordinated capital notes are approved by the Bank of Israel as Upper Tier 2 capital.

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 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.

The balance of the loans provided by Israel Discount Bank to Leumi employees in order to finance their exercise of the options was NIS 52 million as of 31 December 2009 (out of a total amount of NIS 277 million in loans that were provided in February 2006).

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

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. The Bank has not yet issued the above capital notes.

Distribution of Dividends

A. Dividend Policy for 2009-2010

The Supervisor of Banks has announced that he expects that the banking system will not distribute dividends for the year 2009 in light of current risks, with the purpose of building strong levels of capital in anticipation of the implementation of Basel II. Any bank wishing to distribute dividends will be required to apply to the Supervisor of Banks, to give explanations and receive approval for such distribution.

The Board of Directors in its meeting of 24 March 2010 decided to recommend the distribution of a dividend in cash for 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 24 March 2010 not to decide at this stage the dividend policy for the year 2010.

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

**	**2009**	2008	2007
1. Bank Leumi le-Israel B.M. - in NIS millions	**-**	-	1,684
2. The Arab Israel Bank Ltd. - in NIS millions	**80.0**	80.0	89.7
3. Various wholly-owned subsidiaries of the Group - in NIS millions	**12.8**	36.8	25
4. Leumi International – in US$ millions	**-**	10	-
5. Leumi Re – in US$ millions	**-**	10	5
6. Bank Leumi (UK) – in £ millions	**-**	-	5.7
7. Israel Corporation Ltd. – in NIS millions	**-**	32.2	45.3
8. Paz Oil Company Ltd. – NIS millions	**-**	80.0	14

* 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 accounting year.

Bank Leumi le-Israel B.M. and its consolidated companies
Principal Data of Bank Leumi Group

	2009	2008	2007	2006	2005
Income, expenses and profits (in NIS millions):					
Net interest income before provision for doubtful debts	**7,023**	6,380	7,648	6,922	6,629
Provision for doubtful debts	**1,517**	2,145	407	933	1,426
Total operating and other income	**4,563**	2,800	4,222	3,881	3,727
Total operating and other expenses	**6,937**	7,003	6,937	7,267	6,080
Of which: costs of voluntary retirement	**-**	3	-	175	107
costs of privatization (issue of shares and options to employees)	**41**	(66)	250	452	-
Operating profit before taxes	**3,132**	32	4,526	2,603	2,850
Provision for tax	**1,191**	421	1,722	1,320	1,193
Net operating profit (loss)	**1,986**	(158)	2,984	1,454	2,059
Profit from extraordinary items after tax	**28**	250	373	2,080	77
Net profit	**2,014**	92	3,357	3,534	2,136
Net operating profit per NIS 1 nominal value of share capital (in NIS)	**1.35**	(0.11)	2.11	1.03	1.46
Net profit per NIS 1 nominal value of share capital (in NIS)	**1.37**	0.06	2.37	2.50	1.51
Dividends paid (in respect of the reported year)	**-**	-	1,684	2,500	1,103
Assets and liabilities at end of period (NIS millions):					
Total assets (total balance sheet)	**321,775**	310,792	302,151	289,341	276,119
Credit to the public	**204,669**	213,215	198,557	183,800	180,881
Securities	**57,505**	44,910	47,169	46,375	47,825
Deposits of the public	**250,418**	244,783	238,045	231,823	221,828
Debentures and notes	**25,261**	20,636	19,248	15,622	17,253
Shareholders' equity	**21,862**	18,672	19,549	17,491	16,000
Major financial ratios in annual terms (in %):					
Credit to the public to total balance sheet	**63.6**	68.6	65.7	63.5	65.5
Securities to total balance sheet	**17.9**	14.5	15.6	16.0	17.3
Deposits of the public to total balance sheet	**77.8**	78.8	78.8	80.1	80.3
Deposits of the public to credit to the public	**122.4**	114.8	119.9	126.1	122.6
Total shareholders' equity to risk assets (accordind to Basel I) (a) (c)	**14.31**	11.58 (e)	11.52	11.56	11.55
Tier I capital to risk assets (accordind to Basel I) (c)	**8.52**	7.51	7.55	7.53	7.46
Shareholders' equity (excluding minority interest) to total balance sheet	**6.8**	6.0	6.5	6.0	5.8
Net profit to average shareholders' equity (excluding minority interest)	**10.2**	0.5	17.4	20.1	13.5
Net operating profit (loss) to average shareholders' equity (excluding minority interest)	**10.1**	(0.8)	15.4	8.3	13.0
Rate of provision for tax on the profit	**38.0**	-	38.0	50.7	41.9
Provision for doubtful debts from credit to the public	**0.74**	1.01	0.20	0.51	0.79
Provision for doubtful debts from total risk of credit to the public	**0.49**	0.67	0.13	0.34	0.54
Net interest income before provision for doubtful debts to total balance sheet	**2.18**	2.05	2.53	2.39	2.40
Total income to total assets (b)	**3.60**	2.95	3.93	3.73	3.75
Total income to total assets managed by the Group (b) (d)	**1.48**	1.41	1.55	1.55	1.62
Total operating and other expenses to total assets	**2.16**	2.25	2.30	2.51	2.20
Total expenses to total assets managed by the Group (d)	**0.89**	1.08	0.91	1.05	0.96
Net profit to total average assets	**0.58**	0.03	1.13	1.29	0.82
Net operating profit (loss) to total average assets	**0.57**	(0.05)	1.01	0.53	0.79
Financial margin including income and expenses from derivative financial instruments	**1.10**	1.63	1.71	1.82	1.60
Operating expenses (excluding voluntary retirement) to total income (b)	**59.9**	76.3	58.4	65.6	57.7
Operating and other income to operating and other expenses (excluding voluntary retirement)	**65.8**	40.0	60.9	54.7	62.4
Operating and other income from total income (b)	**39.4**	30.5	35.6	35.9	36.0

(a) Shareholders' equity – plus minority interest, less investments in capital of companies included on equity basis and various adjustments.
(b) Total income – net interest income before provision for doubtful debts plus operating and other income.
(c) In accordance with the standardized approach of Basel II - Pillar 1, total capital ratio to risk assets 14.09%, primary capital ratio to risk assets 8.33%.
(d) Including off-balance sheet activity.
(e) Re-classified.

C. Other information

Principal Developments in the Economy[*]

General

In 2009, the Israeli economy grew at a real rate of some 0.7%, which meant a decrease of some 1.1% in GDP per capita, after growth of some 4.0% in 2008. The severe slowdown in the growth of the economy was influenced by a noticeable reduction in exports and investments, of 12.5% and 6.0% in (negative) real terms, respectively. This was against the backdrop of the global crisis affecting countries with which Israel trades and acted to worsen the situation of companies in the economy which, *inter alia*, reduced their investments. Commencing in the second quarter of the year, signs of the beginning of recovery were noted in the Israeli economy, whose background macro-economic conditions at the beginning of the period of the crisis were better than those of most Western countries. Thus, the economy grew at a real rate of some 4.9%, in the last quarter of 2009 together with a decrease in the rate of unemployment to 7.4%. The recovery in economic activity began to have an effect on the State's revenues from taxes, and the budget deficit totaled some 5.15% of GDP, lower than the target of 6% of GDP set out in the current budget law.

The exchange rate of the shekel against the US dollar appreciated during 2009 by some 0.7%, although volatility was high (during the year the rate ranged from NIS 3.69-4.26 to the dollar, approximately). The Consumer Price Index went up in 2009 by 3.9%, a rate which exceeded the upper limit of the government's inflation target (1%-3%). The Bank of Israel continued to take steps to lower the interest rate at the beginning of 2009 by also using other monetary tools, out of its intention to bring about a very expansive monetary policy to support economic activity in the economy. So the interest rate which reached 2.5% in December 2008 was lowered to 0.50% as of April 2009. A change in this trend began in the decision on the level of interest in September 2009, when the interest rate was raised by 0.25 percentage points to 0.75%, and the interest rate for December 2009 went up to 1.0%. At the beginning of 2010 this trend continued and the interest rate for the month of February stood at 1.25%.

The stock market in 2009 recorded sharp price rises of some 78.8% in the shares and convertible securities index, after sharp declines in 2008. The low interest rate together with investor optimism in Israel and abroad that the recession is coming to an end, as can be seen from the positive economic figures published in the second half of the year, formed a backdrop to the sharp rises in prices. As of 8 March 2010, the shares and convertible securities index was some 0.5% higher than its record level in October 2007. Prices of government debentures also recorded price-rises, with corporate debenture indices recording especially sharp price rises of more than 40%

The Global Crisis

Commencing in the second quarter and with greater strength in the second half of 2009, indications were recorded in the global economy of an improvement in economic activity. The international Monetary Fund, in an economic update published on 26 January 2010, estimated that real activity is in a process of recovery, mainly with the support of the expansive policy measures taken by various countries around the world. Against this backdrop, the IMF updated its forecast for world growth in 2010 upwards in comparison with precious forecasts it published during the year. Currently, the IMF is of the opinion that growth in the U.S. and the Euro area for the year 2010 will be at rates of 2.7% and 1.0% respectively, compared with negative growth of (2.5%) and (3.9%), respectively, in 2009

In February 2010 concerns began to develop in financial markets over the financial situation of several European countries, especially Greece, Portugal, Spain and Italy. This is mainly against the backdrop of their large budget deficits and the noticeable rise in government debt due to the financial crisis. In a meeting of heads of government of the European Union that took place on Brussels on 11 February 2010,

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

there was widespread agreement on formulating an aid package for Greece, whose condition is the worst of the four countries mentioned above, which will be accompanied by strict fiscal regulations.

Business Product and Economic Sectors

The business sector product decreased in 2009 by some 0.2%, following growth of some 4.5% in 2008. However, beginning in the second quarter of 2009 positive growth was recorded, and in the last quarter it totaled some 5.2% in annual terms, compared with the third quarter. This acceleration in the rate of growth expresses the positive change in the trend in economic activity of the business sector.

The Bank of Israel's companies' survey for the fourth quarter of 2009 indicated a marked improvement in economic activity in most sectors of the economy, except for hotels. In leading sectors of the business sector (industry, trade and construction) according to responses by companies, a significant increase was recorded in activity with a return to the levels typifying the business sector two years ago.

Looking forward, companies in industrial sectors expect an increase in activity in the first quarter of 2010 (mainly export influenced) with an evaluation of accelerated growth in sales in trade sectors. In business and construction sectors too there are expectations of continued growth in activity in the first quarter of 2010. On the other hand in the hotel sector moderate activity is anticipated. The summary of the companies review indicates similar trends to those which can be learned from macro-economic data: an improvement in activity in the last quarter of 2009, together with ending of the recession, an improvement which is expected to continue in the first quarter of 2010.

The State Budget and its Financing

The State Budget deficit (excluding net credit granted) amounted in 2009 to some NIS 39.3 billion which is some 5.15% of GDP, as compared with a planned deficit for the whole of 2009 of some NIS 44.4 billion (6% of GDP). Last year's deficit was lower than forecast because of an increase in revenue from taxes above that planned and a lower level of expenses, primarily in connection with interest payments. According to Ministry of Finance figures, the year 2009 began with a declining trend in tax collection, and during the year this was reversed: in the months of March-April in indirect taxes, and beginning in June in direct taxes. This is a result of recovery in the economy, mainly in the second half of the year.

In July 2009 the State Budget for the years 2009-2010 was approved by the Knesset, with its base being the expansion of the bi-annual State Budget for these years at a rate of 3.05% each year (1.7% under the Budget Law and an additional temporary rate of 1.35% in each of the years), and fixing a maximum target for budget deficit of 6% of GDP in 2009 and 5.5% of GDP for 2010.

Foreign Trade and Capital Flows

Israel's overall trade deficit in 2009 recorded a decline of some US$ 8.1 billion, in comparison with 2008, totaling US$ 5.1 billion, primarily under the effect of the reduction of expenses on fuel and diamond imports (after neutralizing these volatile components, a surplus was recorded of some US$ 2.3 billion). This reduction is a result of a much sharper decline of imports in nominal dollar terms (-27%) in relation to exports (-19%).

During 2009, total exports were higher than imports, on the basis of data neutralizing the effect of volatile components in foreign trade. Specifically this phenomenon was pronounced in the last quarter of the year, when there was a significant contribution to the growth of the economy from the surplus of exports over imports. Behind the figures, there are growing indicators of a marked improvement in economic activity in many economies worldwide. Thus, the "Index of Leading Indicators" published monthly by the OECD, whose aim is to point out indications of change in trend in economic activity six months in advance, indicated in November 2009 a strengthening in the signs of recovery in countries such as the U.S., China and Japan. In large European countries such as France, Germany and the U.K., there are signs for expansion in economic activity.

Figures for capital flows to and from Israel in 2009 display a pronounced trend of growth in financial investments abroad by Israeli residents (mainly institutional investors), especially in shares. Investments totaled some $7.7 billion compared with investments totalling some $2.1 billion in 2008. An additional notable component is direct capital flows of foreign residents to Israel, mainly through banks in Israel, which continue to expand although at a slightly lower rate than in the past: some $4.5 billion in 2009, compared with $5.4 billion in 2008. The combination of the outgoing and incoming flows indicates outgoing foreign currency capital flows were higher than the incoming flows. At the same time, the recent strengthening of the shekel has been affected by additional factors which appear to carry significant weight, such as the global weakening of the dollar, and the improvement of the current balance of payments (in 2009 a surplus of some 3.7% was recorded in GDP compared with 0.7% in GDP in 2008). The cessation of the Bank of Israeli's continual intervention in foreign currency trading also served to strengthen the shekel.

Exchange Rate and Foreign Currency Reserves

In 2009 an appreciation of some 0.7% was recorded in the exchange rate of the shekel against the dollar, and against the Euro the shekel was devalued at a rate of about 2.7%.

The shekel's appreciation against the dollar beginning in the second quarter of 2009 is a result of the combination of the depreciation of the dollar globally, and the impact of local macroeconomic factors, while the cessation of fixed purchases by the Bank of Israel in the foreign currency market also furthered this trend.

In 2008, the Bank of Israel began buying dollars in the forex market in the framework of a program to increase reserves. From March 2009, the Bank of Israel announced that against the backdrop of the economic situation worldwide and as part of its overall policy, it would continue to buy an average of US$100 million a day in the Israeli forex market. In August 2009, the central bank announced that "it will take action in the foreign currency market in the event of unusual fluctuations in the exchange rate, which are not in accordance with the underlying economic conditions, or when the foreign currency market is not functioning properly" and that it would discontinue the program of fixed purchase on a daily basis of US$100 million . Since then, the Bank of Israel intervenes in trading from time to time, purchasing foreign currency in varying amounts.

At the end of December 2009, the foreign currency reserves at the Bank of Israel stood at some US$ 60.6 billion, compared with some US$ 42.5 billion at the end of December 2008 (and some US$ 28.5 billion at the end of February 2008, close to the period when it began to purchase dollars in the forex market). This notable increase in reserves derives primarily from the Bank of Israel's foreign currency purchases over the last year.

Inflation and Monetary Policy

The CPI rose by 3.9% in 2009. An analysis of the CPI according to its key items indicates that two items contributed the bulk of the rise: housing rose by some 5.6% and contributed approximately a third of the overall rise. The housing market was affected this year by the increasing demand for apartments for investment, and from the reduction in the cost of mortgage payments because of the significant decrease in the interest rates. On the other hand, the moderate economic activity, primarily in the second half of the year, helped to reduce demand. The second item whose rise was prominent was transport and communications which rose by about 6.5% and also contributed about one third of the overall rise in the Index. The main contribution to this was the increase in fuel prices (the item in the Index in which fuel prices are included went up by about 28% in the past year, a contribution of about a quarter of the rise in the general index). Of course, the increase in various taxes during the year also contributed to the general rise in the Index (a contribution of more than one percentage point).

The Bank of Israel took action at the beginning of 2009 to continue to lower the interest rate. This was a result of its desire to support economic activity, against the backdrop of the economic crisis worldwide. Here the Bank of Israel acted in a similar manner to central banks throughout the world which lowered interest rates, and also took steps through other monetary tools, with the intention of bringing about a very expansive monetary policy (one of the expressions of this was the marked increase in 2009 of more than 51% in the quantity of money). Thus, the Bank of Israel interest rate stood at 2.5% in December 2008 and declined to 0.50% in April 2009, and stayed at this level until August 2009. Beginning with the decision on the rate of interest for September 2009, a rising trend began in the rate of interest, and it was raised to 0.75%. In December 2009 and at the beginning of 2010, the trend continued and interest for February 2010, stands at 1.25%. The improvement in the condition of the economy and the inflationary environment being above the mid-point of the inflation target, worked towards a change in the trend with the aim of returning interest to a "normal" level, as stated by the Bank of Israel.

In the months December 2008 to February 2009, the Bank of Israel announced a series of measures with the monetary tools available to it. Details can be found in the Directors' Report for 2008, page 30.

On 25 March 2009, the Bank of Israel announced an expansion of its activity in the debentures market, through the purchase of government debentures on an average daily basis of some NIS 200 million. On 5 August 2009, the Bank of Israel discontinued the above mentioned purchasing activity and announced that it did not intend to sell the securities that it had purchased.

The Capital Market

In 2009, the share and convertible securities index rose by some 78.8%, following a sharp decline of 46.4% in 2008, with the TA-100 Index rising by some 88.8% last year. Price rises were recorded for every month of the year, except August, and are explained by the very expansive monetary policy leading to a low-point in the interest rate (0.5%), and by the trend of rapid recovery by the economy, beginning in the second quarter of the year, which also contributed to the positive trend in the stock market. Trading turnovers also expressed this trend: however on an annual average, the trading turnover for shares and convertible securities amounted to some NIS 1,705 billion in 2009, a decline of about 13.2% in comparison with 2008, but this figure was influenced by the year's first quarter figures (some NIS 1,208 million on a daily average) which were especially low. Beginning in the second quarter trading turnovers recorded a significant increase.

The debentures market was typified in 2009 by price rises both in government debentures (CPI-linked and non-linked) and in corporate debentures. CPI-linked government debentures rose by some 10.3%, with medium-term (5-7 years) debentures standing out with their prices increasing by some 10.9%. Prices of unlinked government debentures rose by a moderate rate of about 2.5%. The increase in debenture prices, especially long term, was affected both by Bank of Israel intervention in trading in the months March-August, and perhaps also by the migration to investments in debentures with a longer redemption period, against the backdrop of low interest rates in the short term.

In the non-government debentures market (corporate debentures), CPI-linked debentures recorded sharp rises in prices of about 40.2%. This is after sharp price decreases in 2008, especially in the last quarter of the year. It appears that this is a result of over-concern prevalent at the end of 2008 as to the condition of many firms in the economy, with the rapid recovery of the economy especially in the second half of 2009 justifying the correction in debenture prices.

Key Capital Market Indices – Rate of Periodic Change in 2009

	First quarter	Second quarter	Third quarter	Fourth quarter	Annual
TA-100 Index	18.1%	20.3%	15.8%	14.8%	88.8%
TA-25 Index	11.2%	18.4%	15.4%	15.1%	74.9%
Government debenture index	4.0%	-0.5%	2.3%	0.1%	5.9%
Bank shares index	0.6%	30.1%	35.0%	21.1%	114.0%

Yield to Redemption – Monthly Averages

	December 2008	March 2009	June 2009	September 2009	December 2009
Makam – 1 year to redemption	2.0%	1.1%	1.3%	1.7%	1.9%
Shahar – 3 years	3.4%	2.5%	3.0%	3.0%	3.5%
Shahar – 7 years	4.7%	4.2%	5.0%	4.7%	4.6%
Galil – 5 years	3.1%	1.4%	1.9%	1.4%	1.3%
Galil – 9 years	3.4%	2.5%	2.9%	2.5%	2.3%

Financial Assets of the Public

The portfolio of financial assets held by the public grew by some 22% in 2009 and amounted at the end of December 2009 to some NIS 2,302 billion. This was after a decrease of some 8.2% in the value of the portfolio in 2008. All the components of the portfolio grew since the beginning of the year, with shares in Israel and abroad contributing to an increase of about 65%. This is primarily against the backdrop of the rise in share prices in stock exchanges in Israel and abroad. Another expression of significant increase taking place in price rises, could be seen in the distribution of the portfolio: currently, the weighting of shares is about 23% of the portfolio, whereas over the last two decades there were periods in which the "risk appetite" of the public could be seen in its holdings at a higher rate reaching 27% to 30%. If the effect of evaluation of various balances of assets is neutralized, an estimate can be made of asset acquisition (the financial savings estimate). According to this estimate the annual rate of saving, which has a high correlation with the rate of development in economic activity, went up in recent months and reached some 43%, after it reached 0% during last year. That is an additional expression of the improvement in economic activity expressing itself in renewed accumulation of savings.

Total financial assets of the public managed by the **Group** (deposits of the public, debentures and capital notes, securities portfolios, including securities in custody of mutual funds, provident funds and supplementary training funds to which operational, management and custody services are provided), amounted at the end of December 2009 to some NIS 736 billion, compared to some NIS 606 billion at the end of December 2008, an increase of 21.5%.

Bank Credit

Bank credit to the private sector (before provisions for doubtful debts and including housing loans) grew by some 0.3% in 2009. This followes an increase of some 9.0% in 2008, and was the result of a reduction in credit given to the business sector, among others against the backdrop of a decrease in demand because of the slowdown in economic activity in the economy, primarily in the first half of the year. Against this, an increase was recorded in credit given to households deriving mainly from credit given to housing (an increase of some 12.5%), in the light of the rise in demand for mortgages against the background of low interest rates in the economy. Non-bank credit expanded, notwithstanding large scale redemptions, because of the increase in debenture issues by the non-financial business sector (quoted and unquoted) which according to Bank if Israel figures amounted to some NIS 26 billion. This is in comparison with total issues of some NIS 9.8 billion in the whole of 2008. The rise in issues is a result of the recovery in the capital market against the backdrop of the relatively good condition of the Israeli economy and the declining concern over payment default by companies in the economy amongst purchasers of the issued debentures.

Credit by the **Bank** to the public, including housing loans given by Leumi Mortgage Bank, amounted at the end of December 2009 to some NIS 176 billion, compared with NIS 184 billion at the end of December 2008, a decline of 4.3% in relation to the end of 2008.

Credit in the economy (annual rate of change):

	Year 2009	Year 2008	Credit balances at the end of December 2009
		(%)	(NIS billion)
Business sector credit (excluding banks and insurance companies)			
Total from banks	**(5.1)**	7.9	393.4
Non-bank credit	**3.9**	0.0	341.7
Total debt for all borrowers	**(1.1)**	4.2	735.1
Credit to households			
Total from banks	**9.8**	10.9	258.2
of which: non-housing credit to the public (consumer credit)	**6.0**	7.6	102.3
Housing credit + designated credit	**7.4**	8.6	195.2
Total debt for all borrowers	**7.2**	8.1	310.0

Credit Rating of the State of Israel and of Bank Leumi

The Moody’s credit rating agency announced on 12 March 2009 that it was lowering certain ratings for a number of Israeli banks, including Leumi, in light of the concerns regarding the banks’ financial stability as a result of the worsening of Israel’s economic situation, which could lead to a higher level of provisions for doubtful debts than in the past. The rating change for Leumi included, *inter alia*, a reduction of the rating for local currency deposits to 'A1'.

On 30 April 2009, the S&P Ma'alot rating agency announced that it was reducing the issuer rating of the Leumi Group to 'ilAA+' from 'ilAAA'. The Bank’s rating outlook was changed to "negative" from "stable". At the same time, the global long-term rating had been reduced from 'A-' to 'BBB+' and the short-term rating remained unchanged at a level of 'A-2'. The global ratings outlook is "negative". The lowering of the ratings reflects the agency’s view regarding the negative impact of the global and local recession on the profitability of the Leumi Group and on the quality of its credit portfolio. The "negative" ratings outlook reflect their expectation that, notwithstanding the Bank’s satisfactory financial and business profile, it could be adversely affected from negative developments in the environment in which it operates, primarily from the weakening of both local and global economic activity and capital markets.

Credit rating of foreign and domestic ratings agencies

	Rating agency	Short-term rating	Long-term rating	Long-term ratings outlook	Date of adjustment
State's rating in foreign currency	Moody's	P-1	A1	stable	August 2009
	S&P	A-1	A	stable	March 2010
	Fitch	F1	A	stable	November 2009
Leumi's rating in foreign currency	Moody's	P-1	A1	negative	December 2009
	S&P	A-2	BBB+	negative	April 2009
	Fitch	F2	A-	stable	August 2009
Leumi's rating in local currency	Moody's	P1	A1	negative	December 2009
Leumi's rating in local currency for debentures and standard deposits	Maalot	-*	AA+	negative	May 2009
	Midrug	P-1	Aaa	stable	January 2010
Leumi's rating in local currency for subordinated notes	Maalot	-*	AA	negative	August 2009
	Midrug	-*	Aa1	stable	January 2010
Leumi's rating in local currency for subordinated capital notes (Upper Tier II)	Maalot	-*	(A+,A)**	negative	January 2010
	Midrug	-*	Aa2	stable	January 2010

* Not relevant.

** A: Upper Tier II with compulsory conversion of principal (rating updated in January 2010)
A+: "New" Upper Tier II not convertible to shares (rating updated in August 2009)

Developments regarding Leumi Shares

From the beginning of the year until 31 December 2009, the price of Leumi shares has risen from 790 points to 1,745 points, a change of 120.9%. During this period, the Bank's market value has increased from NIS 11.6 billion to NIS 25.7 billion.

The share price as at 15 March 2010 was 1,673 points, and the Bank's market value has reached NIS 24.7 billion.

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

	31 December				
	2009	2008	2007	2006	2005
	NIS				
Exchange Rate of:					
US dollar	**3.775**	3.802	3.846	4.225	4.603
Euro	**5.442**	5.297	5.659	5.564	5.446
Pound Sterling	**6.111**	5.548	7.711	8.288	7.941
Swiss Franc	**3.667**	3.565	3.420	3.465	3.498
Consumer Price Index:	(points)				
November – known CPI	**105.2**	101.3	97.0	94.3	94.6
December – CPI in respect of	**105.2**	101.2	97.5	94.3	94.4

The following are the exchange rates for 15 March 2010:
US$ – 3.715, GBP – 5.588, Euro – 5.093, CHF – 3.506.

The following table sets out the rates of change

	For the year ending 31 December				
	2009	2008	2007	2006	2005
Rate of change	In percentages				
US dollar	**(0.7)**	**(1.1)**	(9.0)	(8.2)	6.8
Euro	**2.7**	**(6.4)**	1.7	2.2	(7.3)
Pound Sterling	**10.2**	**(28.0)**	(7.0)	4.4	(4.4)
Swiss Franc	**2.9**	**4.2**	(1.3)	(0.9)	(8.1)
Consumer Price Index:					
November – known CPI	**3.8**	**4.5**	2.8	(0.3)	2.7
December – CPI in respect of	**3.9**	**3.8**	3.4	(0.1)	2.4

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, page 51.

Pension Counseling

In August 2008, the Bank received a pension counseling license, which included certain restrictions.

During the first half of 2009, the deployment of the pension counseling service, which began in pilot branches during the last quarter of 2008, was expanded to reach all the branches throughout the country. The counseling is provided subject to the terms of the license, by licensed pension counselors, most of whom also have investment counseling licenses.

Pursuant to the terms of the license from the Ministry of Finance, as of 1 April 2009, the restrictive terms in the pension counseling license were removed, and the Bank may provide comprehensive pension counseling regarding pension products, including insurance products, to the entire population throughout the country.

The provision of comprehensive pension counseling regarding all pension products to the entire population requires complex operational and business preparations, in which the Bank has invested and continues to invest considerable resources.

As a rule, the absence of computerized interfaces between the Bank and the institutional bodies (clearing houses) complicates the monitoring of the implementation of the recommendations and makes such monitoring difficult. This issue becomes especially significant with regard to counseling provided to salaried employees, and to counseling with respect to insurance products.

Regarding counseling to salaried employees – the absence of the interfaces between the Bank and the institutional bodies, and the absence of interfaces between the Bank and the employers and their salary departments, both regarding information and regarding the clearing of funds for the employees after the provision of counseling, seriously damages the implementation of the counseling process for salaried employees.

Regarding insurance counseling – the absence of computerized interfaces between institutional bodies and the distributors of insurance products, and the fact that the Ministry of Finance has not dealt on its website ("BituachNet") with standardized values which would allow for the products to be examined and identified, makes it difficult to construct a model to support decisions and therefore prevents the provision of insurance counseling. Similarly, in the absence of standardized values, as stated, and in the absence of interfaces with the institutional bodies, it is not possible to monitor the implementation of the counseling recommendations *vis-à-vis* the institutional bodies. Additionally, no regulations have yet been enacted to regulate payment of distribution commissions for counseling regarding insurance products. In September 2008, a draft amendment of the Financial Services (Control) (Provident Funds) (Distribution Commissions) Regulations was submitted to the Knesset Finance Committee for approval. In September 2009, a draft of the regulations was resubmitted to the Knesset Finance Committee. Pursuant to the draft, no distribution commissions will be paid for some of the insurance products in respect of which counseling will be provided, and for those in respect of which distribution commissions may be paid, the maximum rate of commission will be an annual rate of 0.25% of the accumulated amount saved in regard to the insurance product on which counseling has been given.

Leumi is in the process of creating computerized interfaces with the institutional bodies that manage provident funds in order to simplify the process of transferring information, and executing transactions carried out pursuant to pension counseling and pursuant to counseling on supplementary training funds, in the framework of investment counseling. A Ministry of Finance circular dealing with an abridged uniform structure for the transfer of information from the institutional bodies to the licensees was published in August of 2009. This circular, which will come into effect at the beginning of February of 2010, determines which data an institutional body must transfer to a licensee and the rules for such a transfer of information. The Bank is preparing for the implementation of this circular.

In parallel, the Ministry of Finance has begun promoting the establishment of a clearing house in the pension savings field, whose main functions will be the transfer of information between the various parties active in the pension savings market (including pension counselors, pension agents, institutional bodies and employers), and the clearing of pension savings payments. In July 2009, the Ministry of Finance published a memorandum of understanding on cooperation in promoting such a clearinghouse. The model planned for the operation of the clearing house involves the establishment of a company to be owned jointly by the various entities in the market (institutional bodies, distributors and salary departments). A steering committee, led by the Ministry of Finance, has been established to promote the creation of the clearing house. The Bank is represented on this steering committee.

In April 2009, a number of private members' bills were tabled before the Knesset for the amendment of the Financial Services (Control) (Engagement in Pension Counseling and Pension Marketing) Law, 2005. Pursuant to the proposed laws, the banks will be defined as distributor counselors, and not as objective counselors. It is proposed that the distribution commission which is currently paid by the institutional bodies in respect of the counseling will not be paid under certain circumstances. It is also proposed that the banks be responsible for the products that they distribute, in addition to their existing responsibility for the counseling, and to delay for a period of 60 days the coming into effect of customers' instructions to transfer funds to a different pension product, unless the instructions regarding the change are given through the counselor through whom the product was purchased.

A preliminary analysis of the proposed laws indicates that they do not protect those who receive the counseling and may even have the opposite effect, and if they are enacted the Bank's ability to provide pension counseling will be materially adversely affected.

In July 2009, draft regulations and a draft circular were published concerning the adaptation of savings tracks to the characteristics of the saver (the "Chilean model”). According to these drafts, the institutional bodies will be required to establish investment tracks for the management of provident fund members’ savings which will serve as default options for fund members when they join the provident funds managed by such institutions. This will be in accordance with the model for the classification of fund members – a plan to be established by the institutional bodies based on relevant characteristics determined by them, including the age of the fund member. In the absence of other instructions from fund members, the institutional body will transfer the members who invest via the general investment tracks (as opposed to members who invest via the specialized tracks) to the default tracks established for them. It appears that after discussions between the Ministry of Finance and the Bankers' Association, the Ministry of Finance will issue a draft circular on this subject.

In August 2009, regulations to enable the operation of personally managed provident funds were approved. According to the regulations, the model will be implemented at this stage only with regard to funds held in supplementary training funds, and to funds of self-employed fund members that are not accompanied by employer contributions. The regulations prohibit the payment of a distribution commission in respect of a personally managed provident fund. This means that the banks are not entitled to a distribution fee in respect of counseling in connection with such a fund.

Until the end of 2009, the number of customers who received counseling services amounted to 33,030, and the balance of investments under counseling mounts to NIS 7.9 billion.

The Reform of Bank Commissions

In July 2008, a major reform came into effect regarding commissions, which is anchored in an amendment to the Banking (Service to Customers) Law. Details regarding the reform are provided in the 2008 Annual Report on pages 39-40.

During 2009, private members' bills were introduced, with the aim of imposing additional restrictions on the collection of commissions from individual customers and small businesses, and *inter alia*, restricting under certain circumstances the possibility of charging them, and, as opposed to the above reform, some of the above proposed bills were not limited only to individuals and small businesses.

Furthermore, in September 2009, a Sub-Committee for Banking Services was set up under the Economics Committee, which is supposed to discuss various matters, excluding commissions, for example the issue of queues in branches, the credit freeze and so on.

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.

Since the above date, the announcement of the Authority was extended by telephone and recently the representative of the Authority confirmed to the Bank's counsel by e-mail that the General Director intends to issue a further extension, which will apply retroactively to the current consortium agreements between the banks.

Companies Tax

On 14 July 2009, the Knesset approved the Improved Economic Efficiency Law (Statutory Amendments for Implementation of the Economic Plan for 2009-2010), 2009, which, *inter alia*, gradually reduces the companies tax rates from 25% in 2010 to 18% for the year 2016 and thereafter.

For further details, see the chapter on the Description of the Tax Situation on page 262

Value Added Tax

On 1 July 2009, the Value Added Tax Order (Tax Rate for Non-profit Organizations and Financial Institutions) 2009 was published in the Israel Government Gazette. The Order raised the rates for salary tax and profit tax that are applicable to financial institutions, as from 1 July 2009 and continuing through 31 December 2010, from 15.5% to 16.5%.

On 31 December 2009, the Value Added Tax Order (Tax Rate for Non-profit Organizations and Financial Institutions) (Temporary Order) (Amendment) 2009, was published in the Israel Government Gazette, reducing the rates for salary tax and profit tax that are applicable to financial institutions, as from 1 January 2010 and continuing through 31 December 2010, from 16.5% to 16.0%.

For further details see page 262

Property of Holocaust Victims

On 24 June 2009, the Tracing and Restitution of Property of Holocaust Victims Company Ltd. (the "Company"), which was established pursuant to the provisions of the Assets of Holocaust Victims (Restitution to Heirs and Endowment for the purpose of Assistance and Commemoration) Law, 2006 (the “Law”) filed a claim in the Jerusalem District Court, whereby it requested that the Court make various declarations regarding “assets of Holocaust victims.”, the Company claims are held or were held by the Bank. Before a response was submitted on behalf of the Bank for an originating motion, an arbitration agreement was signed between the Company and the Bank on 26 February 2010, with the aim of bringing the arguments between the parties to an efficient and speedy arbitration.

For further details, see Note 18 to the Financial Statements.

Legislation Affecting the Banking System

Engagement in Investment Counselling and Marketing, and in Investment Portfolio Management (Amendment No. 13) Law, 2010

On 16 February 2010, Amendment No. 13 to the Counseling Law was published in the Official Gazette. This Amendment will take effect 60 days from the date of its publication. This Amendment to the Advisory Law allows banks to employ, for the provision of investment counseling to sophisticated customers, employees who do not have an investment counseling license.

This Amendment also expands the types of sophisticated customers in respect of whom concessions have been granted regarding the counseling process to counselors, such as: an exemption from having the advisory agreement signed and from certain disclosure obligations, from institutional investors acting solely on their own behalf, also to institutional investors acting for others, to corporations whose equity exceeds NIS50 million, and also for an individual meeting two of the three following conditions: (a) the value of his financial assets and securities exceed NIS 12 million; (b) he has expertise and qualifications in the capital market area or was employed for at least one year in a professional position requiring expertise in the capital market; (c) carried out at least 30 transactions on average in every quarter during the last four quarters. ("Transaction" – excluding a transaction carried out by a portfolio manager for an individual connected to him under an investment portfolio management agreement).

This Amendment regulates primarily the possibility of foreign parties authorized to engage in their country of origin in investment counseling and marketing and in investment portfolio management, engaging in these activities and giving the said services in Israel, without the need for an appropriate Israeli license, on condition that the services will be provided in the framework of a corporation authorized in Israel. The duty of supervision will be placed on such an authorized corporation, with relation to the activity of the foreign trader and also civil liability for the actions of the foreign trader. An Israeli bank can sign an agreement with a foreign trader for the provision of such services.

In addition, draft regulations have been published whose aim is to regulate applications for registration in the foreign traders' registry by an authorized corporation and the foreign trader, and also the registration in the registry.

Banking (Licensing) (Amendment) Law, 2009

On 22 February 2010, the Proposed Banking (Licensing) (Amendment No. 15) Law, 2009 was approved on its second and third readings. The main points of the Amendment are: 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; an insurer will be deemed as acting in a single economic sector, the insurance sector, regardless of the insurer's passive financial investments in other corporations, as such an approach conforms to the insurer's true occupation; the term "acting" in economic sectors will be defined explicitly, such that a corporation will be considered to be a non-banking (real) holding corporation only if it has a real ability to influence more than three economic sectors; that a holding in a corporation of less than 5% will not be considered to be "acting" for the purpose of section 24A; 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, the manner in which the amounts in section 24A of the Banking (Licensing) Law are updated has been changed.

Proposed Prohibition of Money Laundering (Amendment No. 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;
- The expansion of the types of activities defined as granting foreign exchange services
- Amendments relating to criminal aspects of the Law, including an amendment of the section regarding the offenses relating to the prohibition of money laundering, 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 are deemed "source offenses" pursuant to the Law, to include also offences relating to the quality of the environment and 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.

Proposed Banking (Service to the Customer) (Amendment – Interest on Credit Balance) Law, 2009 – 25 October 2009

The proposed law is intended to oblige the banks to pay interest on amounts accumulating in their customers' current accounts. The proposer claims that in light of the fact that the banks charge commissions for every transaction and charge the account with interest for debit balances, they should be obliged to pay credit interest, as was customary in the past in some of the banks.

Similar proposals were tabled in previous terms of the Knesset; the proposal has not yet made any progress and has not even passed its preliminary reading.

Bank of Israel Law, 2010

The purpose of the proposed law is to replace the existing Bank of Israel Law from the year 1954 with a new law which passed its second and third reading on 16 March 2010, but has not yet been published in the Official Gazette.

The main changes included in the Proposed Law are in two areas: the first, determining by law that the main purpose of the Bank of Israel is safeguarding price stability; and the second, reinforcing the independence of the Bank of Israel in determining tools to achieve its purposes and the manner of using the same.

Various authorities to be granted the Bank of Israel are detailed in the Proposed Law, *inter alia* in view of the lessons learned from the recent global financial crisis, and the duties and status of institutions and office holders in the Bank of Israel are regulated, including the establishment of the "Monetary Committee" whose task is to set monetary policy (an authority that was until now given solely to the Governor, after consultation) and monitor its execution.

A chapter is included in the Proposed Law entitled "Administrative Sanctions" which is intended to assist the Bank of Israel in enforcing certain directives on banking corporations and financial bodies, by means of granting authority to the Governor to impose monetary sanctions in an amount of up to NIS 8 million in cases of violations of those directives. In addition it is proposed that there be imposed on the CEO of a corporation the duty of supervision and the duty to take all reasonable measures to prevent such violations, by the corporation or one of the employees of the corporation, and it is determined that if the corporation committed a violation, there is a presumption that the CEO of the corporation breached the duty of supervision, unless he can prove that he took all reasonable measures to carry out his obligations. In the event that the CEO breached his obligation as stated, the Governor is authorized to impose on him a monetary sanction in the sum of NIS 100,000 and in certain circumstances even to order the termination of his service.

Proposed Law – Amendment to Section 5 of the Banking Ordinance, 1941

In the framework of the Proposed Improved Economic Efficiency Law (Statutory Amendments for Implementation of the Economic Plan for 2009-2010), 2009, (a law proposed by the government), *inter alia*, to amend the Banking Ordinance.

It is proposed to amend Section (5C) 1 of the Ordinance and to stipulate specifically in it the authority of the Supervisor of banks to give directives in the matter of passing information on customers of a banking corporation and of a corporation controlled by a banking corporation, for purposes of managing the credit risk of the banking corporation or the banking group, to a central database in the banking group to be set up for this purpose. For purposes of such directives, it is proposed to define a" banking group" to include " the banking corporation and any corporation controlled by it".

In order to achieve a proper balance between the risk management requirements of the banking corporation and the privacy of the customers, it is proposed to reduce the information which may be passed to the said central database, and to exclude from the definition "information" especially sensitive items of information, even if they may contribute to the management of the credit risks of the banking corporation and the banking group, such as: information on the health of a customer, nationality, origin, religion of a customer or a detailed list of purchases that the customer made with a charge card.

In the directives, the Supervisor will refer, *inter alia*, to the manner of maintaining the database, deleting information from the database, and data security.

It is further proposed to authorize the Supervisor of Banks, after consultation with the Justice Minister, to determine what information may be passed from the central database of the banking group to corporations included in the same group, for the purpose of managing the credit risks of the banking corporation of the banking group.

In addition it is proposed to authorize the Supervisor of Banks, with the agreement of the Justice Minister, and while paying attention to the need to protect the privacy of customers, to determine another way of passing information than that proposed as mentioned, namely, passing it to the central database in the banking group; and it is also proposed to authorize him to determine directives in the matter of passing information on a customer of a corporation included in the banking group for purposes of risk management of a different type than credit risks (for example, money laundering risk management). In view of the possible damage to the privacy of customers, the directive of the Supervisor will be published in the Official Gazette.

Proposed Improvement of Efficiency of Enforcement Procedures by the Israel Securities Authority (Amendments to Legislation) Law, 2010

The purpose of the law as detailed in the explanatory section is to enforce more efficiently the provisions of the laws regulating the securities laws – Securities Law, 1968 ("the Securities Law"), the Investment Councelling, Investment Marketing and Investment Portfolio Management Law, 1995 ("the Advisory Law"), and the Joint Trust Investments Law, 1994.

It is proposed to appoint an Administrative Enforcement Committee whose duty will be to discuss and decide on certain violations of the above laws.

Provisions have been stipulated in the above laws whereby, in respect of their violation, it will be possible to commence administrative enforcement proceedings against the person committing the violation. With regard to the Advisory Law, it was determined that the Israel Securities Authority will be authorized to determine additional acts and omissions, the carrying out of which will constitute a violation for which it is possible to commence administrative enforcement proceedings against the person committing the violation.

A panel of the Administrative Enforcement Committee which determined that a violation had been committed will be authorized to impose various means of enforcement on the violator, including prohibiting the violator from serving as a senior office holder in certain corporations for a certain period., canceling the license given to the violator under the Advisory Law or suspending it for a certain period, monetary sanction, payment to parties injured by the violation, a directive to the violator to perform acts to amend the violation and prevent its reoccurrence.

The Chairman of the Authority is authorized to undertake with the violator (or suspected violator) an arrangement not to start proceedings or to discontinue proceedings, subject to conditions in the framework of which the violator will agree that means of enforcement will be imposed on him of the type the enforcement committee is authorized to impose in the framework of administrative enforcement proceedings.

Monetary sanction – it is proposed that the Israel Securities Authority will be authorized to impose a monetary sanction also on an individual, clearing system or corporation whose main business is issuing financial products (products whose value is derived from the value of a basis asset). It is proposed to increase the maximum amounts of monetary sanction which the Minister of Finance can determine.

It is also proposed to increase the punishment for certain violations of the above laws.

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

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.

The above does not detract from the reporting duties of the Bank under the law.

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 have 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 lines of business. The methodology includes a structured quarterly work process in the context of which a thorough 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 judgment 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 is based on Proper Conduct of Banking Business Directive no. 314 – "Dealing with Problem Debts" and 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.

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 and recommendations for the classification of problem loans. 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 and the reporting thereof to Accounting/Bank Balance Sheet Section.

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.

Pursuant to the directive of the Supervisor of Banks in a circular dated 18 February 2010, the banking system will adopt the American Accounting standards FAS 114 and 118 for calculation of the measurement and disclosure of impaired debts, credit risk, and provisions for loan losses. The directive will come into effect as of 1 January 2011. In addition, banking corporations are required to report to the Banking Supervision Department on the calculation of provisions for loan losses in accordance with the above every quarter, as of the report relating to 31 December 2009.

For further details see Note 1 (Y) (1) to the Financial Statements.

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.

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 a few 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 0.6% of total derivatives and some 0.3% of the Bank's assets as at 31 December 2009.

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 of Israeli securities is based primarily on prices quoted on the Tel Aviv Stock Exchange, and of overseas securities, on prices received from external sources. Most of the portfolio is calculated on a monthly basis by a reputable international body which is engaged in the business of calculating the fair value of financial assets for their disclosure in the financial statements. This organization is not dependant on th issuing houses or the marketing bodies. The calculation is based mainly on the transaction prices in active markets, and the calculated value of similar transactions. The calculation reflects the price that a willing buyer in the market would pay for securities, based on current information available in the market. Due to the fact that only a small part of the securities is traded worldwide on a daily basis, the organization makes use of valuation models as described on page 98.
Regarding the portfolio of CLO asset-backed securities, where there is no active market, fair value is determined by an international model acceptable for revaluing these products. 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 0.6 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 98 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 rating at the date of its purchase by the banking corporation and the rating at the date of the publication of the Report. Reduction of the rating below BBB- only is considered a significant downgrading for purposes of this item.

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. The objective evidence and relevant factors include parameters such as: a rise in value after the date of the financial statement, a high credit rating (group A or above), analysis of stability in stress scenarios by an external professional body or by the Bank, its backing including direct government investment in the equity for the purpose of ensuring the strength of the issuing bank.

These principles conform to the guideline issued by the Supervisor of Banks, apart from the definitions of "significant downgrading" and "significant decline in value" decided by the Bank.

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 305 million in the total of the obligations, and any change of 0.25% in salary levels will cause an increase/decrease of some NIS 134 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.

In 2009, a re-evaluation of the rate of the actuarial parameters relating to the rate of utilization of pension rights and the rate of withdrawal of severance pay and provident fund monies was carried out .The new distribution is 76%, those electing for a pension as against 64% up to 2008, with the remainder electing for severance pay and providence fund monies. Furthermore, the rate of women's retirement at age 62 was also examined. The net impact of the aforementioned items totaled NIS 55 million.

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, after adjustment for previous experience with the bank's pensioners.

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 is 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

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 recognized in respect of all taxable temporary provisions, and that a deferred tax asset must be recognized in respect of all temporary differences that can be deducted, losses for tax purposes and tax benefits that have not yet been utilized, if it is anticipated that there will be taxable income against which it will be possible to utilize them, except for a limited number of exceptions.

In certain matters relating to the accounting treatment of income tax, including with regard to recognizing 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 investee 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 and credit card companies, the financial statements of which are prepared in accordance with the directives and guidelines of the Supervisor of Banks.

In June 2009, the Supervisor of Banks published a circular on the subject of "Reporting of Banking Corporations and Credit Card Companies in Israel in accordance with International Financial Reporting Standards (IFRS)", which determines the expected manner of adoption of IFRS by banking corporations and credit card companies.

Pursuant to the circular, the target date for reporting of banking corporations and credit card companies according to IFRS standards is:

1. Subjects that are not a core part of the banking business – beginning 1 January 2011.

2. Subjects that are a core part of the banking business – beginning 1 January 2013, while the Banking Supervision Department intends to make a final decision in this regard during 2011. The final decision will be made while taking into account the timetable laid down in the U.S., and progress made in the convergence process between the International and American Standard Boards.

See Note 1 Y (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 287 to 289 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 Chief Legal Advisor, 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 "Disclosure Controls and Procedures for the Financial Statements" on page 279 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 the 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.

On 4 February 2010, Companies Regulations (Directives and Conditions concerning the Procedure for approving Financial Statements), 2010 were published, which will apply to financial statements prepared as at 31 December 2010 and after. The regulations determine *inter alia* that the board of directors of a public company will approve the financial statements after the financial statements review committee has discussed the statements and given its recommendations to the board of directors and reported to it on every deficiency and problem disclosed during the review process. The regulations determine the composition and qualifications of the members of the financial statements review committee.

Disclosure Policy

Pursuant to Bank of Israel directives, reporting requirements in Pillar 3 of the Basel II directives obligate the Bank to determine a formal disclosure policy. The policy is to refer to the banking corporation's approach to determining what disclosure will be made including the internal controls on the process.

Leumi has determined its disclosure policy which has been approved by the Board of Directors.

Disclosure policy is based on the directives for Reporting to the Public and the provisional directives of the Israel Securities Authority which were adopted by the Supervisor of Banks.

In accordance with the said disclosure policy, Leumi will aim to give material information in its statements, which will be reported clearly and in detail.

Information given in the financial statements is based on the directives of the Supervisor of Banks for Reporting to the Public. Information given in the Directors' Report is prepared in accordance with directives for Reporting to the Public, especially pursuant to "Temporary Order concerning the Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report" In accordance with the directive, the directors' report is to include information in the Bank's business, the operating segments in which it operates, the general environment in which it operates and its influence on the Bank, the control structure of the Bank and its organizational structure, legal proceedings, material agreements, and detailed information on other matters.

Regarding information which can be quantified, quantitative data is given, and regarding other information, qualitative data is given.

The general principle according to which information is given in the report is the principle of materiality. The Bank's business and its activities are examined according to their scope and nature, and at the end of the examination disclosure is made regarding matters of material monetary size in relation to the annual profit of the Bank, its assets or its equity. In addition, disclosure is made of matters with public aspects or of special sensitivity, such as matters connected with the structure of the Bank, its management, legislation affecting the bank and so on.

For purposes of complying with this policy, every material subject is brought for discussion to the Disclosure Committee, (see above chapter of the Procedure for Approval of the Financial Statements), which decides in every case of doubt if not make the necessary disclosure. Minutes of the Disclosure Committee are sent for perusal by the members of the Financial Statements Review Committee of the Board of Directors.

See also page 279 Controls and Procedures regarding Disclosure in the Financial Statements".

D. Description of the Group's Businesses According to Segments and Areas of Activity

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

2009 was characterized by recovery from the global financial crisis, beginning in the second quarter of the year. The recovery was accompanied by price rises on stock exchanges worldwide and in Israel, as opposed to 2008 which was characterized by the global financial crisis in the collapse of the Lehman Brothers investment bank and the American bank, Washington Mutual, as well as many banks in the U.S. and in Europe. This had a detrimental effect on the state of the economy in the world and in Israel, as well as on Leumi Group's businesses in Israel and abroad. The direct consequences of this recovery in 2009 was a reduction in provisions for doubtful debts, and profits from the revaluation and realization of part of the investments in securities in Israel and abroad, compared with losses in 2008. The decrease in the contribution of the companies included on the equity basis partially offset the above effects.

The net profit of the Leumi Group in 2009 totalled NIS 2,014 million, compared with a profit of NIS 92 million in 2008 – an increase of NIS 1,922 million. The operating profit in 2009 totalled NIS 1,986 million, compared with a loss of NIS 158 million in 2008.

The following table presents the principal changes in the Group's net profit in 2009:

	2009	2008	Change
	NIS millions		
Net profit	**2,014**	92	1,922
Net operating profit (loss)	**1,986**	(158)	2,144

The increase in the net profit in 2009 compared with 2008 is mainly explained by the following factors*:

1. an increase in operating and other income in the amount of NIS 1,763 million, an increase of 63.0% before the effect of taxes, mainly resulting from profits from investments in shares;

2. an increase in net interest income, before provision for doubtful debts, in the sum of NIS 643 million, a 10.1 % increase before the effect of taxes;

3. a reduction in provisions for doubtful debts in the amount of NIS 628 million, before the effect of taxes, a decrease of 29.3%;

4. a reduction in operating and other expenses (including salaries) in the amount of NIS 66 million, a decrease of 0.9% before the effect of taxes;

5. a decrease in the effective tax rate, as explained on page 71 in the chapter on Provision for Taxes.

* Before minority interests.

On the other hand, the following factors partially offset the above rise:

1. a reduction in the Group's share in the profits of companies included on equity basis, in the amount of NIS 168 million, net;

2. a decrease in profit from extraordinary activities in the amount of NIS 222 million, net.

[1] The Financial Statements are prepared in reported values. The known Consumer Price Index rose by 3.8% in 2009. The shekel appreciated in nominal terms by 0.7% against the U.S. dollar and depreciated by 2.7% against the euro. The representative rate of exchange of the U.S. dollar on 31 December 2009 was NIS 3.775.
For further details see Note 1(D) to the Financial Statements.

The Group concluded the fourth quarter of the year with a net profit of NIS 544 million, compared with a net loss of NIS 1,183 million in the fourth quarter of 2008.

Following are the main factors contributing to the profit in the fourth quarter compared with the loss in the corresponding quarter last year:

1. an increase in net interest income, before provision for doubtful debts, in the amount of NIS 836 million, before the effect of taxes, mainly due to the decline to net profits from investments in debentures in the amount of NIS 10 million, compared with a loss of NIS 682 million last year;

2. an increase in operating and other income in the amount of NIS 710 million, an increase of 130.3% before the effect of taxes, mainly resulting from profits from investments in shares and funds in the amount of NIS 236 million, compared with a loss of NIS 434 million last year, an increase of NIS 670 million;

3. a reduction in provisions for doubtful debts in the amount of NIS 709 million, before the effect of taxes;

4. an increase in the Group's share in the profits of companies included on equity basis in the amount of NIS 303 million, net .

On the other hand, the increase in the operating and other expenses in the amount of NIS 174 million, before the effect of taxes partly offset the increase in profit.

For further details, see pages 73-76 below and Exhibit H to the Management Review.

Net Interest Income Before Provision for Doubtful Debts of the Leumi Group amounted to NIS 7,023 million in 2009, compared with NIS 6,380 million in 2008 – an increase of 10.1%.

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

	2009	2008	Change	Change
	NIS millions		NIS millions	%
Current activities	**6,459**	6,677	(218)	(3.3)
Collection and reduction of interest in respect of problem loans	**380**	507	(127)	(25.0)
Exchange rate difference in respect of financing shares credited to operating income or to capital reserve	**(62)**	199	(261)	-
Provisions for decline in value of available-for-sale debentures	**(196)**	(1,328)	1,132	(85.3)
Profits (losses) from the sale of available-for-sale debentures, net	**490**	(9)	499	+
Realized and unrealized profits (losses) from adjustments to fair value of debentures held for trading	**232**	82	150	+
Financing costs in connection with the hedging of investments abroad (2)	**(15)**	(98)	83	-
Adjustments of derivatives to fair value	**(319)**	34	(353)	-
Effect of the known CPI	**54**	316	(262)	(82.9)
Total (1)	**7,023**	6,380	643	10.1

(1) of which: commissions from financing business in the amount of NIS 345 million and other finance income in the amount of NIS 1,167 million.

(2) Cost of hedging asymmetry in tax liabilities in respect of exchange rate differentials on investments abroad compared with exchange rate differentials on sources of funds; the compensation for this cost is shown under taxes. See the effect also under taxes.

As seen from the above table, the majority of the increase in net interest income derives from a drastic decrease in the provisions for decrease in value of debentures available-for-sale, realized profits from debentures available-for-sale, and from adjustments for fair value of debentures held for trading, which were partially offset by adjustments to fair value of derivative instruments, known CPI Index and exchange rate differences..

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

1. the total interest margin decreased by 0.53%, and contributed to a reduction of some NIS 1,692 million.
2. on the other hand, the increase in the volume of activities of 10.8% contributed to an increase of some NIS 206 million.
3. a decrease in collections and reduction in interest in respect of problematic debts in the amount of NIS 127 million.

For further details, see Exhibit C to the Management Review and Note 20 to the Financial Statements
For a breakdown by segment of the changes in net interest income before provision for doubtful debts, see 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 76 of the Report.
For details in connection with net interest income by quarters, see page 74

The following table shows the development of net interest income according to principal operating segments:

Segment	**2009**	2008	Change
	NIS millions		%
Households	**2,081**	2,637	(21.1)
Small businesses	**856**	906	(5.5)
Corporate banking	**1,892**	1,883	0.5
Commercial banking	**1,411**	1,523	(7.4)
Private banking	**435**	289	50.5
Financial management – capital markets	**346**	(844)	+
Other	**2**	(14)	+
Total	**7,023**	6,380	10.1

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

	2009			2008			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 Quantitative effect	NIS millions Price effect
Israeli Currency:								
Unlinked	**39**	**49**	**3,519**	40	61	3,863	337	(681)
CPI-linked	**13**	**1**	**49**	15	16	1,043	(361)	(633)
Foreign currency, including foreign-currency linked	**48**	**27**	**1,888**	45	32	2,036	230	(378)
	100		**5,456**	100		6,942	206	(1,692)
Options and other derivatives**		**1**	**55**		(5)	(298)		
Financing commissions		**5**	**345**		5	337		
Other financing income (expenses), net		**17**	**1,167**		(9)	(601)		
Total		**100**	**7,023**		100	6,380		

* Including financing income/expenses from activity in derivatives.

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

The ratio of net interest income before provision for doubtful debts, to the average balance of financial assets was 2.33% in 2009, compared with 2.29% in 2008.

Total Interest Margin (excluding transactions in derivatives) was 2.08% in 2009, compared with 2.49% in 2008 (at the Bank – 1.99% in 2009, compared with 2.57% in 2008). The interest margin, including transactions in derivatives, was 1.10% in 2009, compared with 1.63% in 2008 (at the Bank – 0.93% in 2009, compared with 1.49% in 2008).

The financial margin in 2009 was affected detrimentally *inter alia* by the following factors:

a. the low level of the Bank of Israel interest rate and low interest rates worldwide led to erosion in the interest margin as a result of current account balances not bearing interest and interest received for them went down significantly.

b. the low level of interest rates led to a reduction in the interest margin mainly in the unlinked shekel sector in respect of time deposits in small amounts, where the interest rate was not reduced at the same rate as the reduction in the Bank of Israel interest rate.

c. the reduction in the overall interest margin derives also from timing differences in measuring the profitability of activity in derivative financial instruments, exchange rate differentials in respect of hedging investments abroad and investments in shares, and differences in the known index between the two periods.

d. competitive factors in the system also contributed to the decrease in the interest margin.

e. on the other hand the raising of risk margins in lending partially offset these decreases.

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

Financing Commissions totalled NIS 345 million in 2009, compared with NIS 337 million in 2008, an increase of 2.4%. These commissions include mainly 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 held 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 repayment of credit; collection of interest in respect of doubtful debts from previous years and a reduction of provisions for interest. The net income in respect of these activities totaled NIS 1,167 million in 2009, compared with expenses totaling NIS 601 million in 2008.

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

	2009	2008	Change
	NIS millions		%
Profit/loss from the sale of available-for-sale debentures	**490**	(9)	+
Provision for decline in value of available-for-sale debentures*	**(196)**	(1,328)	+
Profit from the sale of and adjustments to market value of debentures held for trading	**232**	82	182.9
Collection/reduction of interest in respect of doubtful debts	**380**	507	(25.0)
Commissions from early repayment of credit	**119**	141	(15.4)
Other	**142**	6	+
Total	**1,167**	(601)	+

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

* Of which, NIS 59 million in 2009 in respect of SCDO compared with NIS 341 million in 2008, NIS 17 million in respect of CLO compared with NIS 435 million in 2008, NIS 19 million in respect of corporate debentures compared with NIS 298 million in 2008, and NIS 101 million in respect of bank debentures compared with NIS 254 million in 2008.

The provision for doubtful debts in the Leumi Group in 2009 totalled NIS 1,517 million, compared with NIS 2,145 million in 2008 – a reduction of NIS 628 million. The provision for doubtful debts at the Bank in 2009 totalled NIS 1,269 million, compared with NIS 1,751 million in 2008 – a reduction of NIS 482 million.

Specific provisions for doubtful debts in the Leumi Group decreased in 2009 by NIS 507 million, of which, a reduction of NIS 410 million at the Bank.

The reduction in specific provisions for doubtful debts in 2009 was mainly influenced by the improvement in the state of the Israeli economy, compared with 2008 when the global crisis was at the height of its intensity which in 2008 caused deterioration in the repayment ability of some borrowers and the erosion of the value of some borrowers' collateral. There was however an increase in provisions for private individuals (excluding housing loans) of some 27% and their share of total provisions rose from 13.4% to 22.7%.

The main provisions for doubtful debts in 2009 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 shows specific provisions for doubtful debts by principal sectors of the economy:

	2009		2008	
	NIS millions	**% of total**	NIS millions	% of total
Industry	**254**	16.3	**631**	30.5
Construction and real-estate	**305**	19.6	**423**	20.4
Trade	**222**	14.3	**206**	9.9
Transport and storage	**104**	6.7	**21**	1.0
Communications and computer services	**45**	2.9	**12**	0.6
Financial services	**148**	9.5	**393**	19.0
Other business services	**58**	3.7	**29**	1.4
Private individuals – housing loans	**(12)**	(0.8)	**97**	4.7
Private individuals – other	**353**	22.7	**277**	13.4
Other	**79**	5.1	**(17)**	(0.9)
Total	***1,556**	100%	**2,072**	100%

* Furthermore a provision exists for banks in the amount of NIS 9 million.

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 sectorial excess of credit (at the Bank, there is an actual sectorial excess only in credit to the construction and real estate sector at the rate of 5.7%). 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 sectorial excess, in accordance with a formula established in the said directive. Since the Bank's minimum capital ratio complies with the aforesaid directive under Basel I and under Basel II, the Bank did not make an additional provision in the amount of NIS 308 million in respect of sectorial excess.

The general and supplementary provision decreased in 2009 by NIS 48 million, compared with an increase of NIS 73 million in the provision in 2008. The decrease in 2009 derives from a reduction in volume of problem loans. On the other hand, the majority of the increase in 2008 derived from an increase in volume of problem loans under special supervision.

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

	For the year ended 31 December	
	2009	2008
	NIS millions	
Specific provision during the period	**2,571**	2,780
Reduction of a specific provision	**(989)**	(679)
Collection of debts previously written off	**(17)**	(29)
Net addition recorded in the profit and loss statement	**1,565**	2,072
Net addition recorded in the profit and loss statement re supplementary and general provision	**(48)**	73
Total provision for doubtful debts	**1,517**	2,145

The rate of provision for doubtful debts in 2009 was 0.74% of total credit to the public at the end of the year, compared with 1.01% in 2008. The rate of the specific provision in 2009 was 0.76%, compared with 0.97% in 2008. For quarterly developments in the rate of provisions see below in this chapter on page 75.

The aggregate balance of the general provision, the supplementary 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 companies totalled NIS 900 million at the end of 2009 (constituting some 0.29% of total credit risk), compared with NIS 948 million at the end of 2008, (at the Bank, NIS 657 million, compared with NIS 661 million in 2008). Since the general provision and the supplementary 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 1,411 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 97 of the Report.

The Supervisor of Banks announced on 18 February 2010 that application of the adoption of financial accounting standards FAS 114 and 118 regarding the measurement and disclosure of impaired debts, credit risk and provisions for loan losses will be as of 1 January 2011.

For further details, see Note 1(Y)(3)

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

Segment	**2009**	2008	**2009**	2008
	NIS millions		(percentages)*	
Households	**281**	340	**0.42**	0.5
Small businesses	**228**	182	**1.29**	1.0
Corporate banking	**579**	1,070	**0.84**	1.4
Commercial banking	**383**	487	**0.88**	1.0

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

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

	2009	2008
	NIS millions	
The Bank	**1,269**	1,751
The Arab Israel Bank	**26**	26
Leumi Mortgage Bank	**(20)**	103
Leumi Card	**29**	26
Bank Leumi USA	**90**	53
Bank Leumi (UK)	**111**	155
Leumi Romania	**11**	24
Others	**1**	7
Total	**1,517**	2,145

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

	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000
	%									
The banking system in Israel	**(*)**	0.71	0.21	0.52	0.69	0.88	1.13	1.36	0.85	0.51
Leumi Group	**0.74**	1.01	0.20	0.51	0.79	0.87	1.09	1.09	0.93	0.44

(*) Data for the banking system is not known on the date of publication of this Report.

For details regarding problem loans, see page 94 below.
For details of the provision for doubtful debts by sector of the economy see page 66 above.

Net Interest Income of Leumi Group in 2009, after provision for doubtful debts, totalled NIS 5,506 million, compared with NIS 4,235 million in 2008 – an increase of 30.0%. The increase derived from a rise in net interest income and from a reduction in provisions for doubtful debts. At the Bank, net interest income after provision for doubtful debts totalled NIS 3,985 million in 2009, compared with NIS 3,221 million in 2008 – an increase of 23.7%.

Total Operating and Other Income of the Leumi Group in 2009 totalled NIS 4,563 million, compared with NIS 2,800 million in 2008 – an increase of 63.0% (at the Bank – NIS 3,211 million in 2009, compared with NIS 1,628 million in 2008 – an increase of 97.2%). After neutralizing the effect of profits (losses) from investments in shares, total operating income in the Group increased by 3.9%.

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

	2009	2008	Change	Change
	NIS millions		NIS millions	%
Operating commissions(1)	**3,511**	3,538	**(27)**	(0.8)
Profits (losses) from investments in shares (2)	**707**	(912)	**1,619**	+
Other income (3)	**345**	174	**171**	98.3
Total operating and other income	**4,563**	2,800	**1,763**	63.0

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

1. Operating commissions (reduction of NIS 27 million)
   a. A decrease in income from the handling of credit and the drawing up of contracts, in the amount of NIS 90 million (26.5%);
   b. A decrease in income from commissions from conversion differences, in the amount of NIS 20 million (6.5%);
   c. An increase in income from activity in securities, in the amount of NIS 71 million (9.0%) partially offset these decreases.

2. Profits from investments in shares and funds (increase of NIS 1,619 million).
   a. Net profits totalling NIS 582 million from the sale of available-for-sale shares, compared with losses and reductions in value in the same period last year in the amount of NIS 515 million;
   b. Profits from realization and adjustment to fair value of securities held for trading in the amount of NIS 8 million, compared with a loss of NIS 528 million during the corresponding period in 2008, including the recording of negative exchange rate differentials in the portfolio of foreign securities held for trading;
   c. The income from dividends totaled NIS 117 million in 2009, compared with NIS 131 million in 2008. The decline in income from dividends in 2009 is mainly explained by the fact that in 2008

income from dividend was recorded from the Cellcom company, the shares in which were sold during 2008.

3. Other income

The increase in other income derives mainly from profits in 2009 of the severance pay provident fund in the sum of NIS 237 million. As of September 2008, the Bank has been providing pension counselling 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 counselling.

The following table shows details of other income:

	2009	2008	Change	Change
	NIS millions		NIS millions	%
Profits from the severance pay fund	**237**	-	237	+
Other income	**108**	174	(66)	(37.9)
Total	**345**	174	171	98.3

With regard to the commissions reform and the Bank of Israel's directives in this regard, see page 44 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 Note 18 (N).

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 39.4% in 2009, compared with 30.5% in 2008.

Operating and other income covered 65.8% of operating and other expenses, and, after neutralizing special expenses as detailed below, 66.1%, compared with cover of 40.0% and 42.3%, respectively, in 2008.

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

Total Operating and Other Expenses of the Leumi Group in 2009 amounted to NIS 6,937 million, compared with NIS 7,003 million in 2008 – a decrease of 0.9%. After neutralizing special salary expenses as specified below, there was an increase of 4.0% (at the Bank – NIS 4,992 million in 2009, compared with NIS 5,085 million in 2008 – a decrease of 1.8% and a rise of 5.1% after neutralizing special salary expenses).

a. Salary expenses totalled NIS 4,052 million in 2009, a decline of NIS 66 million or 1.6% compared with the same period last year. The decline in salary expenses derives mainly from the positive yield of the severance pay fund and the provident fund, which are also used as a reserve for covering pension obligations to employees, in comparison with a negative yield in the same period last year. In 2009, salary costs were reduced in respect of profits from the funds by some NIS 280 million and in addition income was recorded of NIS 237 million in operating and other income (of which NIS 50 million in the fourth quarter), compared with 2008 when salary costs were increased because of the negative yields of the funds by some NIS 237 million. After neutralizing special salary expenses as specified below, salary expenses in 2009 increased by 7.1%.

The following table shows details relating to special salary expenses:

	2009	2008
	NIS millions	
Supplementing provisions for severance pay and pension	**(9)**	* 535
Income in respect of issue of options to employees	**-**	(16)
Recording (cancellation) of benefit in respect of sale of shares to employees	**41**	(50)
Actuarial adjustments in respect of jubilee grant	**4**	47
Salary tax refunds	**-**	(154)
Other	**2**	9
Total	**38**	371

* Of which, the sum of NIS 237 million was caused due of the funds' losses in 2008, with the balance in respect of the updating of provisions in respect of current salary expenses.
For further details, see Note 15 to the Financial Statements.

Below are additional details of 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 2009, actuarial parameters relating to the rate of utilization of pension rights and the rate of withdrawals of severance pay and provident fund monies were reexamined. The new distribution is about 76% choosing a pension compared with 64% up to 2008 and the rest choosing severance pay. In addition the rate of retirement by women from age 62 was examined. The net impact of the above items amounted to NIS 55 million.
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 58.2% of total operating expenses in 2009, compared with 56.4% in 2008.

b. Operating and other expenses, excluding salary expenses, totalled NIS 2,885 million in 2009, similar to 2008. Detailed below are the principal changes in operating expenses:

1. An increase in the expenses of maintenance of buildings and equipment in the amount of NIS 24 million (2.7%);

2. An increase in depreciation expenses in the amount of NIS 93 million (17.9%), mainly as a result of operating new systems.

3. A decrease in expenses in respect of professional services in the amount of NIS 11 million (3.8%);

4. A decrease in computer expenses in the amount of NIS 36 million (15.5%).

5. A decrease in marketing and publicity expenses in the amount of NIS 56 million (20.7%).

The Group's computer expenses, which are shown 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 2009 constitute 59.9% of total income, compared with 76.3% in 2008 and 58.4% in 2007. After neutralizing the special salary expenses detailed in the Report, operating expenses constitute 59.6% of total income, compared with 72.1% in 2008.

Total operating and other expenses constitute 2.16% of total assets, compared with 2.25% in 2008, and, after neutralizing special salary expenses, 2.15% and 2.13%, respectively.

Operating Profit before Taxes of the Leumi Group in 2009 totalled NIS 3,132 million, compared with NIS 32 million in 2008 – an increase of NIS 3,100 million (at the Bank – a profit of NIS 2,204 million in 2009, compared with a loss of NIS 236 million in 2008). After neutralizing special salary expenses, the increase was NIS 2,767 million, while at the Bank it was NIS 2,151 million.

Provision for Taxes on Operating Profit of the Leumi Group in 2009 totalled NIS 1,191 million, compared with NIS 421 million in 2008. The statutory tax rate for financial institutions in Israel in 2009 was 36.2%, compared with 36.8% in 2008.

The actual tax provision for 2009 is about 38.0%, similar to the statutory tax rate. However in 2008 the tax rate was higher because of the very small consolidated profit before tax, as well as provisions for tax in respect of profits in profitable subsidiaries compared with the loss by the Bank which was not offset for tax purposes.

The provision for taxes in 2009 was affected principally by the following matters:

1. Exchange rate differentials in respect of investments abroad which are not included in the basis of the tax calculation which were positive in 2009, compared with negative exchange rate differentials in the same period last year, as explained on page 177 of the Report, decreased the rate of the provision by NIS 10 million, compared with an increase in the provision of NIS 88 million in the same period last year;
2. The companies tax rate reduction program as explained below which came into effect in July 2009 influenced the increase of tax expenses by the amount of NIS 146 million due to the updating of deferred taxes in accordance with the reduction in future companies tax rates to 25% in 2010 and down to 18% in 2016;
3. In 2009 provisions for tax for previous years were reduced by a net amount of NIS 65 million, following the signing of an agreement between the Bank and several subsidiaries and the tax authorities, as well as the updating of the tax shelter in respect of the value of the benefit to employees arising from the issue of shares in 2006 and other adjustments, including the closing of tax assessments;
4. On 1 July 2009 the Value Added Tax Order (Tax Rate for Non-profit Organizations and Financial Institutions) 2009 was published in the Official Gazette, which raised the rates for salary tax and profit tax that are applicable to financial institutions, as from 1 July 2009 and continuing through 31 December 2010, from 15.5% to 16.5%. At the end of December 2009, it was published in the Israel Government Gazette, that the rate for salary tax and profit tax for 2010 will be 16.0%.

Due to the fact that the Bank is a "financial institution" for the purposes of the Value Added Tax Law, the increase in profits tax will result in an increase of the overall tax rate that is applicable to the Bank, so that for 2009 the overall tax rate will be 36.21% instead of 35.93%, (an increase of 0.28 percentage points), and in 2010 the overall tax rate will be 35.34% instead of 35.06% (an increase of 0.28 percentage points).

The total effect of the change in the rate of Value Added Tax on the provision for taxes in 2009 is not material.

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 page 263 of the Report.

Operating Profit (Loss) after Taxes of the Leumi Group in 2009 amounted to NIS 1,941 million, compared with a loss of NIS 389 million in 2008.

The Group's share in Operating Profit after Taxes of Companies Included on Equity Basis in 2009 amounted to a profit of NIS 81 million, compared with a profit of NIS 249 million in 2008, a decrease of NIS 168 million.

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

1. The Israel Corporation Ltd.: profit of NIS 1 million in 2009, compared with a profit of NIS 157 million in 2008.
2. Paz Oil Company Ltd.: profit of NIS 72 million in 2009, compared with a profit of NIS 82 million in 2008.

For further details, see page 158 of the Report.

Minority Interests in the Profits (Losses) of the Group amounted to a profit of NIS 36 million in 2009, compared with NIS 18 million in 2008. The increase in profit derives from the minority interest in Leumi Card.

Net Operating Profit (Loss) of the Leumi Group amounted to NIS 1,986 million in 2009, compared with a loss of NIS (158) million in 2008. After neutralizing special salary expenses as specified above, there was an increase of NIS 1,698 million.

After-Tax Profit from Extraordinary Items in 2009 amounted to a profit of NIS 28 million, compared with NIS 250 million in 2008. The profit in 2008 derived from the allotment of 20% of the issued and paid-up share capital of Leumi Card to Kanit-Investment Management and Financing Ltd.

For further details, see Note 27 to the Financial Statements.

Net Operating Profit (Loss) per share reached NIS 1.35 in 2009, compared with NIS (0.11) in 2008.

Net Earnings per share reached NIS 1.37 in 2009, compared with NIS 0.06 in 2008.

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

	2009	2008
	%	
Net profit	**10.2**	0.5
Net operating profit (loss)	**10.1**	(0.8)

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

	2009				2008			
	4th Qtr.	**3rd Qtr.**	**2nd Qtr.**	**1st Qtr.**	4th Qtr.	3rd Qtr.	2nd Qtr.	1st Qtr.
	%							
Net profit (loss)	**10.6**	11.0	11.1	9.7	(22.2)	(1.6)	19.1	9.8
Net operating profit (loss)	**10.6**	11.0	10.4	9.6	(22.2)	(1.6)	13.4	9.8

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 (excluding companies included on equity basis and minority interests):

	2009				
	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	**Annual Total**
	NIS millions				
Net interest income	**1,812**	**1,923**	**1,926**	**1,362**	**7,023**
Provision for doubtful debts	**(381)**	**(443)**	**(339)**	**(354)**	**(1,517)**
Operating and other income	**1,255**	**1,292**	**1,013**	**1,003**	**4,563**
Operating and other expenses	**(1,975)**	**(1,758)**	**(1,640)**	**(1,564)**	**(6,937)**
Operating profit (loss) before taxes	**711**	**1,014**	**960**	**447**	**3,132**
Provision for taxes (tax benefit)	**(241)**	**(499)**	**(409)**	**(42)**	**(1,191)**
Operating profit (loss) after taxes	**470**	**515**	**551**	**405**	**1,941**

	2008				
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Annual Total
	NIS millions				
Net interest income	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	(1,801)	(1,746)	(1,662)	(1,794)	(7,003)
Operating profit (loss) before taxes	(1,370)	(210)	839	773	32
Provision for taxes	423	(61)	(400)	(383)	(421)
Operating profit (loss) after taxes	(947)	(271)	439	390	(389)

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

	2009				
	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	**Annual Total**
	NIS millions				
Current activities	**1,653**	1,492	1,683	1,631	**6,459**
Collection and reduction of interest in respect of problem loans	**106**	97	88	89	**380**
Exchange rate differentials for shares credited to income or to capital reserve	**(1)**	17	31	(109)	**(62)**
Profits (losses) from the sale of available-for-sale debentures, net	**(1)**	120	32	143	**294**
Realized and unrealized profits (losses) from adjustments to market value of debentures held for trading	**11**	60	48	113	**232**
Financing cost of hedging investments abroad	**(8)**	87	50	(144)	**(15)**
Adjustments of derivatives to fair value	**49**	19	(59)	(328)	**(319)**
Effect of the known CPI	**3**	31	53	(33)	**54**
Total net interest income	**1,812**	1,923	1,926	1,362	**7,023**

	2008				
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Annual Total
	NIS millions				
Current activities	1,794	1,584	1,671	1,629	6,678
Collection and reduction of interest in respect of problem loans	91	80	87	249	507
Exchange rate differentials for shares credited to income or to capital reserve	(30)	2	129	97	198
Profits (losses) from the sale of available-for-sale debentures, net	(829)	(456)	(80)	28	(1,337)
Realized and unrealized profits (losses) from adjustments to market value of debentures held for trading	147	(135)	(4)	74	82
Financing cost of hedging investments abroad	(134)	9	-	27	(98)
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

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

	2009				
	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	**Annual Total**
	NIS millions				
Specific provision	**385**	461	396	323	1,565
Additional provision	**(4)**	(18)	(57)	31	(48)
Total	**381**	443	339	354	1,517
Ratio of the provision to total credit to the public (annual basis)	**0.74%**	0.87%	0.66%	0.67%	0.74%

	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%

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

	2009				
	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	**Annual Total**
	NIS millions				
Operating commissions	**925**	915	840	831	3,511
Profits (losses) from investments in shares	**236**	286	90	95	707
Other income	**94**	91	83	77	345
Total operating and other income	**1,255**	1,292	1,013	1,003	4,563

	2008				
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Annual Total
	NIS millions				
Operating commissions	867	887	882	902	3,538
Profits (losses) from investments in shares	(434)	(363)	(44)	(71)	(912)
Other income	112	16	26	20	174
Total operating and other income	545	540	864	851	2,800

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

	2009				
	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	**Annual Total**
	NIS millions				
Salary expenses, excluding special salary expenses	**1,102**	961	948	1,003	4,014
Special salary expenses	**86**	91	(19)	(120)	38
Of which: expenses in respect of the issue of options to employees	**-**	-	-	-	-
Recording of benefit in respect of the sale of shares to employees	**26**	15	-	-	41
Provision for severance pay and pension	**55**	76	(20)	(120)	(9)
Salary tax refunds	**-**	-	-	-	-
Actuarial changes in respect of jubilee bonus	**4**	-	-	-	4
Miscellaneous	**1**	-	1	-	2
Total salary expenses	**1,188**	1,052	929	883	4,052

	2008				
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Annual Total
	NIS millions				
Salary expenses, excluding special salary expenses	982	857	956	952	3,747
Special salary expenses	(13)	186	19	179	371
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)	–	8	9
Total salary expenses	969	1,043	975	1,131	4,118

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

1. **Net interest income before provision for doubtful debts:** (for quarterly details, see Table B above.

   In the first quarter of the year:

   - 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 held for trading compared with the corresponding period in 2008;
   - the negative effect of adjustments to fair value of derivative instruments (timing differentials);
   - a decrease in collections and reduction of interest in respect of problem loans regarding which provisions had been made in the past;

- the negative effect of exchange rate differentials in respect of shares credited to operating income or to capital reserve;
- the negative effect of financing costing connection with hedging investments abroad;
- the negative effect of the known CPI.

In the second quarter of the year:

- an increase in the volume of financial activity, mostly in the unlinked shekel sector;
- a decrease in profits the sale of available-for-sale debentures and in realized and unrealized profits from adjustments to market value of debentures held for trading;
- a reduction of the decrease in adjustments to fair value of derivatives;
- the positive effect of financing costing connection with hedging investments abroad;
- the positive effect of exchange rate differentials in respect of shares credited to operating income or to capital reserve;
- the positive effect of the known CPI.

In the third quarter of the year:

- an increase in profits the sale of available-for-sale debentures and in realized and unrealized profits from adjustments to market value of debentures held for trading;
- the positive effect of financing cost in connection with hedging investments abroad;
- the negative effect of a decline in the margin.

In the fourth quarter of the year:

- a decrease in profits the sale of available-for-sale debentures and in realized and unrealized profits from adjustments to market value of debentures held for trading.

2. **Provisions for doubtful debts:** (for quarterly details see Table C above)
   - During the first three quarters of the year, there was a rise in provisions for doubtful debts compared with average quarterly provisions in the first three quarters of 2008.
   - In the fourth quarter of the year, there was a decrease in provisions for doubtful debts relative to average quarterly provisions during the same period last year.

3. **Operating and other income:** (for quarterly details see Table D above)
   - In 2009, operating and other income increased relative to quarterly income in 2008, mainly as a result of profits and/or increases in the value of investments in shares and funds.
   - In other income the increase derives from profits from the provident fund for severance pay above the updating of costs in respect of current salary increases recorded in operating income (Q1 - NIS 57 million, Q2 - NIS 58 million, Q3 - NIS 72 million, Q4 - NIS 50 million) .
   - In the fourth quarter there was a reduction in other income compared with the fourth quarter of 2008 as a result of the recording of income of NIS 91 million from Visa International in the fourth quarter of 2008.

4. Salary expenses and related expenses (for quarterly detail see Table E above):

- Due to losses of the provident funds in 2008, salary expenses were recorded in supplementing insufficient reserves in the sum of NIS 237 million. However in the first quarter of the year profits were recorded in respect of the provident funds which partially offset salary costs by NIS 223 million.
- The quarterly average of annual salary expenses totalled some NIS 1,013 million, compared with an average of NIS 1,030 million in 2008, and after deducting special salary expenses, some NIS 1,004 million, compared with an average of NIS 937 million in 2008.
- Salary expenses, after neutralizing special expenses, increased in the fourth quarter.

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 some NIS 54 million, some 16.3%. On the other hand, relative to the fourth quarter of 2008, there was a decrease of NIS 72 million, some 15.8%.
- 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 lower as a result of positive exchange rate differentials in respect of investments in subsidiaries abroad that are not included in the tax basis.
- In the third quarter of the year, the tax rate was high, mainly as a result of the reduction in companies tax which necessitated an according updating of deferred taxes, the increase in the tax rate was partially offset following an agreement signed in this quarter between the Bank and several subsidiaries, and the tax authorities.
- The rate of tax in the fourth quarter was 33.9%.

For additional multi-quarter information, see Exhibit H in the Management Review.

Structure and Development of Assets and Liabilities

Total Assets of the Leumi Group on 31 December 2009 amounted to NIS 321.8 billion, compared with NIS 310.8 billion at the end of 2008, an increase of 3.5%. The Bank's total assets on 31 December 2009 amounted to NIS 280.0 billion, compared with NIS 267.7 billion at the end of 2008, an increase of 4.6%.

Out of the Group's total assets, the value of assets denominated in or linked to foreign currency was some NIS 97.8 billion, some 30.4% of total assets. In 2009, the shekel appreciated against the US dollar by 0.7% and depreciated against the euro by 2.7%.

The change in the exchange rate of the shekel in relation to foreign currencies in general contributed to a increase of some 0.2% in the total assets of the Group.

The total assets under the Group's management – the total balance sheet as well as customers' securities portfolios, and provident funds and supplementary training funds in relation to which operational management and custody services are provided - amounted to some NIS 782 billion, compared with NIS 651 billion at the end of 2008 (about US$ 207 billion and US$ 172 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		
	2009	2008	Change	**2009**	2008	Change
	NIS millions		%	NIS millions		%
Total assets	**321,775**	310,792	3.5	**280,001**	267,706	4.6
Deposits of the public	**250,418**	244,783	2.3	**230,223**	221,409	4.0
Debentures, capital notes and subordinated capital notes	**25,261**	20,636	22.4	**5,526**	4,637	19.2
Deposits from banks	**3,785**	3,742	1.1	**4,838**	3,481	39.0
Cash and deposits with banks	**42,933**	33,130	29.6	**71,953**	58,355	23.3
Securities	**57,505**	44,910	28.0	**48,627**	37,056	31.2
Credit to the public	**204,669**	213,215	(4.0)	**132,620**	144,574	(8.3)
Buildings and equipment	**3,553**	3,445	3.1	**3,134**	3,011	4.1

The increase in investments in securities and in deposits with banks in the amount of some NIS 22 billion was funded by an increase in deposits from the public and the issue of capital notes totaling NIS 10 billion, and from a reduction in credit to the public of some NIS 9 billion.

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

	Consolidated			The Bank		
	31 December			31 December		
	2009	2008	Change	**2009**	2008	Change
	NIS millions		%	NIS millions		%
Documentary credits	**1,773**	1,631	8.7	**1,191**	923	29.0
Credit guarantees	**6,199**	6,821	(9.1)	**7,193**	6,934	3.7
Guarantees to purchasers of apartments	**9,250**	8,117	14.0	**9,064**	7,857	15.4
Other guarantees and liabilities	**14,509**	14,454	0.4	**15,298**	15,453	(1.0)
Derivatives*	**270,884**	234,883	15.3	**258,987**	222,182	16.6
Options of all kinds	**106,629**	125,631	(15.1)	**104,915**	120,030	(12.6)

* Including forwards, financial swap contracts, swaps, futures and credit derivative transactions.
See Note 18A and 18F to the Financial Statements for further details.

C. The following table sets out the development of balances of customers' off-balance sheet financial assets with the Leumi Group(1):

	Consolidated		
	2009	2008	Change
	NIS millions		%(1)
Securities portfolios of customers	**401,676**	295,853	28.9
Of which: in mutual funds(2) (3)	**47,666**	36,572	24.1
provident funds(2) (3)	**40,785**	31,794	53.6
supplementary training funds(2) (3)	**17,771**	12,769	30.1
Total	**460,232**	340,416	31.2

(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 operational management and custody services are provided.
(2) The Group in Israel does 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 increase in value of assets results primarily from the rise in markets in Israel and abroad, and from an increase in activity.

Deposits of the Public

Deposits of the public with the Group amounted to NIS 250.4 billion at the end of 2009, compared with NIS 244.8 billion at the end of 2008, an increase of 2.3%.

The shekel's depreciation against most foreign currencies (it appreciated against the U.S. dollar) contributed to a 0.6% decrease in total 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 25.3 billion as at the end of 2009, compared with NIS 20.6 billion at the end of 2008. Deposits of the public, debentures and subordinated capital notes increased in 2009 by 3.9%, and together constitute 85.7% of total assets.

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

31 December 2009					
	Demand	**Term**	**Savings schemes**	**Ear-marked deposits**	**Total**
	%	%	%	%	**NIS millions**
Israeli currency:					
Unlinked	**46**	**49**	**-**	**50**	**119,050**
CPI-linked	**-**	**13**	**92**	**50**	**26,976**
Foreign currency:					
Including foreign currency linked	**54**	**38**	**8**	**-**	**104,330**
Non-monetary	**-**	**-**	**-**	**-**	**62**
Total, as a percentage	**100**	**100**	**100**	**100**	
Total in NIS millions	**65,979**	**179,927**	**4,498**	**14**	**250,418**

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	27,522
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

The increase in volume of deposits of the public in 2009 was mainly in unlinked shekel deposits, which increased by NIS 7.1 billion, and in CPI-linked shekel deposits which decreased by NIS 0.5 billion. On the other hand, foreign currency deposits declined by NIS 0.9 billion, despite an increase of NIS 0.6 billion resulting from changes in the shekel's exchange rate. After neutralizing the effect of changes in the exchange rate of the shekel, deposits of the public decreased by 1.5%.

Developments in the various types of deposits were as follows:

- Unlinked shekel deposits of the public increased by 6.3% compared with 31 December 2008, primarily as a result of the public's preference for minimizing exposure and risks.

- Deposits of the public denominated in or linked to foreign currency decreased by 0.9% as compared with 31 December 2008, and after the effect of changes in the exchange rate of the shekel are neutralized, such deposits decreased by 1.5%.

- CPI-linked shekel deposits were decreased by 2.0% compared with 31 December 2008, primarily due to demand 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 the possibility 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 2009, investments in these products declined because of the global financial crisis.

The balance of structured deposits totaled US$ 224 million on 31 December 2009, compared with US$ 452 million at the end of 2008.

The following table sets out the development of deposits of the public by principal operating segments:

Segment	31 December **2009**	31 December 2008	Accumulated Change
	NIS millions		%
Households	**118,930**	120,846	(1.6)
Small businesses	**15,057**	14,475	4.0
Corporate banking	**25,324**	23,111	9.6
Commercial banking	**33,533**	29,723	12.8
Private banking	**41,158**	38,085	8.1
Financial management, capital markets and other*	**16,416**	18,543	(11.5)
Total, net	**250,418**	244,783	2.3

* Includes mainly deposits of institutional bodies.

Deposits from Governments amounted to some NIS 0.7 billion at the end of 2009 - 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 2009 there was a decline of some NIS 0.1 billion in deposits from governments.

Deposits of the government for the granting of credit at its responsibility were offset against the credit, and amount to NIS 0.6 billion.

This item also includes deposits of foreign governments in overseas subsidiaries, which amounted to some NIS 76 million at the end of 2009, compared with NIS 64 million at the end of 2008.

Deposits with Banks and from Banks

A. Deposits with Banks (Central and Commercial):

	31 December 2009		31 December 2008	
	With central banks	**With banks**	With central banks	With banks
	NIS millions			
Israeli Currency:				
Unlinked	**23,566**	**1,218**	12,959	1,119
CPI-linked	**-**	**446**	-	529
Foreign currency including foreign currency-linked	**3,336**	**12,433**	4,838	12,229
Total deposits with banks	**26,902**	**14,097**	17,797	13,877

Total deposits with banks increased by 29.4%, mainly from an increase of deposits with the Bank of Israel. There was a increase in deposits with commercial banks of 1.6%. Some of the deposits that were in commercial banks abroad were diverted to investments in US and French government bonds. This activity is a result of adjusting the level of risk to the financial crisis by reducing exposures to commercial banks abroad.

B. Deposits from Banks:

	31 December 2009		31 December 2008	
	From central banks	**From banks**	From central banks	From banks
	NIS millions			
Israeli Currency:				
Unlinked	**-**	**2,115**	-	1,581
CPI-linked	**-**	**439**	-	800
Foreign currency including foreign currency-linked	**-**	**1,231**	-	1,361
Total deposits from banks	**-**	**3,785**	-	3,742

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 2009, deposits of the Group with the Bank of Israel totaled NIS 24.2 billion, against which there were no loans from the Bank of Israel.

For further details, see page 111.

As may be seen from these tables, the liquidity position of the Group is extremely positive, and the Group has net deposits with banks amounting to NIS 37.2 billion.

Credit to the public

Credit to the public in the Leumi Group at the end of 2009 totaled NIS 204.7 billion, compared with NIS 213.2 billion at the end of 2008, a decrease of 4.0% (at the Bank, a decrease of 8.3%). Credit to the public comprises 63.6% of total assets (compared with 68.6% at the end of 2008).

The decline in total credit derives primarily from the reduction in demand due to the recession prevailing at the beginning of the year, repayment of short-term loans granted at the end of 2008, a reduction in loans by capital market customers, and a reduction of specific loans in accordance with the Group's risk appetite definition.

The shekel's depreciation against most foreign currencies (there was an appreciation against the U.S. dollar) contributed to an increase of 0.2% in total credit to the public.

As well as granting credit to the public, the Group invests in the securities of companies, in a total amount of NIS 8,206 million at the end of 2009, as compared with NIS 8,204 million at the end of 2008. These investments also involve 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	(184)	827	2,295	**1,423**	**4,361**
% increase	(0.2)	0.8	2.2	**1.4**	**4.3**
CPI-linked in NIS millions	(2,397)	(605)	(606)	**(531)**	**(4,139)**
% increase (decrease)	(4.5)	(1.2)	(1.2)	**(1.1)**	**(7.7)**
Foreign currency including foreign currency-linked in NIS millions	2,244	(5,886)	(4,932)	**(194)**	**(8,786)**
% increase (decrease)	3.9	(9.7)	(9.0)	**(0.4)**	**(15.1)**
Total in NIS millions	(337)	(5,664)	(3,243)	**698**	**(8,546)**
% increase (decrease)	(0.2)	(2.7)	(1.6)	**0.3**	**(4.0)**

Total credit to the public by the Group in Israel amounted to some NIS 182 billion at the end of 2009, compared with NIS 189 billion at the end of 2008, an increase of 3.8%.

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

	31 December 2009		31 December 2008		Change
	NIS millions	**% of mix**	NIS millions	% of mix	%
Unlinked*	**105,930**	**52**	101,569	48	4.3
CPI-linked	**49,318**	**24**	53,457	25	(7.7)
Foreign currency including foreign currency-linked	**49,421**	**24**	58,189	27	(15.1)
Total	**204,669**	**100**	213,215	100	(4.0)

* Including non-monetary items.

Most of the decrease in credit to the public was in foreign currency and foreign currency-linked credit amounting to NIS 8,768 million, and after neutralizing the effect of the changes in the exchange rate of the shekel, decreased by 15.8%. Unlinked shekel credit to the public increased by NIS 4,361 million, and CPI-linked shekel credit decreased by NIS 4,139 million, 7.7%.

Total credit to the public that was offset from deposits according to the extent of collection amounted to NIS 8.4 billion in the Group. Some 82.2% of such credit is granted from government deposits according to the extent of collection for mortgage financing.

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

	31 December 2009	31 December 2008
	NIS millions	
US dollar	**32,494**	39,959
Euro	**6,578**	7,498
Other currencies	**10,349**	10,732
Total	**49,421**	58,189

The shekel's depreciation against most foreign currencies contributed to a rise of some 0.7% 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		
	2009	2008	Change
	NIS millions		%
Balance sheet credit risk	**41,541**	40,374	2.9
Guarantees to apartment purchasers*	**4,547**	3,621	25.6
Other off-balance sheet risk	**19,213**	16,686	15.1
Total	**65,301**	60,681	7.6

* Weighted according to balance sheet value.

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 2009 by 7.6%. Credit risk of the construction and real estate sector in Israel constitutes some 22.1% 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 amounts to some 25.7% of total indebtedness in Israel, and therefore there is a sectorial excess of credit of some 5.7%, compared with an excess of 2.27% at the end of 2008.

For details regarding the additional provision, see also page 66 of the Report.

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

Segment	**31 December 2009**	31 December 2008	Change since December
	NIS millions		%
Households [(1)]	**66,889**	62,145	7.6
Small businesses [(2)]	**17,653**	18,161	(2.8)
Commercial banking [(3)]	**43,516**	48,488	(10.3)
Corporate banking [(4)]	**69,089**	76,563	(9.8)
Private banking	**6,439**	6,455	(0.2)

Total business credit (commercial and corporate) amounted to NIS 112.6 billion and in 2009 decreased by a rate of 10.0%. Total private credit (households, small businesses and private banking) amounted to NIS 91 billion and in 2009 increased by a rate of 4.9%.

* Reclassified.

(1) Credit to households also includes housing loans (mortgages). After neutralizing this credit, credit to households (banking and finance) decreased by 3.2%. Housing loans totaled NIS 44.4 billion at the end of 2009, an increase of 9.4%. (The increase in credit in 2008 was 6.5%.)

(2) After neutralizing the effects of segmentation between the segments, there was an increase was 2.0%.

(3) After neutralizing the effects of segmentation between the segments, there was a decrease was only 9.1%.

(4) There was an decrease of some NIS 7.6 billion in credit activities in Israel of the corporate banking segment, and an overall decrease of 9.8%, or 11.0% 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
	NIS millions			
Households	**62,242**	**63,252**	**65,401**	**66,889**
Small businesses	**17,711**	**17,099**	**17,283**	**17,653**
Commercial banking	**47,095**	**44,466**	**43,747**	**43,516**
Corporate banking	**77,873**	**74,680**	**70,016**	**69,089**
Private banking	**6,470**	**6,513**	**6,286**	**6,439**

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 page 111 of the Report.

Credit risk according to economic sector

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

Sectors of the Economy	**31 December 2009** Overall credit risk to the public	**31 December 2009** Percentage of total	31 December 2008 Overall credit risk to the public	31 December 2008 Percentage of total	Change
	NIS millions	**%**	NIS millions	%	%
Agriculture	**2,282**	**0.7**	2,501	0.8	(8.8)
Industry	**44,658**	**14.3**	52,212	16.3	(14.5)
Construction and real estate	**65,301**	**21.2**	60,681	18.9	7.6
Electricity and water	**1,939**	**0.6**	1,851	0.6	4.8
Trade	**27,832**	**8.9**	31,009	9.7	(10.2)
Hotels, accommodation and food services	**4,787**	**1.5**	5,275	1.6	(9.3)
Transportation and storage	**5,724**	**1.8**	6,673	2.1	(14.2)
Communications and computer services	**6,557**	**2.1**	7,084	2.2	(7.4)
Financial services	**39,018**	**12.5**	42,565	13.3	(8.3)
Other business services	**8,253**	**2.6**	9,279	2.9	(11.1)
Public and community services	**8,548**	**2.7**	8,564	2.7	(0.2)
Private individuals - housing loans	**45,813**	**14.8**	43,603	13.5	5.1
Private individuals – other	**50,833**	**16.3**	49,197	15.4	3.3
Total	**311,545**	**100.0**	320,494	100.0	(2.8)

* Including off-balance sheet credit risk and investments of the public in debentures, and including other assets in respect of derivatives.

See Exhibit E to the Management Review for further details as to the spread of credit to the public according to sectors of the economy.

Part of the information set forth below is "**forward-looking information**". For the meaning of this term, see the chapter "General Environment and Effect of External Factors on Activities" in the "Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report" section on page 51 above.

Industry Sector:

The following discussion is according to industry sub-sectors:

Industrial Sectors:

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 during the period. This process caused large losses for companies during the second half of 2008 and the first quarter of 2009, when the prices of commodities throughout the world began to drop rapidly. Many companies were left with high levels of inventory of raw materials of which no use was made, and were forced to report declines in value in their financial statements. Towards the end of the first quarter of 2009, the steep drop in prices of raw materials was checked; the market began to stabilize and even recorded slight price increases throughout 2009. In addition, a small increase in demand was observed in the sector, but most companies in the sector continued following a conservative policy throughout 2009, and were in no hurry to recruit more staff or to increase inventory levels.

a. Metal
In Israel, the metals sector is a combination of the area of base metal, which is concentrated primarily in the provision of construction, industrial and infrastructure inputs, and the area of finished metal products. Data for the sector indicate that turnover of the metal products segment is a primary component in the sector as a whole.

This sector as a whole is heavily 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 a halt of trading in steel. 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 fix 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. Following the crisis, steel manufacturers worldwide also decreased production to reduce supply and as a result many mines and steel manufacturing plants were closed.

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.

As a result of the above, competition increased between companies engaged in the sector, which led to further erosion of prices of sales and as a result in profitability. In response companies in the sector used 2009 to take steps to increase efficiency and they are careful to keep relatively low inventory levels while adjusting expenses to sale prices. Throughout the year there was a decline in quantities of finished goods sold by the companies in the sector compared to 2008. As a result, most companies operating in this sector reported a decrease in profitability relative to 2008. In the third and fourth quarter of 2009 most companies again reported a net operating profit.

Regarding prices of raw materials, prices began to stabilize at the beginning of 2009, and remained around that level with a tendency to increase slightly during the year. Estimates in the sector are that prices will remain around existing price levels, because of a relative balance between demand and supply. In the mid-long term with recovery in increase worldwide demand for metal is expected to increase for purposes of industrial construction.

b. Hi-tech Companies
The hi-tech sector was badly hurt as a result of the world crisis, because of the sector's heavy dependence on demand from abroad (the rapid development which had typified the sector came to a halt at the end of 2007, with the outbreak of the financial crisis in the United States and turned into real recession when the global economic crisis erupted in the second half of 2008). The sector is also significantly exposed to the appreciation in the exchange rate of the shekel against the dollar and other currencies (the companies are exporters most of whose income is in dollars and expenses in shekels). 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 chip and semiconductors sectors have been the most badly affected by the crisis.

During the last months of 2009 the beginning of recovery in hi-tech activity in the U.S. was noted. Looking forward, as the main export destinations of the Israeli high-tech industry are the United States and the Euro Bloc countries, the economic recovery of the different countries, particularly the U.S. is vital to continued increase of the sector. Furthermore in recent years Asian countries have become a significant export target of the hi-tech industry. Rapid recovery of the industry in Asian countries is expected to boost export increase of the sector in the years 2010-2011 (in Asian countries there was a steep and rapid decline in industrial exports compared with Western countries, although this is true also for the rate of recovery and ending the crisis).

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 peak of the crisis in the sector was in March 2009 when activity in the sector almost completely stopped. This was shown by the decline in global demand which 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 was hurt the most. As a result of declining demand for polished diamonds, large global companies significantly reduced the quantity of raw diamonds being produced.

Beginning in mid-2009 there is stability in diamond prices, and even upward price corrections mainly in the area of commercial diamonds. It should be noted that the main decline in demand for polished diamonds was in the U.S., which prior to the crisis purchased some 60% of all polished diamonds worldwide. This decline was somewhat offset by a rise in the purchase of polished diamonds in the Far East (which which was less hurt by the crisis), and mainly in India and China. Reports of diamond sales in the U.S. for the holiday season at the end of 2009 indicated a rise of some 4% compared with the same period in 2008, which was drastically affected by the global credit crisis.

The Israeli diamond industry, which is typified by a high level of exposure to exports (primarily to the United States), suffered in the first half of 2009 from a decline of more than 60% in total transactions because of the global crisis. However in the second half of 2009 recovery was noted in terms of commercial activity (exports and imports), and the Israeli diamond sector finished 2009 with a decrease of some 43% in imports of diamonds (raw and polished), and a decline of some 40% in diamond exports (raw + polished).

Residential Real Estate

The residential construction sector in Israel in 2009 showed great strength in dealing with the financial crisis compared with other sectors of the economy. Activity in the sector was one of the first to show signs of "awakening" beginning at the end of the first quarter of 2009. This activity became significantly stronger as the year went by. In the secondary sector of luxury apartments, the recovery trend was more moderate and came at a later stage.

Below are a number of characteristics that affected the behavior of the sector in 2009:

1. A significant increase in the number of apartments for investment, which derived from attractive financing rates to those receiving mortgages and from the lack of alternative investment channels (low interest, and a volatile capital market.

2. An increase in the number of purchasing groups in relation to the total apartments acquired in Tel Aviv and central Israel.

3. Low supply of apartments compared with high demand for apartments led to pressure for a rise in prices of apartments and to a rise in the prices for land.

4. In 2007 tenders were published by the Israel Land Authority for 13,365 dwellings; in 2008 tenders were published for marketing 17,621 units. Throughout the whole of 2009 some 20 thousand units

were sold, representing an increase of some 16% in comparison with 2008. Most of the apartments were sold in the last quarter of 2009.

2009 finished with a moderating intensity of sales and there is a certain amount of uncertainty regarding the continuation of the trend in 2010. This is against the backdrop of the possibility of an increase in mortgage interest rates on the one hand, and increased supply of land in accordance with announcements by the Ministry of Construction and Housing on the other.

In connection with the letter of the Supervisor of Banks dated 8 February 2010 regarding purchasing groups, see below under the Mortgage Sector.

Income-producing Property

Non-residential construction in Israel included income-producing property, mainly offices, shopping, commercial and business centers, and other buildings used for industry and trade.

In the commercial area it is possible to point to a trend of strength shown by relatively high occupancy rates and relative stability of rents collected and rates of return on assets.

Following a small drop in occupancy rates and in rents some weakness was felt in office construction. It should be pointed out that the scarcity of supply of new building in the office market contributes to relative stability in this market despite the economic crisis.

The increase expected in 2010 will retain stability and may lead to an improvement in occupancy rates and rental prices in the office segment.

Infrastructure Projects

There has been continued moderate increase in carrying out large volume national infrastructure projects during recent years and during 2009, 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 (including private power stations based on gas and/or solar energy).

Trade and Services

Some of the commercial companies experienced a decline in sales during 2009 along with an erosion in profitability. 2009 was characterized by decrease in inventory levels held by companies and a more conservative policy regarding credit for their customers. This has been shown by a decrease in the volume of imports and a lower utilization of credit.

a. Food Chains:
This sector is comprised of the two largest food chains (including sub-chains) - "Shufersal" and the "Blue Square", and of private chains - "Tiv Tam", "Kolbo Chetzi Chinam", "Rami Levi" and others.

During the first nine months of 2009, the large chains reported erosion in operating profits, deriving *inter alia* from increased competition in the sector and an expansion of the Heavy Discount format (small chains on the structure of the network can lower prices significantly). However, companies are still reporting good profits and the sector is one of those less affected relatively than the other sectors by the economic crisis. The chains are working towards increasing market share, inter alia by marketing through customer loyalty programs and broadening the private label product range.

Competition was felt also from the smaller chains ("Rami Levi" and Chetzi Chinam") mainly in the geographic areas where they are represented and it appears that this will continue also in 2010 in view of their anticipated expansion.

b. Hotels:
After the record year of 2008 in the tourism sector (when the number of tourist visits to Israel reached a record of 3 million visitors) forecasts at the beginning of 2009 indicated a significant decrease in activity in the sector. The main reasons for these estimates were the "Cast Lead" campaign which began at the end of 2008 and the deepening global economic crisis. In actual fact, figures for 2009 in the hotel sector were lower in comparison to the figures for 2008, but higher than the forecasts. This is mainly thanks to a relatively long period of calm in the security situation and to signs of recovery in the world economy.

In total, 2.7 million tourist visits were recorded during 2009 (including overnight stays), compared with some 3.0 million visits in 2008 and about 2.7 million visits in 2000. The decrease in tourist visits in 2009 broke the chain of increases in the number of visiting tourists since 2006 until the record in 2008.

Total hotel stays in 2009 totaled 20.0 million stays (compared with 21.6 million in 2008). The decrease derived mainly from a decline of some 2 million tourist hotel stays. This decline was partially offset by an increase of some 500 overnight stays of Israelis.

Average room occupancy in 2009 was 59%, compared with 66% in 2008 and 60% in 2000. However, there was a small increase in the availability of hotel rooms from 47.6 thousand rooms in 2008 to a level of 48.0 thousand rooms in 2009 (in 2000 the availability of rooms was 45.7 thousand rooms).

Looking forward and subject to continued calm in the security area, and continued improvements in the economic situation in Israel and the world, and continued massive marketing activity, the industry estimates that results in 2010 will be close to the results of 2008.

c. Communications Services:
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 worthy of note in this sector in 2009 are:

- On 13 August 2008, the Ministry of Communications announced the adoption of most of the recommendations of the **Gronau Commission** (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.

- Beginning in mid-2009 the communications sector was typified by moves of changes in ownership, in almost all companies operating in the sector.

- DTT (digital terrestrial television): beginning in August 2009, DTT began operations, by means of which the State enables the reception of five channels which will be broadcast digitally, through a converter that will be sold anyone for a one-time payment.

- In 2009 significant investments began to be made in upgrading infrastructures for fixed line communications in Israel. In our opinion, this will already have implications in the next few years for everything relating to improving the speed of surfing the Internet by customers, improving the range and quality of communications services supplied to customers, and the possibility of supplying high quality television services to customers through the Internet.

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

1. Fixed line communications – Beginning in 2007, commercial licenses were granted to companies in this sector to provide VOB broadband telephony services - fixed line calls through the Internet. This platform was added to the two existing platforms in the sector: traditional fixed lines and cable television.

Additional companies in the communications sphere (particularly in the international and cellular telephone field) received IO licenses. Some of the cellular companies operating in this area which had directed their activity until now mainly at the business sector began to market these services also to private customers in 2009.

Implementation of Ministry of Communications policy to allocate licenses for the supply of VOB telephony to various companies continues the intensification of competition in this area. According to various reports in 2009, the different companies that entered this field are continuing to increase their market share in the area of fixed line telephony.

2. Cellular communications - The cellular companies continued to report high profitability and cash generation ability in 2009 despite the slowdown experienced in the economy. The decline in the cost of the investments required for the transition to advanced technologies, contributed to the financial ability of the companies. The Ministry of Communications continues to work towards increasing competition in the sector, and in 2009 took steps mainly to allow the entry of operators in this area as Mobile Virtual Network Operators (MVNO), 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 report 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. The recession in the economy in 2009 did not cause any significant harm to these companies, due to the fact that this product is a cheaper alternative for 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). Three large companies continue to operate in the sector, with the market share being equally divided between them. Rates of penetration in the sector are relatively high (more than 70% of Israeli households) and so levels of increase in the sector are not high. However, completing processes of acquisition in the sector carried out in 2008 and continued steps to increase efficiency have led *inter alia* to an increase in profitability in 2009 of companies operating in this area. In 2009, no significant impact was felt on the results of these companies, because some of the cellular companies have begun to market internet access also to private customers.

Households and Private Consumption

Private consumption expenses rose in real terms in 2009 by 1.1 percent only, after rapid rises in previous years. The sharp checking of expansion in private consumption in 2009 reflects mainly the decrease in consumption of durable goods, while in consumption of perishable goods there was hardly any slowing down. Looking forward, private consumption per capita is expected to expand in 2010 by about 1.2 percent (about 3-4 percent in real terms). In 2011-2012 there is expected to be further acceleration in the expansion of private consumption, returning to rates appropriate to the long-term average in Israel.

Credit cards

In the credit cards sector there were signs of recovery and accordingly in the figures of the Central Bureau of Statistics for the fourth quarter of 2009, an increase was recorded in fixed prices in the volume of credit card purchases (after identifying seasonal and holiday influences), at a rate of 8.7% on an annual basis, which is in continuation of the rise of 8.9% in the third quarter of 2009. In 2009 an increase of 4.6% was recorded in fixed prices in the volume of credit card purchases by private consumers compared to increase at a rate of 6% in 2008.

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, led to increased demand for mortgages. The halt in growth during the second half of 2008 unsettled confidence in job security by apartment purchasers, and led to a significant drop in the demand for new mortgages. This effect also continued into the beginning of 2009. The decrease of the interest rate in shekels by the Bank of Israel and the low interest rates for mortgages caused a change in direction of the trend in the second quarter of 2009. Improvement in the state of the economy led to strengthening in demand for mortgages towards the end of the year.

On 17 February 2010, the Supervisor of Banks published a draft letter dated 8 February 2010 on the subject of "Purchasing Groups", which refers *inter alia* to the matter of classifying loans to purchasing groups.

According to the above draft, credit granted in the framework of a purchasing group is to be classified, until the stage the customer receives ownership of the apartment, as a loan to a corporation in the real estate sector. From the above mentioned, it appears that these loans, which until now were classified in the balance sheet as retail mortgage loans and were weighted according to Basel II at 35% or 75%, in accordance with the rate of financing, should be weighted at 100%. According to the above draft, the Bank considers the effect immaterial.

Below is additional data on the 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 2009				
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	**84.9**	**6.3**	**18.4**
80	600	**13.2**	**19.6**	**13.0**
600	1,200	**1.1**	**7.7**	**3.2**
1,200	2,000	**0.3**	**3.6**	**1.7**
2,000	8,000	**0.3**	**9.1**	**5.8**
8,000	20,000	**0.1**	**8.0**	**5.9**
20,000	40,000	**0.05**	**7.9**	**6.3**
40,000	200,000	**0.04**	**17.2**	**19.2**
200,000	800,000	****0.01**	**13.5**	**16.3**
Above 800,000		*****0.00**	**7.1**	**10.2**
Total		**100.0**	**100.0**	**100.0**

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	12.0
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		100.0	100.0	100.0

* After deducting the specific provisions for doubtful debts.
** In 2009 – 118 borrowers and in 2008 - 131 borrowers
*** In 2009 – 20 borrowers and in 2008 - 20 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 2009:

1. Credit risk according to size of credit to the borrower, as of 31 December 2009:

		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	**13**	**1**	**9,635**	**918**	**2,551**	**109**
1,200	1,600	**4**	**-**	**2,517**	**-**	**3,251**	**-**
1,600	2,000	**1**	**1**	**1,349**	**1,349**	**520**	**520**
2,000	2,400	**2**	**-**	**1,293**	**-**	**3,337**	**-**
Total		**20**	**2**	**14,794**	**2,267**	**9,659**	**629**

2. Credit risk according to economic sectors, as of 31 December 2009:

	Total number of borrowers	Balance sheet credit	Off-balance sheet credit
	Total	Total	Total
	In NIS millions		
Industry	8	5,338	6,066
Construction and real estate	7	4,462	1,757
Public and community services	1	895	5
Communications and computer services	1	1,288	211
Financial services	3	2,811	1,620
Total	20	14,794	9,659

1. Credit risk according to size of credit to the borrower, as of 31 December 2008:

		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, as of 31 December 2008:

	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

All the related parties in the above tables are corporations in which the Bank holds at least 20% and which are not controlling shareholders of the Bank. There are no debts in the credit detailed in the above table in respect of which provisions have been made for doubtful debts.

The indebtedness of the six largest groups of borrowers represented 8.1% of total credit risk at 31 December 2009 and 69.1% of the capital calculated for the limitation on the six largest groups of borrowers.

For additional details, see page 215 of the Report.

Credit to Governments at 31 December 2009 amounted to NIS 407 million, a decrease of NIS 113 million (21.7%) compared with 31 December 2008.

Problem Loans

The following shows the development of problem credits[(1)(6)] according to classifications determined in the directives of the Supervisor of Banks:

	31 December 2009	31 December 2008
	(NIS millions)	
Problem Loans[(1)]		
Non-performing	**1,846**	2,012
Restructured [(2)]	**679**	405
To be restructured [(3)]	**410**	558
In temporary arrears	**584**	562
Under special supervision*	**12,349**	14,545
Total balance sheet credit to problem borrowers [(1)]	**15,868**	18,082
Off-balance sheet credit risk to problem borrowers [(1) (5)]	**3,065**	3,482
Debentures of problem borrowers (public)	**683**	506
Total overall credit risk of banks (debentures + deposits in banks)	**190**	108
Other assets in respect of derivatives of problem borrowers	**252**	612
Total overall credit risk in respect of problem borrowers[(1)]	**20,058**	22,790
Assets received in respect of repaid credit	**87**	302
*of which: debts for which there is a specific provision [(4)]	**6,313**	7,373
*of which: credit for housing for which there is a provision according to the extent of the arrears	**389**	505

(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.
(7) Problem debts include credit classifications since implementation of Proper Banking Management Directive No. 325 "Management of Current Account Credit Lines". 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), if the Bank charges the customer excess interest. In this situation the excess is to be classified as a non-performing loan, and credit within the limit and the remainder of the customer's obligations must be classified as a loan under special supervision. The effect of the said directive has been to increase non-performing loans by NIS 58 million, and loans under special supervision by NIS 1,110 million. At the end of 2008 the classification was NIS 100 million, and NIS 1,948 million respectively.

The decrease in volume of problem loans is a result of improvement in the state of the Israeli economy in the second half of 2009.

There was a decline of 15.1% in loans under special supervision. Classified in this group are loans in respect of which, according to Bank of Israel definitions, Bank 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 9.6 billion out of the debts under special supervision is resultant and some NIS 2.7 billion is in accordance with decisions of Management.

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 NIS 900 million at the end of 2009 (constituting some 0.29% of total credit risks), compared with NIS 948 million at the end of 2008 (some 0.3% of total credit risks.)

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

Securities

The Group's investments in securities as at 31 December 2009 amounted to NIS 57,505 million, an increase of NIS 12,595 million, and a rise of 28.0%, compared with 31 December 2008; this resulted from an increase in deposits of the public, a decrease in credit to the public, issue of capital notes and an increase 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 discount or premium).

Method of calculating fair value

The fair value of Israeli securities is based on prices quoted on the Tel-Aviv Stock Exchange and for foreign securities on prices received from external sources. The value of most of the portfolio is calculated each month by a recognized international institution, which is engaged in 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 and valuation of similar transactions. The calculation reflects the price a willing purchaser in the market will pay for securities on the basis of current information observed in the market (observable market inputs). Since only a small part of the securities are traded worldwide on a daily frequency, the institution makes use of two methods of evaluations:

a. Evaluation at asset-grouping level: most of the securities are valued by means of rates of return (capitalization) which relate to groupings of assets of similar characteristics (by country, sector, type of asset, rating, etc.), and primarily from the weight attached to information existing in the market, generally in relation to the relevant index.

b. Evaluation and quotation of specific securities: Other securities are evaluated on an individual basis (evaluation of the issuer and the specific security), on the basis of direct price quotations for a margin for the security or the specific issuer. A small part of the assets in this grouping are evaluated only on the basis of price quotations from very active markets (mainly government debentures with have active market makers.

The CLO portfolio, which constitutes some 1.6% of the securities portfolio, is valued independently based on a model since there is no active market in these instruments. The model is used by leading banks worldwide. The Bank validates the model and ensures, 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, as well as by comparisons with price indications obtained from the market.

Unquoted debentures in Israel denominated in shekels are evaluated by a professional entity engaged in evaluations. Since there is no active market in these debentures, the evaluation is based on a model. The Bank validates the model and ensures, 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. The model refers to the results of the model of the "Sha'arei Ribit" Co., which evaluates these assets for purposes of financial statements of financial institutions. The total value of the assets based on the model is slightly lower than the value obtained from the evaluation of the " Sha'arei Ribit" Co.

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.

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

	31 December 2009	31 December 2008
Securities traded on an active market*	**47,813**	38,594
Securities according to prices determined according to external models**	**8,152**	3,540
Securities according to quotation from counterparty or to cost	**1,540**	2,776
Total	**57,505**	44,910

* Including fair value calculated in accordance with models based on current market data.
** Including securities in the amount of NIS 414 million measured in accordance with a model of a subsidiary company.

For details of accounting policy and the manner of valuing the securities portfolio and the difference between a temporary decrease in value and that of a non-temporary nature, see the Section "Accounting Policy on Critical Subjects" on page 52 and Note 1 to the Financial Statements.

The following table sets out the classification of the securities item in the consolidated balance sheet as at 31 December 2009 in accordance with the above-mentioned rules:

	31 December 2009				
	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	**852**	**23**	**-**	**875**	**852**
Available-for-sale	**44,442**	**454**	**(615)**	**44,281**	**44,281**
For trading	**9,708**	**128**	**(51)**	**9,785**	**9,785**
	55,002	**605**	**(666)**	**54,941**	**54,918**
Shares and funds					
Available-for-sale	**1,849**	**648**	**(7)**	**2,490**	**2,490**
For trading	**446**	**-**	**(349)**	**97**	**97**
	2,295	**648**	**(356)**	**2,587**	**2,587**
Total securities	**57,297**	**1,253**	**(1,022)**	**57,528**	**57,505**

	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	1,509	30	(1)	1,538	1,509
Available-for-sale	30,748	502	(1,923)	29,327	29,327
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

As at 31 December 2009, some 81.3% of the Group's *nostro* portfolio was classified as available-for-sale securities and some 17.2% as securities for trading. This classification allows for flexibility in the management of the securities portfolio. Some 4.5% 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:

	2009	2008
	NIS millions	
Debentures redeemed and/or sold (held to redemption and available-for-sale)	**22,387**	46,987
Purchases of debentures held to redemption and available-for-sale	**35,494**	45,615
Net profit from investments in debentures:		
financing income on accrual basis	**1,557**	914
profit (loss) from sale and from decrease in value of available-for-sale debentures	**294**	(1,337)
profit (loss) realized and/or unrealized from adjustments to fair value of debentures for trading	**232**	82

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

	31 December 2009			31 December 2008		
	Govt. of Israel	**Foreign govts.**	**Other companies**	Govt. of Israel	Foreign govts.	Other Companies
	NIS millions					
Israeli currency:						
Unlinked	**18,095**	**-**	**98**	9,422	-	42
CPI-linked	**8,656**	**-**	**1,009**	4,948	-	1,046
Foreign currency including foreign currency-linked	**1,962**	**4,037**	**21,061**	2,127	4,601	19,400
Total debentures*	**28,713**	**4,037**	**22,168**	16,497	4,601	20,488

* Of which NIS 2,907 million subordinated debentures.

In 2009 there was an increase of some NIS 1.7 billion, or about 8.2% in the Group's investments in corporate debentures, mainly in foreign currency debentures abroad. Some 59.6% of debentures are invested in government debentures, mainly of the Israeli government.

See Note 3 to the Financial Statements for further details.

Below is a table of details of investments in corporate debentures (not banks) only issued in Israel and abroad, by sector of the economy (available-for-sale and trading portfolio:

	31 December 2009	
	Issued in Israel	Issued abroad
Economy sector	NIS million	
Industry	**147**	165
Construction and real estate	**82**	123
Electricity and water	**166**	74
Trade	**183**	-
Transportation and storage	**27**	-
Communications and computer services	**83**	23
Financial services	**336**	6,675
Other business services	**-**	49
Public and community services	**27**	46
Total	**1,051**	7,155

The available-for-sale portfolio

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

	2009		2008		Change	
	NIS millions					
	Abroad	In Israel	Abroad	In Israel	Abroad	In Israel
Debentures	**21,767**	**22,514**	20,246	9,144	1,521	13,370
Shares and funds	**541**	**1,949**	1,260	1,959	(719)	(10)
Total	**22,308**	**24,463**	21,506	11,103	802	13,360

a. In 2009, NIS 1,481 million was recorded to shareholders' equity in respect of the available-for-sale portfolio, due to an increase in value and exchange rate differentials in respect of debentures denominated in foreign currency, compared with a decrease in value of NIS 1,784 million in the same period last year. The main increase in value derives from subordinated debentures of banks abroad.

b. In addition, NIS 294 million was recorded to profit and loss, in respect of profits from the sale of debentures after setting off provisions defined as decreases in value of securities of a non-temporary nature, compared with losses of NIS 1,337 million in the same period last year.

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

	2009	2008
	NIS millions	
Profits (losses) in respect of securities which were recorded to profit and loss*	**1,670**	**(772)**
Adjustments for decrease in value of securities in shareholders' equity	**1,481**	**(1,784)**

* Of which in respect of positive exchange rate differentials in the amount of NIS 285 million in 2009, compared with NIS 1,330 million in 2008.

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

	31 December 2009	30 September 2009	31 December 2008	Movement 4th Quarter	Movement Year 2009
	NIS millions				
Shares	**641**	686	429	(45)	**212**
Israel government debentures	**101**	183	434	(82)	**(333)**
Foreign government debentures	**3**	5	9	(2)	**(6)**
Other debentures *	**(265)**	(505)	(1,864)	240	**1,599**
Other credit instruments	**(18)**	(23)	(27)	5	**9**
Total	**462**	346	(1,019)	116	**1,481**
Related tax	**(153)**	(118)	371	(35)	**(524)**
Net total	**309**	228	(648)	81	**957**

* Of which as at 31 December 2009, NIS (265) million in subordinated notes of overseas banks.

The accumulated net balance of adjustments to fair value of securities held in the available-for-sale portfolio, as at 31 December 2009, totaled a positive amount of NIS 309 million (after the effect of tax) compared with a negative amount of NIS 648 million at the end of 2008. These amounts represent losses/profits which had not been realized at the dates of the Financial Statements.

The balance of impairment accruing in the debentures item in the amount of NIS 265 million relates mainly to the decrease in value of subordinated debentures issued by foreign banks.

e. **Declines in value of available-for-sale securities which were charged to shareholders' equity as at 31 December 2009:**

		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	**15**	**5**	**-**	**29**	**49**
	Other debentures	**41**	**1**	**2**	**250**	**294**
	Total	**56**	**6**	**2**	**279**	**343**
10%- 20%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**-**	**-**	**-**	**16**	**16**
	Other debentures	**2**	**-**	**-**	**128**	**130**
	Total	**2**	**-**	**-**	**144**	**146**
20%-30%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**-**	**-**	**-**	**1**	**1**
	Other debentures	**-**	**-**	**-**	**91**	**91**
	Total	**-**	**-**	**-**	**92**	**92**
30%-35%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**-**	**-**	**-**	**1**	**1**
	Other debentures	**-**	**-**	**-**	**6**	**6**
	Total	**-**	**-**	**-**	**7**	**7**
35%-40%	Shares	**7**	**-**	**-**	**-**	**7**
	Asset-backed debentures	**-**	**-**	**-**	**-**	**-**
	Other debentures	**-**	**-**	**-**	**-**	**-**
	Total	**7**	**-**	**-**	**-**	**7**
Above 40%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**-**	**-**	**-**	**27**	**27**
	Other debentures	**-**	**-**	**-**	**-**	**-**
	Total	**-**	**-**	**-**	**27**	**27**
Total amount	Shares	**7**	**-**	**-**	**-**	**7**
	Asset-backed debentures	**15**	**5**	**-**	**74**	**94**
	Other debentures	**43**	**1**	**2**	**475**	**521**
Overall total		**65**	**6**	**2**	**549**	**622**

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 page 54 above.

*The duration of the decrease in value from the beginning of the decrease, means the beginning of any decrease in value whatsoever of the security.

The Trading Portfolio

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

	2009		2008		Change	
	NIS millions					
	Abroad	In Israel	Abroad	In Israel	Abroad	In Israel
Debentures	**4,441**	**5,344**	4,869	5,881	(428)	(537)
Shares and funds	**93**	**4**	105	-	(12)	4
Total	**4,534**	**5,348**	4,974	5,881	(440)	(533)

In respect of trading debentures, realized and unrealized profits in the amount of NIS 232 million were recorded in the profit and loss statement, compared with profits in the amount of NIS 82 million in 2008, and in respect of shares and funds, realized and unrealized profits were recorded in the amount of NIS 8 million, compared with losses of NIS 528 million in 2008.

Investments in Securities Issued Abroad

The Group's securities portfolio includes some NIS 27.4 billion (some US$ 7.3 billion) of securities issued abroad, all of which (but for about 4.1%) are investment grade securities, of which some 94% are rated 'A-' and above, of which some 37.5% are rated 'AAA'. The portfolio includes subordinated debentures of banks abroad with a fair value of NIS 2,907 million; about 10.6% of all investments in securities issued abroad. Of the said portfolio, some NIS 22.3 billion (some US$ 5.9 billion) is classified in the available-for-sale securities portfolio, about NIS 4.5 billion (some US$ 1.2 billion) is classified in the trading portfolio, and the balance in the portfolio held to maturity.

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

	2009		2008	
	Available-for-sale portfolio	Trading portfolio	Available-for-sale portfolio	Trading portfolio
Balance Sheet Value	NIS millions			
Government debentures	**2,859**	**2,354**	2,175	3,707
Debentures of banks and financial institutions	**12,580**	**1,862**	11,240	472
Asset-backed debentures	**5,938**	**101**	4,211	207
Other debentures	**390**	**124**	2,620	483
Shares and funds	**541**	**93**	1,260	105
Total	**22,308**	**4,534**	21,506	4,974

The Management of the Bank estimates that the decline in the value of the available-for-sale portfolio is mostly temporary in nature, and results after the end of 2009 also support this approach. 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 2009, amounts to some NIS 220 million (some NIS 140 million after taxes). In 2009 the negative reserve decreased by NIS 1,121 million. Most of the movement relates to the increase in value of debentures of banks aboard which are of a subordinated type as explained below.

In addition to the temporary increase in value which was credited to shareholders' equity, an amount of some NIS 196 million was charged to the profit and loss account in 2009, most of which in the first half of the year.

The following table shows the fair value at 31 December 2009 of debentures of banks and financial institutions abroad (excluding asset-backed securities):

	AAA to AA-	A+	A	A-	BBB+ to BBB-	BB+ to B-	Not rated	Total
	NIS millions							
UNITED KINGDOM	270	323	446	232	-	-	-	1,271
AUSTRIA (1)	-	-	469	-	-	-	-	469
ITALY (1)	-	-	288	-	-	-	5	293
IRELAND (1)	43	-	231	-	74	-	-	348
BELGIUM (1)	-	-	392	-	-	-	-	392
GERMANY (1)	186	655	-	5	85	-	4	935
HOLLAND (1)	605	-	526	272	28	-	-	1,431
LUXEMBOURG (1)	-	380	143	-	-	-	-	523
SPAIN (1)	114	-	39	168	-	-	5	326
PORTUGAL (1)	-	-	-	16	-	-	-	16
FINLAND (1)	29	-	-	-	30	-	-	59
FRANCE (1)	296	96	52	-	-	-	-	444
SWITZERLAND	8	20	156	-	-	-	-	184
AUSTRALIA	508	-	15	-	-	-	-	523
SWEDEN	121	-	296	-	-	-	-	417
NEW ZEALAND	503	-	-	-	-	-	-	503
OTHER (2)	81	180	98	11	38	-	195	603
U.S.A. – per bank								
CITIGROUP INC NY	-	-	592	-	-	-	-	592
CHASE MANHATTAN BANK, N.A.	-	-	-	1,014	-	-	-	1,014
MERRILL LYNCH INTERNATIONAL BA	-	-	503	-	-	-	-	503
BANK OF AMERICA	-	-	486	-	-	-	-	486
GOLDMAN, SACHS AND CO.	-	394	-	-	-	-	-	394
WACHOVIA INTERNATIONAL BANKING	-	821	-	-	-	-	-	821
WELLS FARGO BANK N.A.	-	-	336	-	-	-	-	336
MORGAN STANLEY	474	-	-	-	-	-	-	474
U.S. – OTHER (3)	217	579	118	-	171	19	32	1,136
TOTAL (4)	3,455	3,448	5,186	1,718	426	19	241	14,493

(1) Eurozone countries
(2) This amount includes investments in 5 countries
(3) This amount includes investments in 24 banks in the U.S.
(4) Including subordinated debentures with a fair value as of 31 December 2009 of NIS 2,907 million (including available portfolio and trading portfolio.

1. Investments in foreign asset-backed securities

The Group's securities portfolio includes some NIS 6.0 billion (some US$ 1.6 billion) of asset-backed securities (both mortgage-backed and non-mortgage-backed), all of which (save for 4.2%) are rated 'A-' and above, of which some 85.7% are rated 'AAA'. Of the said portfolio, some NIS 5.9 billion (some US$ 1.57 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 2009:

	Adjusted cost	Unrealized profits	Unrealized losses	Balance sheet value (fair value)
	NIS millions			
MBS - mortgage-backed securities	**4,907**	**38**	**(55)**	**4,890**
ABS-asset-backed securities (other than mortgage-backed)	**893**	**194**	**(39)**	**1,048**
Of which: CLO	**763**	**184**	**(36)**	**911**
SCDO	**56**	**10**	**-**	**66**
Other	**74**	**-**	**(3)**	**71**
Total	**5,800**	**232**	**(94)**	**5,938**

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

Securitization Exposures

Investment in asset-backed securities by type of exposure (Table 9(f) – Basel II)	31 December 2009 Accrued amount of exposure
	NIS millions
Mortgage-backed Securities (MBS):	
Pass-through securities:	
Securities guaranteed by US Government GNMA	**2,123**
Securities issued by FNMA and FHLMC	**469**
Other securities	**-**
Other mortgage-backed securities	
Securities issued by FHLMC, FNMA, or GNMA, or guaranteed by these entities	**2,313**
Other mortgage-backed securities	**83**
Total mortgage-backed securities (MBS)	**4,988**
Asset-backed securities (ABS):	
Credit card debtors	**-**
Lines of credit for any purpose secured by dwelling	**8**
Credit for purchase of vehicle	**12**
Other credit to private persons	**7**
Credit not to private persons	**2**
CLO debentures	**911**
SCDO debentures	**66**
Others	**53**
Total Asset-backed (ABS)	**1,059**
Total Asset-backed Securities	**6,047**

Investment in asset-backed securities by type of exposure* (Table 9(g) – Basel II)	31 December 2009 Accrued amount of exposure	Capital requirement for securitization exposure
	NIS millions	
20%	**640**	**12**
50%	**186**	**8**
100%	**143**	**13**
350%	**65**	**20**
Deducted from equity	**47**	**-**
Total	**1,081**	**53**

* Not including GNMA, FNMA, FHLMC securities.

The available-for-sale securities portfolio of foreign asset-backed securities as at 31 December 2009 includes investments in mortgage-backed securities in the total amount of some NIS 4.9 billion. 99% of the mortgage-backed securities in the available-for-sale portfolio are guaranteed or directly issued by United States federal agencies, (FNMA, FHLMC,GNMA). The FNMA and FHLMC agencies have come under governmental protection under the U.S. administration's rescue plan, and there is a government guarantee for GNMA debentures.

As at 31 December 2009, the accumulated net decline in value charged to shareholders' equity resulting from the mortgage-backed securities portfolio was some NIS 17 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 83 million.

The projected term to maturity for all the mortgage-backed securities portfolio is 4.9 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 1,048 million. All these securities, save for 9.7%, are rated 'A-' and above, of which 23.2% are rated 'AAA'. This portfolio includes, *inter alia,* SCDOs in the amount of some NIS 66 million, and CLOs in the amount of some NIS 911 million. The projected term to maturity of the portfolio of securities that are backed by assets other than mortgages is some 4.6 years on average.

Management of the Bank estimates, and on the basis of examination according to the criteria detailed on page 54 of the 2009 Annual Report, 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 2009, the decline in value charged to shareholders' equity attributed to the portfolio of securities backed by assets other than mortgages totaled some NIS 155 million (some NIS 99 million after tax).

The total of asset-backed securities of the SDCO type amounted to NIS 66 million. The amount in respect of a decrease in value of NIS 59 million in 2009 was charged to the profit and loss statement in respect of this portfolio (in 2008 the amount of NIS 341 million).

The total of asset-backed securities of the CLO type amounted to NIS 911 million. The amount of NIS 148 million was charged in 2009 to shareholders' equity in respect of these securities, and a decrease in value in the amount of NIS 17 million was charged to the profit and loss statement (in 2008 – NIS (100) million and NIS (435) million respectively).

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 in Note 1 to the financial statements and on page 96 of the Directors' Report above.

The securities for trading portfolio includes investments in asset-backed securities in the amount of some NIS 101 million, of which some NIS 90 million is invested in mortgage-backed securities and some NIS 11 million is invested in other asset-backed securities.

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

2. Investments in other (non asset-backed) foreign securities

The Group's securities portfolio as at 31 December 2009 includes some NIS 21.4 billion (some US$ 5.7 billion) of non-asset-backed securities, which include mainly securities issued by banks and financial institutions, including subordinated debentures, the balance being securities issued by the governments of the UK, France and Israel, and securities of Israeli companies that were issued abroad. Of these securities, NIS 16.4 billion (US$ 4.3 billion) are classified in the available-for-sale portfolio, and some NIS 4.4 billion in the securities for trading portfolio. Of these securities, 95% are rated 'A-' or above, of which 24.3% are rated 'AAA'.

For further details regarding exposure to overseas banks and financial institutions see page 235.

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 in Note 1 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 well as increase in value after the date of the financial statement, high credit rating (group A and above) and an analysis of stability under stress scenarios.

As at 31 December 2009, the decrease in value charged to shareholders' equity in respect of non-asset-backed securities issued abroad in the available-for-sale portfolio totalled NIS 358 million (NIS 228 million after tax), after a decrease in the amount of NIS 914 million in 2009.

Debentures that are not asset-backed and issued abroad are for the most part debentures of banks.

The portfolio of bank debentures is invested in large and reputable banks in Western European countries (45.5%) and in the USA (46%), of which some $ 771 million is invested in subordinated debentures. The type of debentures held by the Group are debentures with no element of convertibility to shares and their final redemption date is less than ten years. With these debentures the issuer has, generally, the option of early repayment of the debenture (call). In the event where the issuer does not make an early call, the duration of the debenture is extended by a number of years (generally three to five), and the interest increases (step-up mechanism). It is not clear which banks will act as in the past and call their debentures (will execute the call option) and which will prefer the redemption period be extended with a higher rate of interest.

Most of the decline in value of securities issued overseas was in subordinated debentures. As of 31 December 2009, out of the available-for-sale portfolio of subordinated debentures in the sum of some NIS 2.9 billion, their fair value at the date of the Report is some NIS 2.6 billion. Since the major element of decrease in value derives from the increased probability that the issuer will exercise his right not to make an early call, and thus will extend the duration of the debenture, and after the Bank carried out individual examinations to review the survival capability of each of the banks in this group, the Bank considers this decrease in value to be of a temporary nature. The first quarters of this year were materially different with regard to the fair value of this investment. While the first quarter was typified by a significant decrease in fair value and by an increase in negative capital reserve, the second, third and fourth quarter was the complete opposite, and all the decrease in value of the fourth quarter was cancelled out with a final result for the year being an increase in value of NIS 326 Million. The shrinking of debenture margins, as with the even more significant shrinking of margins of the relevant credit derivatives (CDS) from the end of the first quarter until the date of publication of the Report give support to the impairment being of a temporary nature.

The Bank intends and is able to continue holding these debentures until their expected final redemption or at least until restoration of their value.

	Fair value					
	31 December 2009	30 September 2009	30 June 2009	31 March 2009	31 December 2008	Difference in fair value for 2009
	NIS millions					
Total subordinated debentures of banks issued abroad	**2,593**	2,650	2,542	2,261	2,614	(21)
Or which: subordinated debenture which decreased by more than 35%	**6**	24	34	1,073	24	(18)

In addition to the available-for-dale portfolio, the trading portfolio also included non-asset backed securities. The trading portfolio includes mainly securities of banks and financial institutions, as well as securities portfolios of external portfolio manager, and securities funds. All the securities in the trading portfolio are of investment grade, and some 100% are rated A and above. The value of the non-asset backed trading portfolio as of 31 December 2009 amounted to NIS 4.4 billion ($ 1.2 billion). The difference between the fair value and adjusted cost, if there is such a difference, is recorded in the profit and loss account.

As of the end of 2009, some $ 330 million were invested in credit derivatives (CDS) of the State of Israel. Investments in credit derivatives are revalued on a routine basis, for each derivative instrument, according to market value, and in respect of investments of this type in 2009, there was a recorded profit of $ 0.5 million, or NIS 2 million (in 2008 – NIS 109 million).

Investments in corporate debentures issued in Israel

Investments in debentures issued in Israel amounted to NIS 28.1 billion on 31 December 2009, of which NIS 27.0 billion was in debentures issued by the government of Israel, and the balance of NIS 1.1 billion was in corporate debentures. Of the corporate debentures, 94% are rated 'A-' and above, of which 78% are rated 'AA' and above. The investments in the corporate debenture portfolio are spread among various branches of the economy. The largest investment, some 32%, is in the financial services sector. On 31 December 2009, investments in corporate debentures amounted to NIS 0.8 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 65% 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 as described above.

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 to the Financial Statements and on page 54 of the Directors Report.

Out of the total amount of NIS 0.8 billion in the corporate debenture portfolio in the available-for-sale portfolio, the capital reserve amounted to NIS 28 million and the negative reserve to NIS 11 million, with the largest rate of impairment being 11.0%. The Bank considers the decrease in value in the corporate debenture portfolio to be of a temporary nature, based on an individual examination of the debentures.
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 2,587 million on 31 December 2009, of which NIS 1,640 million was in listed shares and NIS 947 million was in non-listed shares. Of the total investment, NIS 2,490 million is classified as available-for-sale and NIS 97 million is classified in the trading portfolio.

Risk Management objectives and policy with regard to investment in shares - (Qualitative Disclosure – Table 13 - Basel II):

Investment policy:
The Bank has defined investment policy to include setting limits for the volume of overall investment and in a single company, an investment mix, and the various levels of risk between types of non-banking investments.

Definition of the aim of the investment:

- Achieving a higher return in comparison with a *nostro* financial investment.
- Raising the value of the investment and achieving better investment terms by leveraging the reputation of the Leumi Group.
- Widening the spread of risk and varying the Group's sources of revenue.
- Flattening the volatility of the *nostro* portfolio (time gaps).

The structure of the portfolio is divided into 3 sub-groups

- Strategic investments (majority of the portfolio).
- Investments of a financial nature.
- Investments in growth companies (start-up companies)

Accounting treatment of the investments:

- The investments are recorded as equity investments or alternatively in the available-for-sale securities portfolio.
- Regarding the accounting method, see the Chapter of Accounting Policy and Note 1

The following table sets out the principal investments in shares and funds recorded in the securities item (available-for-sale portfolio)[1] (Table 13 (B)– Basel II):

	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*		Capital adequacy requirement	Listed/not listed
	31 December 2009	31 December 2008	**31 December 2009**	31 December 2008	**31 December 2009**	
	%		NIS millions			
Migdal Insurance and Financial Holdings Ltd. (2)	**9.85**	9.85	**719**	411	**65**	
Africa Israel Properties Ltd.	**4.3**	4.3	**35**	15	**3**	
Super-Pharm (Israel) Ltd. (4)	**18.0**	18.0	**182**	182	**16**	not listed
Otzar Hityashvuth Hayehudim B.M.	**8.62**	8.62	**80**	29	**7**	
Partner Communications Ltd. (4)	**4.99**	-	**589**	-	**53**	
Hot – Cable Communications Systems Ltd. (5)	**-**	14.96	**-**	239	**-**	
Bezeq – Israel Communications Company Ltd. (6)	**-**	4.23	**-**	683	**-**	
Union Bank of Israel Ltd. (7)	**-**	6.46	**-**	101	**-**	
Tower Semiconductor capital notes	**-**	-	**49**	49	**4**	not listed
Visa International	**-**	-	**40**	27	**4**	
CLS Bank	**-**	-	**21**	21	**2**	not listed
Funds(8)	**-**	-	**246**	991	**22**	
Apax	**-**	-	**59**	56	**5**	not listed
Others	-	-	**567**	520	**51**	389 not listed
Total	-	-	**2,587**	3,324	**232**	

* The value of the investment in the Consolidated Balance Sheet equals the balance of fair value of the investment.

(1) See page 156 for details of non-banking investments reported on 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	
	2009	2008
Listed shares	**1,564**	1,718
Funds according to quote by counterparty	**322**	988
Unlisted shares	**701**	618
Total	**2,587**	3,324

(2) For additional details see page 157 of the Report.

(3) 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.

(4) On 21 August 2009, the Bank signed an agreement with Scailex Corporation Ltd. ("Scailex") for the acquisition of 7,677,037 ordinary shares, constituting 4.99% of the issued and fully paid share capital of Partner Communications Ltd. (on an undiluted basis and after neutralizing dormant shares) for a consideration of NIS 514,553,405. The agreement included standard minority protection rights and an option to purchase debentures convertible into Scailex shares in the amount of some NIS 103 million.

Leumi Partners Ltd. (a wholly owned subsidiary of the Bank) acted as the investment house in all aspects related to this transaction, including *vis-à-vis* additional potential investors, and it was therefore paid a finders fee in the amount of US$ 3 million.

On 18 October 2009, pursuant to the exercise of the option, NIS 102,705,270 par value convertible debentures (series 1) of Scailex were issued to Leumi Partners at a price of NIS 1.002 for every NIS 1 par value, and for an aggregate consideration of NIS 102,910,681 (the " Debentures"). The Issued Debentures were issued by means of an extension of the series of debentures (series 1), all as in accordance with the provisions of the law and the shelf prospectus published by Scailex on 21 August 2009. By 31 December 2009, Leumi Partners sold all the debentures it purchased on 18 October 2009.

On 28 October 2009, the transaction between the Bank and Scailex Corporation Ltd. was completed, pursuant to which Leumi Partners Ltd. acquired from Scailex 7,677,037 ordinary shares constituting 4.99% of the issued and fully paid share capital of Partner Communications Ltd. (on an undiluted basis and after neutralizing dormant shares) for a consideration of NIS 514,887,507.

(5) On 3 August 2009, the Bank sold 11,376,902 Ordinary Shares of Hot – Communications Systems Ltd. held by the Bank (the "Shares") to Cool Holding Ltd., for a consideration of NIS 381,126,210. The profit recorded from the sale of the Shares was some NIS 115 million.

(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 Bezeq, was changed from credit to the public to the securities item. On 10 August 2009, the customer's receiver gave notice that he had completed a transaction for the sale of 155,000,000 ordinary shares of NIS 1 par value each of the company representing 5.849% of the share capital of Bezeq, and the consideration after deducting fees and expenses in the amount of NIS 1,137 million will be used to reduce the debts of the customer to the banks, in accordance with the share of each bank in financing Bezeq shares in 1999. The Bank's share of the consideration after fees and expenses amounted to some NIS 273 million, and the net profit amounted to some NIS 55 million.

On 19 October 2009 the customer's receiver gave notice that he had completed a transaction for the sale of 120,000,000 ordinary shares of NIS 1 par value each, representing 4.52% of the share capital of Bezeq, and the consideration after deducting fees and expenses in the sum of some NIS 977 million will be used to reduce the debts of the customer to the banks, in accordance with the share of each bank in financing Bezeq shares in 1999. The Bank's share of the consideration after fees and expenses amounted to some NIS 233 million, and the net profit amounted to some NIS 60 million.

On 9 November 2009 the customer's receiver gave notice that he had completed the transaction for all the shares of Bezeq held by the customer. The total of shares sold at that time amounted to 184,331,617 ordinary shares of NIS 1 par value each, representing 6.94% of the share capital of Bezeq, and the consideration after deducting fees and expenses amounted to the sum of some NIS 1.5 billion was used to reduce the debts of the customer to the banks, in accordance with the share of each bank in financing Bezeq shares in 1999. The Bank's share of the consideration after fees and expenses amounted to some NIS 242 million, and the net profit amounted to some NIS 27 million.

For details of the claim for granting declarative motions filed by the customer against 7 banks including the Bank – see Note 18 (G) (1) (n).

(7) Union Bank

On 17 November 2003, an agreement was signed between the Bank, Sherodar Assets Ltd. ("Sherodar") and Yishayahu Landau Holdings (1993) Ltd.("Landau") 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.

On 11 May 2009, the Bank delivered to Sherodar and Landau an exercise notice for the Put option.

On 28 June 2009, the transaction was completed and the Bank sold the above mentioned shares to Landau and Sherodar representing the Bank's entire holdings in Union Bank of Israel Ltd., for an aggregate consideration of some NIS 108 million. The Bank's profit from the sale of the shares was some NIS 17 million, net.

(8) 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 2009, the Bank had pledged debentures having a value of NIS 1.226 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 2009 was NIS 152 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. As at 31 December 2009 there were no balances.

As at 31 December 2009, the Bank had no outstanding loans from the Bank of Israel while the balance of the Bank's deposits with the Bank of Israel amounted to NIS 24.2 billion.

Other assets

At the end of 2009, other assets amounted to NIS 9.8 billion, compared with NIS 13.5 billion at the end of 2008, a decrease of some 27.5%, or some NIS 3.7 billion. The decrease in this item resulted mainly from a decrease in the balance of the fair value of derivative instruments of some NIS 3.6 billion, from a decrease in receivable deferred taxes of some NIS 638 million, against which there is a parallel decrease in other liabilities in the amount of NIS 2.2 billion, of which NIS 2.9 billion in the balance of fair value of derivative instruments.

Fixed Assets and Installations

Buildings and Equipment - the cost after depreciation of buildings and equipment as at 31 December 2009 amounted to NIS 3,553 million, compared with NIS 3,445 million as at 31 December 2008.

The investments in buildings and equipment as at 31 December 2009 are as follows:

	Cost	Accumulated Depreciation	Balance for Depreciation	
			31 December 2009	31 December 2008
	NIS millions			
Buildings and land	3,227	1,606	1,621	1,597
Equipment, furniture and vehicles	6,197	4,265	1,932	1,848
Total	9,424	5,871	3,553	3,445

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 2009 amounted to NIS 27 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 126 are branches and archives and 20 are head office buildings. Total property under ownership, of an area of some 262,000 sq.m., is divided into branches - some 82,945 sq.m., head office buildings - some 40,000 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 784 sq.m. as of 31 December 2009, and are presented according to the lower of depreciated cost or realization value.

Investment in buildings in 2009 totaled NIS 109 million (including property purchases in the amount of NIS 9 million) compared with NIS 133 million in 2008 (including property purchases of NIS 14 million). In addition to property owned by the Bank, the Bank leases 193 properties under unprotected leases and 9 properties under protected leases. Total property leased constitutes some 63,000 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. Leumi has 2 mainframe computers produced by 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 8,225 mips (number of instructions in millions per second) 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 Bank has a database of historical data housed on discs and cassettes in the main computer facility at Keshev and in the back-up facility in Tel-Aviv. A third copy of data is stored elsewhere in Israel.

Leumi's branches are computerized and connected on-line to the Bank’s computer center at Keshev. Some 319 servers and some 7,523 work-stations, mostly PC-based, have been installed in the branches. There are 323 innovative automatic teller machines for use by customers and some 559 self-service “Leumi Information” stations (340 stations in the branches and 219 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 upgraded the network of “Leumi Information” external 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.

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.

Matam operates an array of computerized systems to the Arab Bank of Israel and to Bank Igud. There is an agreement with the Arab Bank of Israel relating to computer services that Matam provides, which includes operating services, computer systems development, consultancy services, organization and method services, back-ups, training and other services.

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. 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.
In 2009 a project was begun to upgrade the Bank's international communications network for the Bank's US and European subsidiaries and its representative offices. 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. 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.

In 2009, the Group invested some NIS 625 million in equipment, as compared with NIS 601 million in 2008. 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 2009 (as in 2008) 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.)

In 2009 development began on an internet-base sub-custody system for customers (LINCS project). The system will be used by global custodians and internal users.

In 2008 a new Direct Surfing system for retail customers came on- line, and in 2009 for wealthy customers, private banking customers and Leumi Direct customers as part of the infrastructure to all the segments of the Bank.

In 2009, a new version of the internet sites for the Bank's overseas subsidiaries came on line, based on a new content management system (of Vignette 7). In addition new marketing websites came on-line, as part of the infrastructure established for all Group marketing websites, including: the Arab Israel Bank site, Leumi Mortgage site, First Direct and the "Learning from Home" site.

The Collateral and Lev systems become operational in Arab Israel Bank in 2008. The new collateral system became operational in all the branches of Bank Leumi in January 2009 and the Lev system at the end of February 2009.

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 86 million in 2009 (some NIS 121 million in 2008). The principal issues were Basel II, pension counseling, information technology directives, and SOX 404.

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.

At the end of 2009 the Training and Matam units (O & M and Security) building (MI) was opened. The Training building is a unique construction enabling learning in various forms (frontal of computer classes etc.). The building is one of the most advanced training buildings in Israel. The level of satisfaction of the users according to surveys carried out is very high.

Matam has been certified for ISO standards in the subjects of: software quality, data security, quality assurance in the Real Estate and Procurement Department and work safety assurance.

The Real Estate and Procurement Department promotes the subject of environmental quality at national level and also combines together "green" and social projects: for example, the "Kol Dodi" project which converted electric/diesel fuel water heaters to solar heaters for needy families, thus contributing to the quality of the environment.

See Note 7 to the Financial Statements for further details.

Intangible Assets

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

2. 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.

3. 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.

4.. 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.

Operating Segments in the Group

This chapter describes the business development according to operating segments.

For a description of the methodology of the operating segments, see above pages 21-23.

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

	Credit to the Public			Deposits of the Public			Total Assets		
	2009	2008	Change	**2009**	2008	Change	**2009**	2008	Change
Segments	NIS millions		%	NIS millions		%	NIS millions		%
Households(1)	**66,889**	62,145	7.6	**118,930**	120,846	(1.6)	**67,530**	62,775	7.6
Small businesses(2)	**17,653**	18,161	(2.8)	**15,057**	14,475	4.0	**17,669**	18,183	(2.8)
Corporate banking(3)	**69,089**	76,563	(9.8)	**25,324**	23,111	9.6	**71,685**	79,962	(10.4)
Commercial banking(4)	**43,516**	48,488	(10.3)	**33,533**	29,723	12.8	**44,833**	50,048	(10.4)
Private banking	**6,439**	6,455	(0.2)	**41,158**	38,085	8.1	**11,323**	10,730	5.5
Financial management capital markets and others	**1,083**	1,403	(22.8)	**16,416**	18,543	(11.5)	**108,735**	89,094	22.0
Total	**204,669**	213,215	(4.0)	**250,418**	244,783	2.3	**321,775**	310,792	3.5

(1) Credit to households also includes housing loans (mortgages). After neutralizing this credit, credit (banking and financial) to households increased by 3.2% Housing loans amounted to NIS 3.8 billion at the end of 2009, having increased by 9.4% (The rate of increase in 2008 was 6.5%.)

(2) After neutralizing the effect of segmentation between the segments, there was an decrease of 2.0%.

(3) There was an decrease of some NIS 7.6 billion in credit in the corporate banking segment in activities in Israel, and an decrease of 10.3% overall, or 11.0% after neutralizing the effect of segmentation.

(4) After neutralizing the effect of segmentation between the segments, there was a decrease of 9.1% only.

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

	Guarantees and Documentary Credit			Securities Portfolios, including Mutual Funds		
	2009	2008	Change	**2009**	2008	Change
Segments	NIS millions		%	NIS millions		%
Households	**484**	568	(14.8)	**87,282**	66,648	31.0
Small businesses	**1,300**	1,219	6.6	**5,353**	3,562	50.3
Corporate banking	**22,119**	21,319	3.8	**82,712**	52,090	58.8
Commercial banking	**6,808**	7,136	(4.6)	**38,987**	35,362	10.3
Private banking	**495**	391	26.6	**68,913**	59,141	16.5
Financial management – capital markets and others	**525**	390	34.6	**118,429**	79,050	49.8
Total	**31,731**	31,023	2.3	**401,676**	295,853	35.8

Following are details of the net profit and the net operating profit according to operating segments:

	Net profit, after neutralizing special salary expenses			Net operating profit, after neutralizing special salary expenses (1)		
	2009	2008	Change	**2009**	2008	Change
Segment	NIS millions		%	NIS millions		%
Households (2)	**157**	852	(81.6)	**157**	650	(75.8)
Small businesses	**187**	260	(28.1)	**187**	242	(22.7)
Corporate banking	**1,012**	303	234.0	**1,012**	301	236.2
Commercial banking	**310**	336	(7.7)	**310**	310	0.0
Private banking	**116**	64	81.3	**116**	61	90.2
Financial management – capital markets and others	**223**	(1,286)	+	**195**	(1,285)	+
Total	**2,005**	529	279.0	**1,977**	279	608.6

(1) After neutralizing special salary expenses, as detailed above on page 70.
(2) The profit from extraordinary items of the sum of 202 million NIS in 2008, which derived from the allotment of share capital of Leumi Card, was attributed to this segment.
For further details, see Note 28 to the Financial Statements.

Return on Equity According to Operating 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 operating 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 operating segments, calculated as stated above:

	Return on equity as a % of the net profit				Return on equity as a % of the net operating profit			
	2009	2008	**2009***	2008*	**2009**	2008	**2009***	2008*
Segment								
Households	**3.6**	19.7	**3.5**	20.6	**3.6**	14.9	**3.5**	15.7
Small businesses	**16.4**	20.7	**16.4**	21.3	**16.4**	19.2	**16.4**	19.9
Corporate banking	**14.4**	4.5	**14.4**	4.6	**14.4**	4.4	**14.4**	4.6
Commercial banking	**8.9**	8.5	**8.9**	8.8	**8.9**	7.8	**8.9**	8.1
Private banking	**18.8**	10.4	**18.8**	11.0	**18.8**	9.9	**18.8**	10.4
Financial management – capital markets	**10.5**	(46.8)	**10.4**	(34.9)	**10.5**	(46.8)	**10.4**	(34.9)
Others	**(11.1)**	(42.4)	**(11.1)**	(42.4)	**(17.6)**	(42.2)	**(17.6)**	(42.2)

* After neutralizing special salary expenses.

Below is the Return on Risk Adjusted Capital (RORAC) and the Economic Value Added (EVA) taking into account the cost of capital according to the multi-year return set out in the work plan, by operating segments:

The EVA and RORAC amounts were calculated with two alternatives (for 2009):

a. Allocation of all the capital of the Bank between the segments (according to actual capital adequacy under Basel I).

b. Allocation of minimum regulatory capital required (9% of weighted risk assets under Basel I).

Segment	Allocation of all the capital		Allocation of minimum regulatory capital	
	RORAC	EVA	RORAC	EVA
	%	NIS millions	%	NIS millions
Households	**3.6**	**(283)**	**4.3**	**(180)**
Small businesses	**16.4**	**73**	**22.3**	**100**
Corporate banking	**14.4**	**312**	**19.7**	**481**
Commercial banking	**8.9**	**(36)**	**11.9**	**47**
Private banking	**18.8**	**55**	**26.2**	**70**
Financial management – capital market	**10.5**	**10**	**20.1**	**184**
Other	**(11.1)**	**(92)**	**(16.7)**	**(81)**
Total to net profit	**10.2**	**39**	**14.5**	**621**

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

	2009				2008			
	4th quarter	**3rd quarter**	**2nd quarter**	**1st quarter**	4th quarter	3rd quarter	2nd quarter	1st quarter
	NIS millions							
Households	**(36)**	85	53	55	133	207	154	156
Small businesses	**34**	35	58	60	(23)	81	85	99
Corporate banking	**346**	313	228	125	(146)	64	177	206
Commercial banking	**69**	53	89	99	(30)	108	82	151
Private banking	**7**	39	40	30	24	(17)	23	30
Financial management – capital markets and others	**173**	39	-	(17)	(1,029)	(314)	120	(62)
Total	**593**	564	468	352	(1,071)	129	641	580

(For the criteria for classifying customers according to operating segments, see page 22).
For further details regarding activities of the principal subsidiaries and affiliates, see page 172 below.
A breakdown of the results of the operating 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 page 51.

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, cell phone 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 operating 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 counsellors, who have been trained by the Bank (the majority of whom are licensed investment counsellors), 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. Until 31st December 2009 counselling was given to 33,030 customers for the sum of 7.9 billion NIS.

For further details, see page 42.

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: 220 branches (including 13 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 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 further details, see pages 46-50

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 2009, there was a gradual recovery in the growth rate, which was expressed, *inter alia*, by an increase in the growth rates of per capita GDP and in expenditure for private consumption, compared with 2008 and with the first half of 2009.

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 2010, with an emphasis on the cellular field, and performance of a certain transactions by cellular phone, the internet, and adaptation of these services to different customer traits.

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 with the internet, 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:

- Maintaining pro-active service pursuant to the needs and wishes of the customers;
- 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;
- Quality: abiding by the rules of consistent and methodical documentation, while strictly adhering to rules of compliance with consumer laws and regulations;

- Provision of investment counseling and pension counseling services by making available suitable manpower and technological support;
- 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;
- 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

Capital market – brokers, insurance companies, fund managers

Pension savings – pension marketers (insurance companies, companies managing provident funds, supplementary training funds, pension funds and insurance agents, private pension consultants)

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 20-22

Marketing and Distribution

The following information is "forward-looking information." For the meaning of this term, see page 51.

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. Three new branches were opened during 2009 (including a counter), and four new branches are planned to be opened during the course of 2010 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: the 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. In addition, Leumi operates a number of communication channels on social networking media including a twitter account and banking blog. Through these channels, the Bank provides a service to customers, and general and marketing information for the use of the surfing public.

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 2009, the average number of positions assigned to the household segment totalled 6,853 of which 1,353 were management staff, compared with 6,953 positions in 2008, of which 1,405 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 page 164 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 12 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 2009, Leumi Mortgage Bank granted new loans (excluding refinancing) totalling some NIS 9 billion, compared with NIS 8.4 billion in 2008, a growth rate of some 7.1%.
The volume of refinancing at Leumi Mortgage Bank increased in 2009 to NIS 2 billion (18% of the Bank’s performance), compared with NIS 1.1 billion in 2008.
In addition, these sums include NIS 62 million in credit granted from designated deposits, the payment of which is contingent upon the extent of collections, compared with NIS 228 million last year.
Leumi Mortgage Bank’s aggregate share of the credit portfolio in the system as on 31 December 2009, according to the Bank of Israel’s activity report, was 25.2% compared with 25.6% in 2008.
The net profit in the mortgage sector totalled NIS 159 million in 2009, compared with NIS 162 million in 2008, a decrease of NIS 3 million.
The net interest income and the operating income decreased by NIS 118 million, from NIS 599 million in 2008, to NIS 481 million in 2009, as a result of the decrease in the financial differential which was partially offset by the increase in activity.
The provision for doubtful debts decreased from NIS 98 million in 2008 to a surplus of NIS 14 million in 2009 resulting from a reduction in the provision and debt collections.
Operating expenses amounted to NIS 237 million in 2009, similar to that of 2008.

For additional details on Leumi Mortgage Bank, see page 175 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:

	2009	2008	
	Annual Total	Annual Total	Change
	NIS millions		%
From bank funds	**9,817**	9,250	6.1
From Ministry of Finance funds:			
Directed loans	**58**	221	(73.8)
Non-recourse loans	**4**	7	(42.9)
Total new loans	**9,879**	9,478	4.2
Refinanced loans	**1,964**	1,113	76.5
Total performance	**11,843**	10,591	11.8

Following are condensed operating results of the Household Segment:

	Banking and finance	Credit cards	Capital market	Mortgages	Activity abroad	Total
	2009					
	NIS millions					
Net interest income:						
From external sources	**(826)**	**161**	**2**	**1,732**	**(5)**	**1,064**
Intersegmental	**2,406**	**(19)**	**(1)**	**(1,387)**	**18**	**1,017**
Operating and other income:						
From external sources	**609**	**441**	**522**	**121**	**8**	**1,701**
Intersegmental	**-**	**217**	**-**	**16**	**-**	**233**
Total income	**2,189**	**800**	**523**	**482**	**21**	**4,015**
Provisions for doubtful debts	**260**	**23**	**-**	**(14)**	**12**	**281**
Operating and other expenses:						
To external sources	**2,390**	**517**	**296**	**218**	**29**	**3,450**
Intersegmental	**7**	**(4)**	**-**	**19**	**-**	**22**
Operating profit (loss) before taxes	**(468)**	**264**	**227**	**259**	**(20)**	**262**
Provision for taxes	**(185)**	**81**	**81**	**99**	**(3)**	**73**
Operating profit (loss) after taxes	**(283)**	**183**	**146**	**160**	**(17)**	**189**
Minority interests' share in profits of consolidated companies	**-**	**(28)**	**-**	**-**	**-**	**(28)**
Net profit (loss)	**(283)**	**155**	**146**	**160**	**(17)**	**161**
% Return on equity						**3.6%**
Average balance of assets	**15,422**	**6,391**	**92**	**42,374**	**330**	**64,609**
of which: investments in companies included on the equity basis	**-**	**8**	**-**	**-**	**-**	**8**
Average balance of liabilities	**112,961**	**663**	**-**	**11,082**	**1,035**	**125,741**
Average balance of risk assets	**14,204**	**6,286**	**90**	**36,375**	**349**	**57,304**
Average balance of mutual fund and supplementary training fund assets	**-**	**-**	**37,588**	**-**	**-**	**37,588**
Average balance of securities	**-**	**-**	**45,212**	**-**	**157**	**45,369**
Average balance of other assets under management	**162**	**-**	**-**	**7,271**	**-**	**7,433**
Margin from credit-granting activities	**688**	**130**	**1**	**209**	**(5)**	**1,023**
Margin from accepting deposits	**770**	**11**	**-**	**40**	**13**	**834**
Other	**122**	**1**	**-**	**96**	**5**	**224**
Total net interest income	**1,580**	**142**	**1**	**345**	**13**	**2,081**
Balance of credit to the public	**15,548**	**6,496**	**99**	**44,428**	**318**	**66,889**
Balance of deposits of the public	**111,730**	**20**	**-**	**6,190**	**990**	**118,930**

The Household Segment (cont.):

	Banking and finance	Credit cards	Capital market	Mortgages	Activity abroad	Total
	2008					
	NIS millions					
Net interest income:						
From external sources	(1,940)	161	4	2,093	(18)	300
Inter-segmental	3,972	(43)	(3)	(1,630)	41	2,337
Operating and other income:						
From external sources	662	446	451	122	8	1,689
Inter-segmental	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	2,185	441	265	221	29	3,141
Inter-segmental	3	(3)	–	17	–	17
Operating profit (loss) before taxes	293	330	187	263	(8)	1,065
Provision for taxes	160	106	69	101	–	436
Operating profit (loss) after taxes	133	224	118	162	(8)	629
Minority interests' share in profits of consolidated companies	–	(13)	–	–	–	(13)
Net operating profit (loss)	133	211	118	162	(8)	616
Profit from extraordinary items after taxes	–	202	–	–	–	202
Net profit (loss)	133	413	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	-	-	-	8
Average balance of liabilities	108,455	439	–	12,000	1,023	121,917
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 operating segments.

Main Changes in the Volume of Activity

Total credit to households in 2009 totaled NIS 66.9 billion, an increase of 7.6%. of which consumer credit totaled NIS 22.0 billion, an increase of 4.4% and credit for housing totaled NIS 44.4 billion, an increase of 9.4%.

Total deposits from the public decreased by 1.6% mainly in banking and finance, which decreased by NIS 1.2 billion.

There was an increase in the securities portfolios of the segment of some NIS 20.7 billion, or 31.0%, mainly resulting from a rise in market values and increased net activity.

Main Changes in the Net Profit

Net profit from the household segment totaled NIS 161 million in 2009, compared with NIS 818 million in the corresponding period in 2008, a decline of NIS 657 million (80.3%). Operating profit after taxes totaled NIS 189 million, compared with NIS 629 million.

The main reasons for the decline in profits are as follows:

- A reduction of NIS 202 million in net profit derived from extraordinary items. In 2008 this profit segment was credited with an amount arising from the allocation of 20% of the equity of Leumi Card to Kanit Investment Management and Finance Co.Ltd.
- A reduction of NIS 556 million (21.1%) in the financing profits deriving principally from the erosion of the financial margin in the unlinked shekel sector, due to the low interest rates.
- An increase of NIS 314 million (9.9%) in the operating expenses mainly due to the payment of a grant in respect of 2009 that was not paid in 2008.

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 51.

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 operating 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.
- Increasing the use of analytical models as supporting tools for decisions regarding client activities.

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 page 47 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 22 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 2009, the average number of positions assigned to the small business segment totaled 1,886 of which 462 were management staff, compared with 1,754 positions, of which, 398 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	Credit cards	Capital market	Mort gages	Real estate	Overseas activity Banking and finance	Overseas activity Real estate	Total
	2009							
	NIS millions							
Net interest income:								
From external sources	**698**	**19**	**1**	**7**	**251**	**57**	**3**	**1,036**
Intersegmental	**(76)**	**(3)**	**-**	**(4)**	**(64)**	**(34)**	**1**	**(180)**
Operating and other income:								
From external sources	**276**	**99**	**24**	**-**	**44**	**15**	**1**	**459**
Intersegmental	**-**	**(59)**	**-**	**-**	**-**	**-**	**-**	**(59)**
Total income	**898**	**56**	**25**	**3**	**231**	**38**	**5**	**1,256**
Provisions for doubtful debts	**159**	**2**	**-**	**-**	**46**	**18**	**3**	**228**
Operating and other expenses:								
To external sources	**556**	**43**	**9**	**-**	**87**	**40**	**2**	**737**
Intersegmental	**(1)**	**3**	**-**	**-**	**-**	**-**	**-**	**2**
Operating profit (loss) before taxes	**184**	**8**	**16**	**3**	**98**	**(20)**	**-**	**289**
Provision for taxes (benefit)	**65**	**3**	**5**	**1**	**35**	**(8)**	**-**	**101**
Net profit (loss)	**119**	**5**	**11**	**2**	**63**	**(12)**	**-**	**188**
% Return on equity								**16.4%**
Average balance of assets	**11,184**	**676**	**27**	**151**	**4,760**	**715**	**95**	**17,608**
Average balance of liabilities	**11,956**	**1,057**	**-**	**-**	**2,017**	**562**	**98**	**15,690**
Average balance of risk assets	**8,264**	**664**	**24**	**151**	**4,755**	**743**	**86**	**14,687**
Average balance of mutual fund and supplementary training fund assets	**-**	**-**	**1,541**	**-**	**-**	**-**	**-**	**1,541**
Average balance of securities	**-**	**-**	**3,279**	**-**	**-**	**3**	**-**	**3,282**
Average balance of other assets under management	**373**	**-**	**-**	**-**	**-**	**-**	**-**	**373**
Margin from credit-granting activities	**475**	**12**	**1**	**3**	**150**	**-**	**2**	**643**
Margin from accepting deposits	**66**	**1**	**-**	**-**	**8**	**14**	**2**	**91**
Other	**81**	**3**	**-**	**-**	**29**	**9**	**-**	**122**
Total net interest income	**622**	**16**	**1**	**3**	**187**	**23**	**4**	**856**
Balance of credit to the public	**11,130**	**757**	**36**	**148**	**4,780**	**699**	**103**	**17,653**
Balance of deposits of the public	**12,383**	**-**	**-**	**-**	**2,053**	**531**	**90**	**15,057**

Small Business Segment (continued)

	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
Inter-segmental	(111)	(5)	(3)	(7)	(140)	(36)	–	(302)
Operating and other income:								
From external sources	299	51	20	–	47	17	–	434
Inter-segmental	–	(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	514	21	7	–	77	87	–	706
Inter-segmental	–	2	–	–	–	–	–	2
Operating profit (loss) before taxes	343	12	14	2	129	(77)	1	424
Provision for taxes (benefit)	140	5	5	1	47	(8)	–	190
Operating profit (loss) after taxes	203	7	9	1	82	(69)	1	234
Profit from extraordinary items after taxes	–	18	–	–	–	–	–	18
Net profit (loss)	203	25	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 a decline of NIS 508 million (2.8%),mainly as a result of domestic activities. The total deposits of the public in Israel increased by NIS 582 billion, (4%) all of which was from domestic activity.

The securities portfolios recorded an increase of NIS 1.8 billion (50.3%).

Main changes in the net profit

Net profit in the small business segment totaled NIS 188 million in 2009, compared with NIS 252 million in the corresponding period in 2008, an decrease of 25.4%. Operating profit after taxes totaled NIS 188 million, compared with NIS 234 million in the corresponding period in 2008, an decrease of 19.7%.

The decrease in profit derived mainly from a decrease in profits from financing activities totaling NIS 50 million (5.5%) deriving principally from a decline in credit to the public and in the financial margin, from an increase in provisions for doubtful debts in the sum of NIS 46 million (25.3%) that represents 1.3% of the credit portfolio at the end of 2009, and from an increase in operating expenses of NIS 31 million (4.4%).

The entire negative influence above was as a result of the segment's domestic activities, whereas the segment's overseas activities, mainly in Romania, offset in part the decline in the segment's domestic activities.

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), operates 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 and preparing to implement and assimilate the Basel II regulatory directives that came into effect as of 31 December 2009; as well as the directives regarding measurement and disclosure of impaired debts, credit risks and provisions for credit losses that become effective from 1 January 2010.

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.

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(1) Regarding the Construction and Real Estate Division, see below on pages 142-146.

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 page 51

With the increasing signs of recovery that are being felt in certain sectors and areas of the population, the Bank is adopting a broader credit policy. This policy is expressed, through an increased risk appetite, flexibility with criteria and parameters in the field of credit, and an emphasis on financing in the sectors of the economy that are characterized by a potential for growth without a high level of risk.

However, the Bank will continue to implement a cautious and responsible 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), and placing emphasis on financing customers in the sectors of the economy that are characterized by a potential for growth and a suitable risk level.

Restrictions, Legislation, Regulations and Special Constraints that apply to the Segment

The Bank operates 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 (see below on page 220).

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.

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 enhance 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.
The financial crisis that began to be felt significantly in the fourth quarter of 2008, brought to an end a record period of raising funds in the capital market through institutional investors by companies in the Israeli economy. Capital raising outside the banking system, which constituted an alternative to bank credit in the years preceding the crisis, was significantly reduced following the crisis, and the non-bank

source of financing has disappeared almost completely, even for companies that in the past held a low risk rating.

The “dehydration” in the capital market as a result of both the crisis that befell the financial entities, and from the new reality in which companies find themselves, where many of them will have difficulty in maintaining the payments to debenture holders that will be required in the coming years. This significant slowdown in capital market activity, caused a return of borrowers to the banking system.
As of the second half of 2009, a revival in the local capital market has been felt, and some Israeli companies returned to raising capital from sources in the capital market and institutional entities.

Regarding the developments in each of the sectors that comprise the segment, see pages 85-93 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.

For the issue of establishing an advanced system for managing the credit portfolio in the context of Basel 2, see the section on Strategies on Page 224.

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 22 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.

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. In the first half of 2009 a change in the competitive arena emerged, due to foreign institutions and banks refraining from granting credit to the corporate segment. By the second half of 2009 a gradual return to the credit market was witnessed we witness the return of credit market gradually, especially with first-rate companies.

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 2009, the average number of positions assigned to the segment totaled 1,190 positions, of which, 462 were management positions, compared with 1,108 positions in 2008, 411 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 page 51

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 138 above under the corporate banking segment.

Project financing using the closed construction lending tool is carried out *inter-alia* through operational systems 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 2009 reached the rate of 5.7%, compared with the exceptional excess of 2.27% at the end of 2008. Pursuant to the aforementioned directive, when the minimum capital ratio is over 10%, then the bank is not required to make a provision for the excess in the sector according to the formula set out in the directive. As the minimum capital ratio is within the requirements of the directive, the Bank did not make an additional provision totalling 308 million NIS in respect of the excess in this sector.

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. This situation continued until the end of the first quarter of 2009, followed by a process of emerging from the crisis and renewed growth.

As is commonly known, in 2006 and 2007, real estate companies in Israel sharply increased their debenture raising activities. As a result of the crisis, there was a halt in raising debentures in 2008, which renewed moderately in 2009. Furthermore, 2009 was characterized by debt arrangements by companies with some of the debenture holders for spreading the debts. In the majority of cases, the debt arrangements were with companies whose operations are partly outside of Israel. In 2010 the Bank estimates that the extent of the corporate debenture issues will grow in comparison with 2009.

The residential construction sector in Israel displayed increased strength in overcoming the financial crisis in 2009, compared to other sectors in the economy. The operations within the sector were among the first to show signs of recovery from the end of the first quarter of 2009. These operations increased in strength significantly as the year progressed. In the secondary segment of luxury housing the recovery trend was more moderate and occurred at a later stage.

In connection with a communication from the Supervisor of Banks, dated 8 February 2010, on the subject of acquisition groups, see page 93 above.

In the commercial field, there are indications of a trend towards robustness which is expressed by a relatively high rate of occupancy and relative stability of rents payments collected and in yield rates from these assets.

Office construction experienced a certain weakness and as a result, a slight decline in occupancy rates and rents.

The predicted growth in 2010 will preserve the stability and may lead to improved occupancy percentages and rental prices in the office segment.

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.

For the issue of establishing an advanced system for managing the credit portfolio in the context of Basel 2, see the section on Strategies on page 224.

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 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. During 2009, there was a renewed recovery in the market, and by 2010, a growing and strengthening trend of non-banking financing is predicted.

Another trend that has significantly increased during the last two years 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. This trend weakened at the time of the crisis, but at present is again becoming more significant. At the same time, it appears that competition will also come from the capital market where there is an indication of an increase in the capital raising from corporate debentures in comparison with 2008 and 2009.

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 2010 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	Credit cards	Capital market	Mortgages	Overseas activity: Banking and finance	Overseas activity: Real estate	Total
	2009						
	NIS millions						
Net interest income:							
From external sources	**1,573**	**24**	**10**	**1,405**	**15**	**1**	**3,028**
Intersegmental	**(408)**	**(6)**	**(10)**	**(719)**	**2**	**5**	**(1,136)**
Operating and other income:							
From external sources	**680**	**166**	**26**	**57**	**6**	**2**	**937**
Intersegmental	**(1)**	**(119)**	**-**	**-**	**-**	**-**	**(120)**
Total income	**1,844**	**65**	**26**	**743**	**23**	**8**	**2,709**
Provisions for doubtful debts	**371**	**3**	**-**	**207**	**(2)**	**-**	**579**
Operating and other expenses:							
To external sources	**343**	**66**	**10**	**127**	**13**	**5**	**564**
Intersegmental	**4**	**-**	**-**	**-**	**-**	**-**	**4**
Operating profit (loss) before taxes	**1,126**	**(4)**	**16**	**409**	**12**	**3**	**1,562**
Provision for taxes (benefit)	**392**	**(1)**	**6**	**147**	**4**	**1**	**549**
Net profit (loss)	**734**	**(3)**	**10**	**262**	**8**	**2**	**1,013**
% Return on equity							**14.4%**
Average balance of assets	**49,392**	**478**	**63**	**27,115**	**577**	**87**	**77,712**
Average balance of liabilities	**25,686**	**2,803**	**-**	**5,102**	**533**	**287**	**34,411**
Average balance of risk assets	**61,493**	**538**	**40**	**27,228**	**747**	**74**	**90,120**
Average balance of mutual fund and supplementary training fund assets	**-**	**-**	**709**	**-**	**-**	**-**	**709**
Average balance of securities	**-**	**-**	**66,584**	**-**	**167**	**-**	**66,751**
Average balance of other assets under management	**256**	**-**	**-**	**-**	**-**	**-**	**256**
Margin from credit-granting activities	**882**	**9**	**-**	**529**	**14**	**1**	**1,435**
Margin from accepting deposits	**28**	**1**	**-**	**7**	**3**	**5**	**44**
Other	**255**	**8**	**-**	**150**	**-**	**-**	**413**
Total net interest income	**1,165**	**18**	**-**	**686**	**17**	**6**	**1,892**
Balance of credit to the public	**41,367**	**450**	**156**	**26,357**	**646**	**113**	**69,089**
Balance of deposits of the public	**20,289**	**-**	**-**	**4,630**	**57**	**348**	**25,324**

Corporate Banking Segment (continued)

	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
Inter-segmental	(1,392)	(15)	–	(648)	31	2	(2,022)
Operating and other income:							
From external sources	35	219	25	50	6	–	335
Inter-segmental	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	295	87	12	100	18	–	512
Inter-segmental	-	-	–	–	–	–	-
Operating profit (loss) before taxes	311	(8)	13	146	9	1	472
Provision for taxes (benefit)	117	(1)	5	54	3	–	178
Operating profit (loss) after taxes	194	(7)	8	92	6	1	294
Profit from extraordinary items after taxes	–	2	–	–	–	–	2
Net profit (loss)	194	(5)	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 a decrease in credit to the public of some NIS 7.5 billion (9.8%),primarily from domestic banking and financial activities. There was an increase in deposits of the public of some NIS 2.2 billion (9.6%).
There was an increase in activity in securities of some NIS 30.6 billion (58.8%), which derived primarily from an increase in activity and an appreciation in market values. In off-balance sheet activity, there was an increase in guarantees and documentary credit in the segment of 3.8%.

Main Changes in the Net Profit

Net profit in the corporate banking segment totaled NIS 1,013 million in 2009, compared with NIS 296 million in the corresponding period in 2008, an increase of 242.2%. The increase in profit derived mainly from an increase in the operating income, as a result of the profit from the sale of HOT and Bezeq shares that were credited to the segment, and a reduction in provisions for doubtful debts amounting to NIS 491 million. In 2008 a provision was recorded for the decline in value of the credit notes of Tower Semiconductors.

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 have been approved for the interested parties of the business companies, including shareholders and senior office holders.
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 182-189

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 26 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 182.

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 page 51.

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 page 47of 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, especially among those customers who also operate abroad, whether as a result of a decline in demand worldwide and as a result of the effect of the exchange rate; the decline in activities caused a effective lack of utilization of capital in machinery and equipment as well as a decline in investments in renewal, and an increased 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.

A moderate and gradual improvement in the in the activities of customers in the segment was evident from the second half of 2009, although there is a large amount of dependence among exporters on market developments abroad and on the exchange rate.

For details on the sectors of the economy, see pages 87-93 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, but the improvement in economic conditions that commenced in the second half of 2009 again led to increased 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 2009 totaled 1,874, of which 708 were management positions, compared with 1,931 positions in 2008, 725 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:

						Overseas activity			
	Banking and finance	Credit cards	Capital market	Mortgages	Real estate	Banking and finance	Capital market	Real estate	Total
	2009								
	NIS millions								
Net interest income:									
From external sources	**778**	**10**	**-**	**24**	**313**	**481**	**-**	**141**	**1,747**
Intersegmental	**(42)**	**(2)**	**-**	**(19)**	**(119)**	**(96)**	**-**	**(58)**	**(336)**
Operating and other income:									
From external sources	**212**	**60**	**50**	**1**	**29**	**45**	**10**	**11**	**418**
Intersegmental	**1**	**(40)**	**-**	**-**	**-**	**-**	**-**	**-**	**(39)**
Total income	**949**	**28**	**50**	**6**	**223**	**430**	**10**	**94**	**1,790**
Provisions for doubtful debts	**212**	**1**	**-**	**(10)**	**33**	**132**	**-**	**15**	**383**
Operating and other expenses:									
To external sources	**463**	**24**	**31**	**2**	**61**	**293**	**7**	**50**	**931**
Intersegmental	**-**	**-**	**-**	**1**	**-**	**-**	**-**	**-**	**1**
Operating profit (loss) before taxes	**274**	**3**	**19**	**13**	**129**	**5**	**3**	**29**	**475**
Provision for taxes (benefit)	**96**	**1**	**7**	**4**	**46**	**-**	**1**	**9**	**164**
Net profit (loss)	**178**	**2**	**12**	**9**	**83**	**5**	**2**	**20**	**311**
% return on equity									**8.9%**
Average balance of assets	**23,160**	**300**	**120**	**480**	**5,953**	**13,234**	**-**	**3,491**	**46,738**
of which: investments in companies included on the equity basis	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Average balance of liabilities	**21,576**	**755**	**-**	**128**	**2,019**	**8,580**	**-**	**484**	**33,542**
Average balance of risk assets	**22,229**	**307**	**55**	**477**	**5,988**	**12,367**	**-**	**3,206**	**44,629**
Average balance of mutual fund and supplementary training fund assets	**-**	**-**	**2,801**	**-**	**-**	**-**	**120**	**-**	**2,921**
Average balance of securities	**-**	**-**	**30,800**	**-**	**-**	**-**	**2,064**	**-**	**32,864**
Average balance of other assets under management	**616**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**616**
Margin from credit-granting activities	**532**	**5**	**-**	**2**	**151**	**199**	**-**	**75**	**964**
Margin from accepting deposits	**51**	**-**	**-**	**1**	**6**	**152**	**-**	**7**	**217**
Other	**153**	**3**	**-**	**2**	**37**	**34**	**-**	**1**	**230**
Total net interest income	**736**	**8**	**-**	**5**	**194**	**385**	**-**	**83**	**1,411**
Balance of credit to the public	**20,744**	**322**	**379**	**508**	**6,019**	**12,026**	**-**	**3,518**	**43,516**
Balance of deposits of the public	**23,103**	**-**	**-**	**72**	**1,990**	**7,991**	**-**	**377**	**33,533**

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
	2008								
	NIS millions								
Net interest income:									
From external sources	1,223	11	2	30	361	569	–	166	2,362
Inter-segmental	(377)	(3)	(1)	(24)	(170)	(179)	–	(85)	(839)
Operating and other income:									
From external sources	221	48	48	1	25	10	37	11	401
Inter-segmental	–	(32)	–	–	–	–	–	–	(32)
Total income	1,067	24	49	7	216	400	37	92	1,892
Provisions for doubtful debts	273	1	–	–	67	137	–	9	487
Operating and other expenses:									
To external sources	445	20	39	3	55	285	5	47	899
Inter-segmental	1	–	–	–	–	–	–	–	1
Operating profit before taxes	348	3	10	4	94	(22)	32	36	505
Provision for taxes	144	2	4	2	34	6	2	12	206
Operating profit after taxes	204	1	6	2	60	(28)	30	24	299
Group's share in the operating profits of companies included on an equity basis	–	1	–	–	–	–	–	–	1
Net operating profit	204	2	6	2	60	(28)	30	24	300
Profit from extraordinary items after taxes	–	26	–	–	–	–	–	–	26
Net profit (loss)	204	28	6	2	60	(28)	30	24	326
% return on equity									8.5%
Average balance of assets	27,191	288	25	375	5,928	13,861	–	3,008	50,676
of which: investments in companies included on an equity basis	–	4	–	–	–	–	–	–	4
Average balance of liabilities	19,069	709	–	110	2,125	8,707	–	857	31,577
Average balance of risk assets	25,314	295	29	353	5,970	13,669	–	2,729	48,359
Average balance of mutual fund and supplementary training fund assets	–	–	2,833	–	–	–	–	–	2,833
Average balance of securities	–	–	36,764	–	–	–	2,913	–	39,677
Average balance of other assets under management	963	–	–	–	–	–	–	–	963
Margin from credit-granting activities	542	6	1	3	140	210	–	67	969
Margin from accepting deposits	111	–	–	1	13	145	–	13	283
Other	193	2	–	2	38	35	–	1	271
Total net interest income	846	8	1	6	191	390	–	81	1,523
Balance of credit to the public	25,057	297	10	460	5,778	13,636	–	3,250	48,488
Balance of deposits of the public	18,481	–	–	75	1,908	8,600	–	659	29,723

Main Changes in the Volumes of Activity

The credit to the public declined by some NIS 5.0 billion (10.3 %), of which a decline of NIS 3.6 billion was from the activity of the segment in Israel.
Deposits of the public increased by some NIS 3.8 billion (12.8 %), of which some NIS 4.7 billion was in the segment in Israel and NIS 0.9 billion in overseas activities

Activity in securities increased by NIS 3.6 billion, at the rate of 10.3 %, which derived mainly from an increase in activity and an appreciation in market values. In off-balance sheet activity, there was a decline of 4.6 % in guarantees and documentary credit.

Main Changes in the Net Profit

Net profit in the commercial banking segment totaled NIS 311 million in 2009, compared with NIS 326 million in the corresponding period in 2008, a decline of 4.6% The decline in the net profit derived mainly from a decline in profits from extraordinary activities by some NIS 26 million T he net profit from ordinary activities totaled NIS 311 million, compared to NIS 300 mllion in 2008. The increase in profit derives from the reduction in the provisions for doubtful debts totaling NIS 104, all of which is in the activity in Israel and the decrease in the rate of the tax provision from 40.8% to 34.5% which contributed NIS 31 million net. On the other hand, income from activity in Israel decreased by NIS 107 million and expenses increased by NIS 32 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 operates a representative office 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 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 page 47 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. In 2009 the trend reversed and the markets began to emerge from the crisis and customers gradually adapted their investment portfolios to reflect the developments in the market.

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 assists 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 was assimilated in 2009 and operates in all centers of the division. In addition, use is made of the Reuters and Bloomberg systems as decision-making support information.

New Internet Sites for Subsidiaries Abroad

Leumi launched and upgraded new international websites for the Leumi subsidiaries overseas, with a line of uniformity with the international website that was also upgraded. There are currently advanced new and dynamic websites for the benefit of customers, which assist in presenting the Bank and its range of activities around the world. The information and the manner of its presentation are utilized as a premier level marketing tool *vis-à-vis* the customers and *vis-à-vis* the competition in Israel and worldwide.

The new websites will contribute to the image of the Leumi Group and generally to the image of the individual subsidiaries.

The process included building new websites for Panama and Uruguay.

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 2009, the average number of positions assigned to the segment totalled some 884 positions, of which 417 were management positions, compared with 845 positions in 2008, 378 of which were management positions.

Employees of the private banking segment undergo comprehensive training, including professional courses and managerial workshops in Israel and abroad.

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 page 189 below.

Following are condensed operating results of the Private Banking Segment:

	Banking and finance	Credit cards	Capital market	Mort gages	Overseas activity: Banking and finan	Overseas activity: Capital market	Overseas activity: Real estate	Total
	2009							
	NIS millions							
Net interest income:								
From external sources	**(298)**	**-**	**-**	**4**	**92**	**-**	**(1)**	**(203)**
Intersegmental	**453**	**-**	**-**	**6**	**173**	**-**	**6**	**638**
Operating and other income:								
From external sources	**29**	**1**	**141**	**5**	**132**	**129**	**1**	**438**
Intersegmental	**1**	**1**	**-**	**-**	**14**	**-**	**-**	**16**
Total income	**185**	**2**	**141**	**15**	**411**	**129**	**6**	**889**
Provisions for doubtful debts	**1**	**-**	**-**	**-**	**35**	**-**	**(1)**	**35**
Operating and other expenses:								
To external sources	**143**	**1**	**61**	**8**	**347**	**110**	**4**	**674**
Intersegmental	**-**	**1**	**-**	**-**	**1**	**-**	**-**	**2**
Operating profit (loss) before taxes	**41**	**-**	**80**	**7**	**28**	**19**	**3**	**178**
Provision for taxes (benefit)	**15**	**-**	**27**	**3**	**6**	**5**	**1**	**57**
Operating profit (loss) after taxes	**26**	**-**	**53**	**4**	**22**	**14**	**2**	**121**
Minority interests in profits of consolidated subsidiaries	**-**	**-**	**-**	**-**	**(5)**	**-**	**-**	**(5)**
Net profit	**26**	**-**	**53**	**4**	**17**	**14**	**2**	**116**
% Return on equity								**18.8%**
Average balance of assets	**1,322**	**51**	**-**	**389**	**9,295**	**-**	**47**	**11,104**
Average balance of liabilities	**24,178**	**-**	**-**	**713**	**16,564**	**-**	**280**	**41,735**
Average balance of risk assets	**1,448**	**50**	**-**	**381**	**5,976**	**-**	**48**	**7,903**
Average balance of mutual fund and supplementary training fund assets	**-**	**-**	**2,725**	**-**	**-**	**1,397**	**-**	**4,122**
Average balance of securities	**-**	**-**	**30,921**	**-**	**-**	**28,219**	**-**	**59,140**
Average balance of other assets under management	**296**	**-**	**-**	**-**	**-**	**-**	**-**	**296**
Margin from credit-granting activities	**13**	**-**	**-**	**5**	**45**	**-**	**1**	**64**
Margin from accepting deposits	**117**	**-**	**-**	**4**	**135**	**-**	**4**	**260**
Other	**25**	**-**	**-**	**1**	**85**	**-**	**-**	**111**
Total net interest income	**155**	**-**	**-**	**10**	**265**	**-**	**5**	**435**
Balance of credit to the public	**1,117**	**52**	**-**	**417**	**4,823**	**-**	**30**	**6,439**
Balance of deposits of the public	**23,273**	**-**	**-**	**727**	**16,935**	**-**	**223**	**41,158**

Private banking segment (continued)

	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)	(100)	–	(1)	(617)
Inter-segmental	661	–	–	10	232	–	3	906
Operating and other income:								
From external sources	36	1	118	5	124	100	1	385
Inter-segmental	1	1	–	–	13	–	–	15
Total income	183	2	118	14	269	100	3	689
Provisions for doubtful debts	1	–	–	–	7	–	–	8
Operating and other expenses:								
To external sources	151	1	40	7	249	119	1	568
Inter-segmental	1	-	–	–	1	1	–	3
Operating profit (loss) before taxes	30	1	78	7	12	(20)	2	110
Provision for taxes	14	–	29	3	–	2	2	50
Operating profit (loss) after taxes	16	1	49	4	12	(22)	–	60
Minority interests in profits of consolidated subsidiaries	–	–	–	–	(2)	–	–	(2)
Net operating profit (loss)	16	1	49	4	10	(22)	-	58
Profit from extraordinary items after taxes	–	3	–	–	–	–	–	3
Net profit (loss)	16	4	49	4	10	(22)	-	61
% return on equity								10.4%
Average balance of assets	1,448	49	–	231	8,269	–	64	10,061
Average balance of liabilities	22,922	–	–	597	14,239	–	301	38,059
Average balance of risk assets	842	49	–	217	6,196	–	61	7,365
Average balance of mutual fund and supplementary training fund assets	–	–	2,957	–	–	1,720	–	4,677
Average balance of securities	–	–	28,557	–	–	32,634	–	61,191
Average balance of other assets under management	292	–	–	–	–	–	–	292
Margin from credit-granting activities	16	–	–	3	22	–	1	42
Margin from accepting deposits	117	–	–	4	106	–	1	228
Other	13	–	–	2	4	–	–	19
Total net interest income	146	–	–	9	132	–	2	289
Balance of credit to the public	1,291	50	–	291	4,759	–	64	6,455
Balance of deposits of the public	23,098	–	–	719	13,967	–	301	38,085

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 110 billion as at 31 December 2009, compared with NIS 98 billion at the end of 2008, an increase of 12.2%. Deposits of the public in this segment declined by some NIS 3.1 billion (8.1%), which derived mainly from an increase of some NIS 3.0 billion in the segment's activities abroad, and NIS 0.2 billion in the segment's activities in Israel.
Credit to the public in this sector decreased by some NIS 16 million. The increase in deposits derived mainly from depreciation of the shekel against most other currencies. There was an increase in the value of securities, including mutual funds, of some NIS 8.1 billion (13.3 %), as a result of an appreciation in market values of securities and a growth in activities.

Changes in the Net Profit

Net profit of the private banking segment in 2009 totaled NIS 116 million, compared with NIS 61 million in the corresponding period in 2008, a increase of NIS 55 million, such being 90.2%.
The increase in profit derived mainly from the overseas subsidiaries; a growth of NIS 69 million in Luxembourg, NIS 23 million in Switzerland, NIS 12 million in Israel, which were partially offset by the decrease in activities in the US amounting to NIS 40 . The results of the activities abroad were influenced both by the changes in the exchange rates and also by the provisions for a decline in the value of securities made in 2008.

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 operating 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 operating 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 2009, the segment's profit totalled NIS 273 million, compared with a loss of NIS 1,473 million in 2008.

This segment includes the Group's share of the profits of companies included on the equity basis, as detailed below on page 161.

The operating income after taxes of the segment amounted to NIS 190 million in comparison with a loss of NIS 1,722 million.

The profit from operating activities is explained by the following factors:

- An increase of NIS 1,190 million in the net income from financing activities, arising mainly from an increase in value of investments in available-for-sale securities, and from profits from realization of investments in securities, compared with provisions for impairment in 2008;
- A profit in operating income of NIS 1,073 million, arising from the realization of available-for-sale securities (funds) at a profit, the realization of funds for trading, and profits from the severance pay funds, as opposed to a decline in the value of securities available-for-sale and trading in 2008, as well as positive exchange differences, as opposed to negative exchange differences in 2008.
- On pages 62-69 of the Directors' Report, in the explanations of the financing income and the operating income, further details are given in respect of the financing income as well as the operating income of the Bank, although relating mainly to this segment.
- A decrease in operating expenses in the sum of NIS 588 million, arising from a decrease in operating expenses not allocated to other operating segments, mainly a decrease in the liability for pensions of

pensioners, a decrease in the provision for severance pay and pensions, due to the profits of the severance pay fund and the provident funds in 2009, as against losses incurred in 2008. Additional information can also be found regarding the expenses item on page 69 of the Report.

Principal Developments in the Business Environment

In 2009, a slow return by the public to the capital market was evident after 2008, during which there had been a shift in public funds from the capital markets to bank deposits due to the crisis in the capital markets.

During 2009, there was a significant increase in the liquidity balances of the Bank in shekels, as a result of the broadening monetary policy of the Bank of Israel, which was reflected by a growth in deposits in the Bank and by a growth in the securities portfolio in shekels (Government Bonds).

In the foreign currency segment, there was a decrease in foreign currency balance sheet assets. There was a decrease in deposits in overseas banks, with public loans and deposits. These developments were balanced by forward transactions.

In 2009, activities in this segment were concentrated on the management of securities portfolio (*nostro)* and the trading rooms, as well as shekel and foreign currency liquidity management and close monitoring of market risks.

This policy of the Bank of Israel was expressed, *inter-alia,* by public offerings in the stock market and private offerings within Israel, and thereby extending the average duration of public deposits by means of a wide range of deposits and saving schemes.

The segment's results in 2009 were positively affected, in a significant way, by an increase in value of the groups securities *(nostro)* portfolios, that off-set the decrease in value that was recorded in 2008 and produced significant profits in 2009. For additional information, see Investments in Securities, page 95.

Critical Success Factors in the Segment
The critical success factors in the segment are: mainly human capital, supported by advanced computer systems, working in an efficient and flexible management framework of control and monitoring. The main factor for success is human capital, requiring managerial, analytical, professional and commercial abilities, in the area of capital markets in Israel and abroad. This ability relates to both operations in the capital market and to activities with and in the service of customers. Professionalism and constant updating is required regarding financial innovations, and in developments with implications on the capital markets, together with concentrated efforts to provide a response to the needs of customers and working in the proper time-frames.

Customers

The customers belonging to this segment are the mutual funds, provident funds, training funds, pension funds, commercial banks and investment banks, as well as other customers operating intensively in the capital markets.

Competition

The Bank faces strong competition in the field of its activities in the capital market and brokerage from investment houses, provident funds, training funds, and domestic and overseas banks.

Human Capital

In 2009, the average number of positions assigned to the segment was some 528 positions, of which 234 were management positions, compared with 413 positions in 2008, 195 of which were management staff positions.

Companies included on 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 equity basis totaled some NIS 2,178 million on 31 December 2009, compared with NIS 1,842 million on 31 December 2008.

Investments in the Shares of Companies included on Equity Basis (Table 13 (b) of Basle2):

	Balance Sheet Value (NIS millions)			Market Value (NIS millions)		Capital adequacy requirements 2009
	31 December	31 December	Change	**31 December**	31 December	
Name of Company	**2009**	2008	%	**2009**	2008	
The Israel Corporation Ltd.	**1,371**	1,186	15.6	**3,810**	1,184	123
Paz Oil Company Ltd.	**565**	485	16.5	**880**	571	51
Others	**242**	171	41.5	**-**	–	22
Total	**2,178**	1,842	18.2	**4,690**	1,755	196

The contribution of the companies included on equity basis to the Group's profit in 2009 was positive and amounted to a profit of NIS 81 million, compared with a profit of NIS 249 million for the corresponding period in 2008. The decrease in the contribution to the Group's profit in 2009 arose from a reduction in the profits of the Israel Corporation Ltd. ("the Israel Corporation"), compared to 2008, resulting from a decrease in the profits of 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 during 2009. 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):

	2009	2008	% change
The Israel Corporation Ltd.	**1**	157	-
Paz Oil Company Ltd.	**72**	82	(12.2)
Others	**8**	10	(20.0)
Total	**81**	249	(67.5)

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.

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 1,976 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 below. The Bank holds one conglomerate - The Israel Corporation Ltd.

Paz Oil Company 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.

At the request of the Bank, the Bank of Israel approved the sale of its holdings in Paz by 30 December 2010, provided that the Bank's holdings in Paz are transferred to a trustee. To this end, the Bank transferred its holdings in Paz to a trustee at the end of June 2009. The trustee is vested with all the rights that the shares confer – to vote as a shareholder at general meetings of Paz, although the right as a shareholder to appoint directors (and to vote as such at general meetings) and the entitlement to receive dividends, remains with the Bank. The Bank remains entitled to make decisions regarding the sale of shares to a third party or to distribute them as a dividend *in specie*.

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.

At the Bank's request, the Bank of Israel extended the permit issued to the Bank for the holding of Migdal shares, 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 31 August 2010, the trustee will sell the shares to a third party by no later than 31 December 2010. The trustee was vested with all the rights that the shares confer (excluding the right to receive dividends, and 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 31 August 2010).

On 3 March 2010, the Banking Law (Licensing) (Amendment No. 15) -2010.was published in the Official Gazette according to which, *inter-alia,* an insurance corporation operates solely within the insurance sector and thus is not considered to be a conglomerate.

Keshet Broadcasting Ltd.

On 13 September 2009, Leumi Partners Ltd (wholly owned subsidiary of the Bank) ("Leumi Partners") sign an agreement with GN Communication Industries Ltd (a wholly owned subsidiary of Mrs Gal Naor ("the Purchaser") for the sale of 4,124 ordinary shares in Keshet Broadcasting Ltd ("Keshet") and 20 deferred shares in Keshet, that constitute 20% of the issued and paid-up share capital in Keshet and for the sale of rights by virtue of shareholder's loans given by her to Keshet for the total sum of NIS 6.5 billion ("shares and rights sold") ("purchase agreement"). In respect of the shares and rights sold the purchaser will pay the sum of US dollars 6 billion. The purchase agreement is subject to pending conditions including receiving permits from the second broadcasting authority, Bank Hapoalim Ltd and The Board of Directors of Keshet.

7. "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 57.4 billion on 31 December 2009. 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 2009, the loss of the Others Segment totaled NIS 48 million, compared with a loss of NIS 189 million in 2008, an improvement of NIS 141 million. The following table presents a summary of the main changes, in NIS millions:

	2009	2008	Difference
Profit from extraordinary items	**28**	**-**	28
Operating activity at the Bank	**20**	79	(59)
Leumi Partners(1)	**32**	(56)	88
Leumi Capital Market Services	**34**	(4)	38
Other companies in Israel	**51**	(4)	55
Companies abroad	**15**	4	11
Tax adjustments(2)	**(228)**	(208)	(20)
Total	**(48)**	(189)	141

(1) Resulting mainly from an increase in value of securities.

(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.

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 operating segments, according to their proportionate share in the income from this activity.

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 page 8 of these Financial Statements.

Net profit from capital market activities totaled NIS 282 million, compared with NIS 229 million in the corresponding period in 2008, an increase of NIS 53 million. The increase in the net profit arose from the growth in the operating income totaling NIS 88 million that was partially offset by the increase in operating expenses totaling NIS 25 million

The following table presents data on the activities in the capital market as presented in the various operating 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
	2009							
	NIS millions							
Net interest income	**1**	**1**	**-**	**-**	**-**	**-**	**-**	**2**
Operating and other income	**522**	**24**	**26**	**50**	**141**	**88**	**146**	**997**
Total income	**523**	**25**	**26**	**50**	**141**	**88**	**146**	**999**
Operating and other expenses	**296**	**9**	**10**	**31**	**61**	**37**	**125**	**569**
Operating profit before taxes	**227**	**16**	**16**	**19**	**80**	**51**	**21**	**430**
Net profit	**146**	**11**	**10**	**12**	**53**	**33**	**17**	**282**

	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	133	544
Operating profit before taxes	187	14	13	10	78	45	21	368
Net profit	118	9	8	6	49	26	13	229

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.

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.

Data from the Central Bureau of Statistics relating to credit card purchases (data from all credit company) from December 2009 show a real increase of 9.4% in the amount of credit card purchases compared with the month of December 2008 (seasonally adjusted). In total, a rise of 4.6% in the amount of credit card purchases was recorded in 2009 compared to 2008. The increase was with all product groups (Manufacturing products, services, food and drink and other consumer goods).

The turnover of Leumi card's credit cards activity rose in 2009 at the rate of 5% compared with 2008. And the acquiring service turnover increased during this period at the rate of 5%.

During 2009, 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 820 million in 2009, compared with some NIS 789 million in 2008.

Leumi Card ended 2009 with a net profit of NIS 138 million, compared with NIS 146 million in 2008, a decrease of some 5.5% Net operating profit amounted to NIS 138 million, compared with NIS 129 million in 2008, an increase of 7%.

The following table presents a summary of income from credit card activities (in NIS millions):

	2009	2008	% Change
Net operating profit of Leumi Card	**138**	129	7.0
The Bank's share in the interchange fee, before tax	**72**	73	0
Card fees, before tax, collected by the Bank	**55**	79	(30.4)
Total	**265**	281	5.7

In addition, the Bank collected interest amounting to NIS 82 million in 2009 in respect of credit provided for the financing of purchases by credit card (in 2008 – NIS 85 million).

The following table presents data on credit card activities as presented in the various operating segments:

	Households	Small businesses	Corporate banking	Commercial banking	Private banking	Total
	2009					
	NIS millions					
Net interest income	**142**	**16**	**18**	**8**	**-**	**184**
Operating and other income	**658**	**40**	**47**	**20**	**2**	**767**
Total income	**800**	**56**	**65**	**28**	**2**	**951**
Provisions for doubtful debts	**23**	**2**	**3**	**1**	**-**	**29**
Operating and other expenses	**513**	**46**	**66**	**24**	**2**	**651**
Operating profit (loss) before taxes	**264**	**8**	**(4)**	**3**	**-**	**271**
Operating profit (loss) after taxes	**183**	**5**	**(3)**	**2**	**-**	**187**
The external shareholders' share in the profits of consolidated companies	**(28)**	**-**	**-**	**-**	**-**	**(28)**
Net profit (loss)	**155**	**5**	**(3)**	**2**	**-**	**159**

	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	**438**	**23**	**87**	**20**	**1**	**569**
Operating profit (loss) before taxes	**330**	**12**	**(8)**	**3**	**1**	**338**
Operating profit (loss) after taxes	**224**	**7**	**(7)**	**1**	**1**	**226**
The external shareholders' share in the profits of consolidated companies	**(13)**	**-**	**-**	**-**	**-**	**(13)**
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)	**413**	**25**	**(5)**	**28**	**4**	**465**

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.

For further details see note 18 (K) (2) of the financial statements.

C. Construction and Real Estate

This activity includes the activity in the field of construction and real estate in the Bank's various operating segments.

For further details see pages 142 under the operating segments.

The following table sets out data regarding construction and real estate activities, as presented in the various operating segments:

	Small businesses	Corporate banking	Commercial banking	Private banking	Overseas activity	Total
	2009					
	NIS millions					
Net interest income	**187**	**686**	**194**	**10**	**126**	**1,203**
Operating and other income	**44**	**57**	**29**	**5**	**20**	**155**
Total income	**231**	**743**	**223**	**15**	**146**	**1,358**
Provisions for doubtful debts	**46**	**207**	**33**	**-**	**17**	**303**
Operating and other expenses	**87**	**127**	**61**	**8**	**61**	**344**
Operating profit before taxes	**98**	**409**	**129**	**7**	**68**	**711**
Net profit	**63**	**262**	**83**	**4**	**45**	**457**

	Small businesses	Corporate banking	Commercial banking	Private banking	Overseas activity	Total
	2008					
	NIS millions					
Net interest income	183	537	191	9	110	1,030
Operating and other income	47	50	25	5	15	142
Total income	230	587	216	14	125	1,172
Provisions for doubtful debts	24	341	67	-	9	441
Operating and other expenses	77	100	55	7	48	287
Operating profit before taxes	129	146	94	7	68	444
Net profit	82	92	60	4	46	284

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:

	2009(1)	2008(1)	Change	**2009**(2)	2008(2)	Change
	NIS millions		%	NIS millions		%
The Bank	**1,251**	(644)	+	**1,216**	(453)	+
Consolidated subsidiaries in Israel (4)	**616**	432	42.6	**616**	432	42.6
Consolidated subsidiaries abroad (5)	**102**	(110)	+	**137**	(301)	+
Companies including on an equity basis (4)	**17**	164	(89.6)	**17**	164	(89.6)
Net operating profit	**1,986**	(158)	+	**1,986**	(158)	+
Profit (loss) of the subsidiaries abroad, in nominal terms (US$ millions) (6)	**29**	(26)	+	**29**	(26)	+

(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 increased by 1,542 NIS.
(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.

Following are the principal changes in the contributions of the profit centers (after translation adjustments):

The Bank

The increase in the net operating profit at the Bank derived mainly from:

– An increase of NIS 639 million in the net interest income;
– A decrease of NIS 482 million in the provisions for doubtful debts;
– An increase of NIS 1,583 million in operating income;
– A decrease of NIS 93 million in operating and other expenses;
– The increase in net interest income and in operating income arises mainly from an increase in value and profits from the realization of investments in securities.

Subsidiaries in Israel

The increase in the net operating profit of consolidated subsidiaries in Israel derived mainly from an increase in the profits of Leumi Mortgage Bank in the amount of NIS 25 million, and from the pro from Leumi Partners in the amount of NIS 37 million, mainly as a result of an increase in the value of the investments in securities, compared with a loss in the amount of NIS 46 million in 2008 and a reduction in the provisions for tax in respect of previous years in the sum of NIS 78 million, as a result of the signing of the agreement between the Bank and several of its subsidiaries and the Tax Authorities..

Subsidiaries Abroad

The increase in profits of subsidiaries abroad derived from an increase in profitability of the subsidiaries in Romania, Switzerland, Luxemburg and Leumi Re. The total contribution to profit of the subsidiaries abroad (excluding foreign branches), in a convenience translation to US dollars, totaled some US$ 28 million, compared with some US$ 6 million in the corresponding period in 2008. The contribution of the subsidiaries abroad to the net operating profit in shekels (after certain adjustments to comply with accounting principles in Israel, and after offsetting exchange rate differentials in respect of the sources of financing after the tax effect) totaled a profit of NIS 102 million, compared with a loss of NIS (110) million in the corresponding period in 2008.

Excluding the effect of the exchange rate differentials in respect of the net cost of the sources of financing, the profit in the subsidiaries abroad totalled NIS 137 million, compared with a loss of NIS 301 million in the corresponding period in 2008. This increase of NIS 438 million was derived from an increase in profits, primarily as a result of an increase in the value of securities, and from a decline in provisions for doubtful debts.

The following table presents a summary of the aforesaid data:

	For the year ended December 31	
	2009	2008
	NIS millions	
Operating profit (loss) of the subsidiaries in shekels (the Group's share) from ordinary activities	**96**	(23)
Exchange rate differentials in respect of the investment	**41**	(278)
Exchange rate differentials in respect of the net cost of the sources of financing	**(35)**	191
Total contribution of the subsidiaries (after offsetting the net cost of the sources of financing)	**102**	(110)
Total contribution of the subsidiaries without offsetting the cost of the sources of financing	**137**	(301)

For further details about the subsidiaries, see pages 179-189.

Companies Included on the Equity Basis

The decrease in the profits of the companies included on an equity basis derived from a decline in the profits of the Israel Corporation and Paz.

For further details, see page 161.

Activities according to the Group's Structure

The volume of activities in Israel rose in 2009 by 6.2% while the volume of activities abroad declined by 13.4%.

Credit to the public in activities in Israel totaled some NIS 182 billion at the end of 2009, compared with NIS 189 billion at the end of 2008, a rise of 3.8%. Credit to the public in overseas activities totaled some NIS 23 billion at the end of 2009, compared with NIS 24 billion at the end of 2008, a decline of 5.3 %.

Deposits of the public in activities in Israel totaled some NIS 220 billion at the end of 2009, compared with NIS 213 billion at the end of 2008, an increase of 3.4 %. Total deposits in overseas activities totaled some NIS 30 billion at the end of 2009, a decline of 5.1 %.

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		
Region	**2009**	2008	Change	**2009**	2008	Change	**2009**	2008	Change
			%			%			%
Israel	**285,399**	268,792	6.2	**181,935**	189,208	(3.8)	**220,194**	212,923	3.4
United States	**19,295**	22,033	(3.7)	**12,268**	13,810	(11.2)	**14,822**	15,971	(7.2)
United Kingdom	**8,091**	8,760	(7.6)	**6,825**	6,457	5.7	**5,603**	5,901	(5.0)
Switzerland	**5,458**	3,453	58.1	**1,837**	1,977	(7.1)	**4,178**	1,408	196.7
Luxembourg	**1,260**	5,312	(76.3)	**249**	111	124.3	**4,157**	7,111	(41.5)
Romania	**1,698**	1,874	(9.4)	**1,129**	1,204	(6.2)	**919**	979	(6.1)
Others abroad	**574**	568	1.1	**426**	448	(4.9)	**545**	490	11.2
Total	**321,775**	310,792	3.5	**204,669**	213,215	(4.0)	**250,418**	244,783	2.3

* 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:

	Net Profit		Change
	NIS millions		
Region	**2009**	2008	%
Israel [(1)]	**1,881**	516	265
United States [(2)]	**17**	31	(45)
United Kingdom [(3)]	**50**	(243)	+
Switzerland [(4)]	**37**	25	48
Luxembourg [(5)]	**6**	(192)	+
Romania [(6)]	**(7)**	(54)	+
Others abroad [(7)]	**30**	9	233
Total	**2,014**	92	+

The profit from activities abroad is shown according to their contribution in the consolidated financial statements.

1. Net profit in Israel increased by some NIS 1,365 million. Operating profit after tax at the Bank in Israel increased by some NIS 1,669 million (excluding companies included on the equity basis). The increase at the Bank derived mainly due to the reasons detailed on page 61 above.
   The net profit also increased at a number of subsidiaries in Israel, mainly: Leumi Mortgage Bank, Arab Israel Bank, Leumi Leasing 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 2009, compared with a higher appreciation in 2008, 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 positive, deriving from the decrease in the provisions for doubtful debts, and from the positive exchange rate differentials resulting from the depreciation of the shekel against the pound sterling.
4. The increase in profits of the subsidiary in Switzerland derived from the provisions in respect of the decline in value of securities made in 2008.
5. The increase in profit of the subsidiary in Luxembourg derived from the losses in respect of investments in securities incurred in 2008.
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 page 180.

Major Investee Companies *

The Leumi Group operates in Israel and abroad through subsidiaries which are: banks, a mortgage bank, finance companies and financial services companies. The Group also invests in non-banking corporations operating in the fields of insurance, infrastructure and real estate.
(See page 160 with regard to investments in non-banking corporations).

The Bank's total investments in subsidiaries and affiliates amounted to NIS 14,269 million on 31 December 2009, compared with NIS 12,518 million on 31 December 2008, and their contribution to the Group's net profit amounted to NIS 770 million, compared with NIS 295 million in 2008. After offsetting translation adjustments in respect of overseas investments, their contribution to the net profit was NIS 734 million, compared with NIS 503 million in 2008.

- for a definition of investee companies, see Note 1(B) to the financial statements.

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		
		2009	2008	**2009**	2008	Change
		%	%	NIS millions		%
The Bank [(2)]		**-**	-	**1,280**	(410)	+
Consolidated subsidiaries in Israel, total		**10.5**	8.3	**616**	449	37.2
of which:	Leumi Mortgage Bank	**5.8**	6.1	**131**	126	4.0
	Arab Israel Bank	**21.8**	20.4	**79**	73	8.2
	Leumi Card	**18.4**	36.7	**110**	134	(17.9)
	Leumi Partners[(3)]	**12.8**	-	**37**	(46)	+
	Leumi Securities and Investments	**58.1**	6.7	**30**	3	+
	Leumi Capital Market Services Ltd.	**112.9**	-	**35**	(3)	+
	Leumi L.P. Ltd.	**141.9**	4.8	**31**	1	+
	Leumi Real Holdings	**12.7**	16.9	**73**	84	(13.1)
	Leumi Industrial Development	**1.8**	2.5	**2**	3	(33.3)
	Leumi Agricultural Development	**0.5**	1.9	**-**	1	-
	Leumi Finance	**5.5**	6.9	**9**	11	(18.2)
	Leumi Leasing and Investments	**8.6**	5.9	**73**	48	52.1
	Others	**1.3**	2.9	**6**	15	(60.0)
Overseas consolidated subsidiaries, total [(2)]		**2.4**	-	**101**	(110)	+
of which:	Leumi USA (BLC)	**1.1**	2.1	**28**	47	(40.4)
	Leumi (UK)	**2.0**	-	**13**	(103)	+
	Leumi Switzerland	**4.1**	2.3	**23**	12	91.7
	Leumi Luxembourg	**39.9**	-	**16**	(58)	+
	Leumi Romania	**0.5**	-	**2**	(17)	+
	Leumi Re	**26.4**	5.2	**19**	5	280.0
Companies included on the equity basis, total		**1.3**	16	**17**	164	-
Group's total net profit		**10.2**	0.5	**2,014**	92	+

(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 180-181 .
(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.

Consolidated Subsidiaries in Israel

The Bank's total investments in consolidated subsidiaries in Israel amounted to NIS 6,340 million on 31 December 2009, compared with NIS 5,561 million on 31 December 2008. Their contribution to Group net operating profit amounted to some NIS 616 million in 2009, compared with NIS 432 million in 2008, a decrease of NIS 184 million, or 42.6 %. The increase in profit stems mainly from an increase in the profits of Leumi Partners and Leumi Leasing, which was partially offset by the decrease in the share of the profit of Leumi Card. The Group’s return on its investment in the above companies was 10.5 % in 2009 compared with 8.3% in 2008.

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 28 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 4,759 million at the end of 2009, compared with NIS 4,772 million at the end of 2008. Net profit of the Arab Israel Bank totaled NIS 79 million in 2009, compared with NIS 74 million in 2008, an increase of 7.9 %. The net return on shareholders' equity reached 21 % in 2009, compared with 19.5% in 2008.

Shareholders' equity of the Arab Israel Bank amounted to NIS 330 million as at 31 December 2009, compared with NIS 344 million as at 31 December 2008. The Arab Israel Bank distributed a dividend of NIS 80 million in respect of 2009.

The ratio of equity to risk assets as at 31 December 2009, reached 15.91 % according to Basel 2 and 19.18% according to Basel ,as compared with 17.84% as at 31 December 2008.

In December 2008, the Arab Israel Bank raised NIS 50 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 six 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 34 million in 2009, compared with NIS 31 million in 2008.

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 16 billion at the end of 2009, compared with NIS 12 billion at the end of 2008. The business activity of these companies complements the activity of the Bank. The net profit of these companies amounted to some NIS 84 million in 2009, compared with NIS 63 million in 2008.

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 932 million as at 31 December 2009, compared with NIS 948 million at the end of 2008.
The company's total assets totaled NIS 1,091 million as at 31 December 2009, compared with NIS 1,062 million at the end of 2008.
The net profit in 2009 totaled NIS 73 million, compared with a profit of NIS 48 million in 2008.

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 14,833 million at the end of 2009, compared with NIS 10,792 million at the end of 2008. Shareholders' equity amounted to NIS 157 million as at 31 December 2009. The company's net profit amounted to NIS 9 million in 2009, compared with net profit of NIS 10.6 million in 2008.

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 31 above regarding the issue of capital notes by the company.

Leumi Industrial Development Ltd.

Leumi Industrial Development's total assets amounted to NIS 105 million at the end of 2009, compared to NIS 104 million at the end of 2008. Shareholders' equity amounted to NIS 104 million as at 31 December 2009. The net profit of Leumi Industrial Development amounted to NIS 1.9 million in 2009, compared with a net profit of NIS 2.6 million in 2008.

Leumi Agricultural Development Ltd.

Leumi Agricultural Development's total assets amounted to NIS 99 million at the end of 2009, similar to the end of 2008. Shareholders' equity amounted to NIS 99 million as at 31 December 2009. The net profit of Leumi Agricultural Development amounted to NIS 0.5 million in 2009, compared with NIS 2.0 million in 2008.

(1) Including Leumi Industrial Development, Leumi Agricultural Development, Leumi Finance Company and Leumi Leasing & Investments Ltd.

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 2009 amounted to NIS 29 billion.
Total credit to the public at Leumi Mortgage Bank was NIS 44 billion at the end of 2009, compared with NIS 40 billion at the end of 2008, an increase of 9.8%. This amount does not include credit from deposits according to the extent of collection totaling NIS 7 billion, compared with NIS 8 billion at the end of 2008, 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 2009, according to the Bank of Israel report on activities, was 25.2%.

Leumi Mortgage Bank’s total assets amounted to NIS 44 billion on 31 December 2009, compared with NIS 40 billion at the end of 2008, an increase of 9.7%.

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.

	2009	2008	
	Annual Total	Annual Total	Change
	NIS millions		%
From Leumi Mortgage Bank funds	**8,898**	8,134	9.4
From Ministry of Finance funds:			
Directed loans	**58**	221	(73.7)
Non-recourse loans	**4**	7	(42.8)
Total new loans	**8,960**	8,362	7.1
Refinanced loans	**1,964**	1,113	76.5
Total performance	**10,924**	9,475	15.3

The net profit of Leumi Mortgage Bank amounted to NIS 131 million in 2009, compared with NIS 126 million in 2008, an increase of 3.5%. The net return on shareholders' equity came to 5.7% in 2009, compared with 6.1% in 2008.

Shareholders' equity of Leumi Mortgage Bank amounted to NIS 2,481 million at the end of 2009, compared with NIS 2,150 million at the end of 2008, an increase of 15.4% which is derived from the increase in capital amounting to NIS 200 million and from the accumulation of net profit.

On 30 June 2009 Leumi Mortgage Bank issued 44,220 shares of NIS 1 net value to the Bank in consideration of NIS 100 million, and on 29 September 2009 Leumi Mortgage Bank issued 43,046 shares of NIS 1 par value to the Bank in consideration of NIS 100 million.

The capital adequacy ratio, in accordance with Basel 1 (ratio of equity to risk assets) reached 9.66% at the end of 2009, compared with 9.24% at the end of 2008. The capital adequacy ratio, in accordance with Basel 2 reached 16.32% at the end of 2009 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 12 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 36 million to the Bank in 2009, compared with NIS 35 million in 2008.

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 E below.

On 4 February 2009, Leumi & Co. Investment House changed its name to Leumi Partners Ltd. Leumi Partners and its subsidiaries employ 37 employees, most of whom are economists, accountants or graduates in other subjects.

Leumi Partners finished 2009 with a profit of NIS 43 million, compared with a loss of NIS 48 million in 2008.

Shareholders' equity as at 31 December 2009 totaled NIS 464 million, compared with NIS 322 million at the end of 2008.

Below are details concerning developments and main fields of activity:

C. 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 48 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 2009 amounted to some NIS 1,711 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 nature of the investment.

The investment portfolio of Leumi Partners at 31 December 2009 includes, *inter alia*, holdings in:

Included Companies	**Details**	**Percentage Capital Holding**	**Investment in NIS '000s**
Archimedes		16.0%	10,631
Technorov Holdings (1993) Ltd	Investments in Hi-Tech Companies	20.0%	2,981
Keshet Broadcasting Ltd.(1)	License Holder for Second Television Channel	20.0%	13,417
Tene Investment Fund (2)	Investments in Kibbutz Industries	19.9%	18,693
Tene Irrigation Investment Fund L.P (2)		20.0%	19,006
Fox-Wizel Ltd	Clothing Manufacture and Marketing	12.2%	9,723
Fishman Engineering Ltd (2008		20.0%	28,587
Total			103,038
Shares available for Sale			
Partner Communications Ltd	Communications Company	4.99%	588,829
Super-Pharm Israel Ltd	Drugstore chain	18.0%	182,351
Africa Israel Properties Ltd	Real Estate	4.0%	34,951
Yashir IDI Insurance Co Ltd	Insurance	5.0%	16,565

(1) A contract of sale has been signed – for details see page 161 above

(2) Through Tene Investment in the Kibbutz Industries Fund and Tene Growth Capital (Investment Fund), which specialize in investments in mature companies among kibbutz industries, the following investments have been made:.

- Netafim (A.C.S) Ltd., which engages in the production and marketing of irrigation systems (through Tene Irrigation Investment Fund L.P.).
- 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.).
- 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.)
- Lumenis Ltd., which manufactures laser equipment for beauty and medical treatments (through L.M. Partners L.P.).
- Mobileye N.V. engages in computerized automotive vision systems.
- In addition, Leumi Partners has invested NIS 485 million in venture capital, real estate and private equity funds out of undertakings to invest some NIS 761 million. The balance of the amount is transferred to the funds on request.

D. 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.

E. Underwriting and Management of Issues

Between 1 July 2007 until September 2008, Leumi Partners Underwriting Ltd. suspended its underwriting activity. During that period, Leumi Partners was involved in underwriting through a joint partnership with Psagot Investment House Ltd. In September 2008 the joint partnership ceased activity and Leumi Partners Underwriting Ltd returned to activity. Until 18 February 2009, Leumi Partners Underwriters Ltd. operated by virtue of its qualification as a distributor, and was registered in the Underwriters Register from that date, and returned to operating as an underwriter. The company engages in the management and underwriting of private and public issues of securities in the capital market in Israel.

In 2009, Leumi Partners Underwriting was one of the leading underwriters in the Israel market. Leumi Partners Underwriting participated in public issues for a total amount of NIS 22 billion, and led 10 public issues for a total of NIS 4 billion.

F. Economic Analyses and Appraisals

The subsidiary Leumi Partners Research Ltd. engages in economic analyses, economic appraisals and financial counseling for economic entities in the Israeli economy.

The company prepares economic studies and valuations for 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.

G. Leumi Start Venture Capital Fund

Leumi Partners manages the Leumi Start Venture Capital Fund Ltd. 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 2009 amounted to NIS 11.9 million compared with NIS 11.4 million in 2008. The company's net profit in 2009 amounted to NIS 4.0 million, compared with NIS million 5.3 million in 2008.

For more information on the legal claims against the Trust Co., see Note 18(g)(5) in the Financial Statements.

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.

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 12.7 million (NIS 11.5 million in 2008)
- Estate and property management: , some NIS 1.9 million (NIS 1.7 million in 2008)
- Agent for deposits and loans, share transfers, and management of investment accounts, some NIS 14.1 million (NIS 20.5 million in 2008)
- Trustee for debenture and mutual fund holders, some NIS 3.9 million (NIS 3.8 million in 2008)

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 18 countries in 78 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 2009 amounted to NIS 4,345 million, compared with NIS 4,057 million at the end of 2008.

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 for the year ended 31 December					
	2009*	2008*	**2009****	2008**	**2009***	2008*	**2009****	2008**	Rate of change	
	%		%		NIS millions				%	%
Leumi USA (B.L.C.)	**1.1**	2.1	**0.7**	1.5	**28**	47	**17**	32	(40.4)	(46.9)
Leumi UK	**2.0**	-	**7.9**	-	**13**	(103)	**50**	(243)	+	+
Leumi Switzerland	**4.1**	2.3	**6.6**	4.8	**23**	12	**37**	25	91.7	48.0
Leumi Luxembourg	**39.9**	-	**41.6**	-	**16**	(58)	**17**	(64)	+	+
Leumi Re	**26.4**	5.2	**26.4**	3.1	**19**	5	**20**	3	+	+
Leumi Romania	**0.5**	-	**-**	-	**2**	(17)	**(7)**	(54)	+	+
Others	**-**	1.9	**2.9**	-	**-**	4	**3**	(1)	**-**	+
Total of overseas consolidated companies	**2.4**	-	**3.2**	-	**101**	(110)	**137**	(302)	+	+

* 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 (11.3) million in 2009, compared with NIS (14.8) million in 2008.
Leumi UK-NIS 37.0 million in 2009, compared with NIS (139.8) million in 2008.
Leumi Switzerland-NIS 14.2 million in 2009 compared with NIS (12.9) million in 2008.
Leumi Luxembourg-NIS 1.0 million in 2009 compared with NIS (6.1)million in 2008.
Leumi Romania-NIS (8.7) million in 2009 compared with NIS (37.3) million in 2008.

** 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 2009 amounted to a profit in the amount of NIS 137 million, compared with a loss of NIS 302 million in 2008.

The change in the contribution to profit derives mainly from the profits in most of the subsidiaries, and from the effect of the depreciation of the shekel against the euro, the pound sterling, and the exchange rate differentials partially offset by the appreciation of the shekel against the dollar. The net effect of the exchange rate differentials was to increase profits by NIS 41 million in 2009 compared with a NIS 278 million decrease of profits in 2008. Net financing expenses incurred by the Bank which partially offset these exchange differentials amounted to some NIS 35 million in 2009 compared with NIS 191 million in 2008.

The following table sets out a summary of the above data:

	For the year ended 31 December	
	2009	2008
	In NIS millions	
The units' profits (losses) in shekels (the Group's share of operating activities)	**96**	(23)
Exchange rate differentials in respect of the investment	**41**	(278)
Total	**137**	(301)
Exchange rate differentials in respect of the cost of sources of finance, net	**(35)**	191
Total contribution of the units (after offsetting the sources of finance, net)	**102**	(110)

The following table sets out details of the net profit (loss) of the overseas units, as reported by them:

	2009	2008	Change
	In millions		%
Bank Leumi USA ($)	**6.5**	21.5	**(69.8)**
Bank Leumi UK (£)	**2.2**	(4.0)	+
Bank Leumi Switzerland (CHF)	**8.9**	3.6	**147.2**
Bank Leumi Luxembourg (euro)	**3.9**	(14.1)	+
Luxinvest ($)	**-**	1.9	**-**
Leumi Romania (ron)	**12.7**	7.5	**69.3**
Leumi Re ($)	**3.2**	(2.2)	+
Others ($)	**(0.3)**	2.5	**-**
Overseas branches ($)	**(0.9)**	(32.0)	+
Total in $ as reported by the unit	**28.8**	(25.7)	+

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	
	2009	2008
Credit to the public	**5,990**	6,271
Deposits with banks	**2,850**	3,183
Securities	**1,941**	2,516
Other assets	**405**	540
Total	**11,186**	12,510
Deposits of the public	**8,388**	9,090
Deposits from banks	**641**	1,137
Other liabilities	**984**	1,286
Shareholders' equity	**1,172**	997
Total	**11,186**	12,510
Total trust deposits and managed securities	**9,263**	8,617

The assets of the consolidated overseas subsidiaries and branches of the Bank amounted to NIS 42 billion (US$ 11.2 billion) at the end of 2009, compared with NIS 48 billion (US$ 12.5 billion) at the end of 2008.

* The translation to US$ is a convenience translation of the data according to the representative rates of exchange on 31 December 2009 and 31 December 2008, 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) at 31 December 2009:

	USA	UK	Switzerland	Luxembourg	Romania
Total assets	5,098	2,142	1,457	809	441
Credit to the public	3,199	1,805	487	65	299
Deposits of the public	3,804	1,518	1,124	684	244
Shareholders' equity	629	164	174	25	93
Trust deposits and managed securities	3,134	530	4,537	807	1
Net profit	6	3	9	6	4
Return on equity (%)	0.9	2.3	5.2	12.9	4.7

The net profit for all the consolidated overseas companies, including overseas branches, as published by them, totaled US$ 28.8 million in 2009, compared with a loss of US$ 25.7 million in 2008, a increase of US$ 54.5 million.

The contribution of the overseas units to the net profit of the Group in shekels in 2009 amounted to a profit of NIS 137 million, compared with a loss of NIS 302 million in 2008.

The increase in the units' contribution in shekels derives mainly from increases in the profits of most of the subsidiaries, which were partially offset by the decline in the profitability of Leumi USA and the positive exchange rate differentials in 2009 as against the negative exchange rate differentials in respect of the overseas investments in 2008.

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$ 5.1 billion as at 31 December 2009, compared with US$ 5.8 billion at the end of 2008, and the annual profit amounted to US$ 5.7 million, compared with US$ 21.5 million in 2008, a decrease of 73 %.

The decline in the net profit resulted primarily from a decline in the finance profit as a result of the reduction in the credit portfolio and deposits, an increase in the provision for doubtful debts, and an increase in the operating expenses (for further information, see below in Leumi USA).

The return on equity of BLL Corp. reached 0.9% compared with 3.6% in 2008.

As at 31 December 2009, the equity amounted to US$ 629 million. The ratio of equity to total assets was 11.69% and the ratio of equity to risk assets was 14.64%.

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, two branches in Florida (the branch in Miami closed in April 2009), 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$ 5.1 billion on 31 December 2009, compared with US$ 5.76 billion at the end of December 2008. Total shareholders' equity amounted to US$ 484 million on 31 December 2009 compared with US$ 464 million at the end of 2008. Credit to the public totaled US$ 3,200 million at the end of 2009, a decrease of 10.2 %, while deposits of the public, which totaled US$ 4,276 million, decreased by 12.2%.

Customers' managed securities portfolios, which are not included in the balance sheet, totaled US$ 3,134 million at the end of 2009, compared with US$ 2,804 million at the end of 2008.

BLUSA ended 2009 with a net profit of US$ 6.3 million, compared with US$ 19.0 million in 2008.

The decline in the net profit, resulted primarily from a decrease in the profit from financing activities, which was as a result of a decrease in the volume of credit and a reduction in the interest margins (US$ 12.1 million), an increase in the provision for doubtful debts (US $9 million), and an increase in the operating expenses (US$ 8.1 million), mainly as a result of an increase in the cost of premium for insuring deposits to FDIC, and increases in computer expenses, and costs in connection with improving compliance procedures. On the other hand, the operating income increased by US$ 16.2 million, mainly as a result of the recording of losses in securities in 2008 and also improvement in income from other activities.

The return on equity of net profit in 2009 was 1.5% compared with 4.6% in 2008.

The balance of the provision for doubtful debts amounted to US $ 66.8 million at the end of 2009, constituting 2.05 % of total credit to the public. This provision is 0.84 times more than the non-performing loans.

The ratio of equity to total assets was 8.8% (7.7% in 2008) and the ratio of equity to risk assets was 14.47% (12.4% in 2008). These ratios exceed the US supervisory authorities' capital adequacy requirements.

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.

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$ 621 million at the end of 2009 (before offsetting mutual balances), compared with some US$ 1,267 million at the end of 2008. Credit to the public totaled US$ 121 million at the end of 2009, compared with US$ 130 million at the end of 2008. Deposits of the public totaled US$ 559 million at the end of 2009, compared with US$ 1,297 million at the end of 2008. The loss for 2009 amounted to US$ 1 million, compared with a profit of US$ 32 million in 2008.

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. Managerial responsibility was transferred to the finance division from 1 March 2009. In the second half of 2009 it was decided to transfer Georgetown's activities to the Central Branch in Tel Aviv.

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. The representative office was closed during the second half of 2009.

Total consolidated assets of Bank Leumi (UK) amounted to £ 1,323 million at the end of 2009, compared with £ 1,573 million at the end of 2008.

Deposits of the public decreased from £ 1,086 million at the end of 2008 to £ 938 million at the end of 2009. Bank Leumi (Jersey)'s portion of the balance of deposits at the end of 2009 was £ 309 million.

Credit to the public decreased from some £ 1,151 million at the end of 2008 to £ 1,115 million at the end of 2009. Bank Leumi (Jersey)'s portion of the balance of credit at the end of 2009 was £ 142 million.

Capital, reserves and surpluses totaled some £ 101 million at 31 December 2009, compared with some £ 96 million at the end of 2008.

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).

In February 2010, the Committee for Risk Management of the Board of Directors and the Audit Committee of the Board of Directors of Bank Leumi approved credit facilities to BLUK totaling £ 120 million to be utilized in a worst case liquidity scenario. This step was taken pursuant to the liquidity management directives published in October 2009 by the supervising authority over financial services in the U.K.(FSA).

The ratio of equity to assets amounted to 7.6% (6.1% in 2008).

Bank Leumi (UK) ended the year 2009 with a profit of £ 2.2 million, compared with a loss of £ 4.0 million in 2008. This resulted from an increase in the provision for doubtful debts and the reduction in the fair value of financial instruments made in 2008.

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 a representative office in Israel. 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 1,507 million at the end of 2009, compared with CHF 1,113 million at the end of 2008. The profit in 2009 amounted to CHF 8.9 million, compared with CHF 3.6 million in 2008, an increase of 147.2%.

Total capital and reserves, including inner reserves, amounted to CHF 179 million at the end of 2009 (of which CHF 2 million was inner reserves), compared with CHF 167 million at the end of 2008.

The total value of assets managed and/or held for customers totaled CHF 4.7 million at the end of 2009, compared with CHF 4.9 billion at the end of 2008.

During October 2009, Bank Leumi Switzerland was reprimanded by the Supervisor of Banks in Switzerland (FINMA) for a one-time incident that occurred at the Bank's Geneva Branch at the end of 2007.
The matter in question was an incident that was examined by FINMA that determined that the Branch had given FINMA incorrect information with regard to a specific customer. Moreover, it became apparent that the Branch had used the services of an attorney who had been in the service of the Bank for many years, but, who in this case, was also involved as an authorized signatory in the customer's account, which created a situation of conflict of interest.
FINMA appointed a firm of international accountants to examine the manner of implementing the findings of the examination by Leumi Switzerland.

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 were effected through the above-mentioned program during the years 2006- 2009.

In total, LII has raised US$ 1.087 billion within the context of this program, of which some US$ 747 billion had been repaid by the end of 2009
.
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$ 660 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 2009 amounted to some € 561 million, compared with some € 740 million at the end of 2008.
At the end of 2009, deposits of the public totaled some € 475 million compared with some € 498 million at the end of 2008. Trust deposits and securities held by customers of the bank totaled € 1,023 million at the end of 2009, compared with € 922 million in 2008.

Bank Leumi Luxembourg ended the year 2009 with a profit of € 3.9 million, compared with a loss of € 14.1 million in 2008. The loss in 2008 resulted 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 € 28 million, compared with € 20 million at the end of 2008.

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 November 2008,in light of the developments in the global financial markets and their effect on the bank's *nostro*, the Leumi Board of Directors approved an additional capital increase of € 6 million. The increase was 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 was carried out in April 2009.

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 30 branches and 7 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. The Board decided to close the branch in Bulgaria on 6 May 2009 as a result of the implications of the global economic crisis.

Leumi Romania ended 2009 with a profit of some 12.7 million Ron (some US $ 4.3 million), compared with a profit of some 7.5 million Ron (some US$ 3.0 million) at the end of 2008.

The increase in profit derives mainly from the increase in net financing profit in the amount of 10 million Ron, resulting from the reduction in the provisions for doubtful debts in the amount of some 10 million Ron.

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 2009, the balance of the deposit stands at some US$ 86 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 letter in January 2009 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 1,295 million Ron (US$ 441 million) at the end of 2009, compared with 1,343 million Ron (some US$ 456 million) at the end of 2008. Deposits of the public amounted to 716 million Ron (some US$ 244 million) at the end of 2009, compared with some 737 million Ron (some US$ 251 million) at the end of 2008, and credit to the public amounted to 879 million

Ron (some US$ 299 million), compared with some 905 million Ron (some US$ 308 million) at the end of 2008.

The capital, reserves and surplus amounted to some 273 million Ron (some US$ 93 million) at the end of 2009, compared with 260 million Ron (some US$ 87 million) at the end of 2008.

1 Ron = US$ 0.340 (at the end of 2008 - US$ 0.349).

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$ 39 million at the end of 2009, compared with US$ 41 million at the end of 2008.

Capital, reserves and surplus totaled some US$ 10 million on 31 December 2009, compared with some US$ 7.7 million at the end of 2008.

The year 2009 ended with a profit of some US$ 716 thousand compared with a profit of some US$ 540 thousand in 2008. The balance of off-balance sheet activity totaled some US$ 208 million in 2009, compared with US$ 237 million in 2008.

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. By the second half of last year, there were no developments whatsoever in this regard, and at this stage, it is not possible to estimate the results of the investigation or whether it will be continued or closed.

In 2008 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. There were no further developments in this matter during the last year

The Bank’s representative office in Sao Paolo was closed in January 2008. The offices in Rio de Janeiro were closed in March 2009.

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 2009 amounted to US$ 38.8 million, compared with US$ 34.4 million at the end of 2008, and the insurance reserves amounted to some US$ 15.8 million, compared with some US$ 15.1 million at the end of 2008. Shareholders’ equity amounted to US$ 17.4 million as of 31 December 2009. The profit for 2009 amounted to US$ 3.2 million, compared with a loss of US$ 2.2 million in 2008.

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

Leumi Global Managers ("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 company was established in 2004 and is registered in Luxembourg.

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 the field of asset management solutions, investment process management and handling institutional and private customers' investments. At the end of December 2009, the company managed assets amounting to US$ 158 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 2009, the LGM funds had accumulated some US$ 202 million.

For further details regarding income from capital market activity, see page 164.

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 2,178 million as at 31 December 2009, compared with NIS 1,842 million as at 31 December 2008. The contribution to net operating profit of companies included on the equity basis amounted to NIS 81 million in 2009, compared with NIS 249 million in 2008.

See page 161 with regard to the sale of non-banking companies.

For further details, see pages 161-163.

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
Ms. N. Sandhaus	– Manager of Legal Risks

Risk management is carried out by the Risk Management Control Department, which reports directly to the President and 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 President and Chief Executive Officer.

- 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. 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. Risk Management

In Leumi Group there is a culture of meticulous risk management, which is the key to effective risk management. Senior Management and the Board of Directors are actively involved in risk management of processes and determining the risk appetite of the Group. The Senior Risks Committee headed by the CEO, the specialized risks committees headed by the risk managers and the risks committee of the Board of Directors discuss all aspects of the various risk exposures and set limits in accordance with market conditions and forecasts.

For every area of risk, a chief risk manager has been appointed who is a member of Bank Management (as detailed above), whose responsibility is to determine policy and its implementation at Group level. The Risk Manager is responsible for ensuring the existence of quality risk management by determining guidelines, controls, research and development, investment in human resources and reports to management and the risk management control committee of the Board of Directors. In addition, for every financial instrument or customer service, a product manager is appointed who is responsible for mapping out, identifying and assessing all the risks inherent in the activity, an especially important matter in connection with new products.

The Risk Management Control Department (RMCD) is responsible for maintaining comprehensive and independent risk management throughout the Group. The RMCD fulfills a key function in promoting understanding by Bank Management and senior management of the overall risk profile of the corporation, and ascertaining that all material risks are identified, assessed and managed. The areas of responsibility of the RMCD include also the following up or development of methodologies for managing and assessing risks in accordance with qualitative standards accepted worldwide. The RMCD leads the Capital Adequacy Assessment Process in the Group.

The importance attached by Leumi Group to risk management control, is expressed in:

- The setting up of a senior risk management committee headed by the CEO. All the risk managers, the Internal Auditor and the Chief Risk Controller are members of the Committee.

- The setting up of a committee of the Board of Directors for risk management.

- Setting the subject of excellence in risk management as a central target of Group strategy.

- Providing large budgets for the subject of risk management and the allocation of high-level manpower resources.

2. Policy and Material Risks

Leumi attaches great importance to risk management with the aim of the being the most profitable banking group in Israel over the long term. Improving profitability is carried out while managing the level of risk as is reflected by capital adequacy ratios and in current risk management policy in the Group. Leumi focuses its exposures only on activities for which it has the expertise required for assessing and managing risk.

In the Bank and the principal subsidiary companies there are policy documents relating to managing principal types of risk. As part of policy, risk appetite, limits and authorities are determined, and there are also control systems and periodic management reports examining the limits against the actual position.

There is generally segregation between those taking risk and those controlling risk, and there are a number of levels of control: control by immediate management, control at unit-headquarters level (area, division, and department), professional control by content experts in the various types of risk, risk management control and internal audit of the appropriateness of the processes, procedures and limitations.

The main risk of the Group is credit risk, which includes credit to the public, banks, governments, securities, derivatives and the like. This risk matches the core business of the Group and expresses itself in activity with corporate, commercial and retail customers, as well as nostro activity. Bank policy in Israel is to be a dominant factor in all types of credit in order to create a spread of risk. The Bank's aim is that management of the loan portfolio, determination of the level of working facilities with borrowers, limitations on the loan portfolio, and measuring concentrations will be in terms of risk and not in terms of exposure. The allocation of dealing with customers between the lines of business is carried out in accordance with the size of indebtedness and the level of complexity/specialization of the type of transaction in order to ensure the required level of expertise for dealing with each sector and type of activity.

Market risk, including liquidity risk, is the second most important risk that the Bank takes upon itself. The routine management of market risks is intended to support the achievement of business targets, while estimating the forecast profit from managing the risks against the damage likely to emanate from exposure to these risks. Exposures to market risk are managed dynamically at Group level. The system of limitations determined by the Board of Directors delineates the impact of exposure on the economic value, accounting profit, and liquidity position from unexpected changes in the various risk factors.

In the Bank's activity as a financial intermediary, there are operational risks that also include legal risks, compliance risks and the subjects of business continuity and information security. Operational risk management is carried out according to the highest (best practice) standards in all parts of the Group.

3. Market and Liquidity Risks

3.1 Strategy for Management of Market and Liquidity Risks

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 management of market risks is intended one the one hand to support the achievement of business goals by assessing the damage that can result from exposure to risks and its limitation, in comparison with the forecasted profit from them, and on the other hand is intended to reduce the level or risk deriving from the Bank's ongoing activity. This is after taking into account the volume of activity, limitations and costs of hedging activity, changes occurring in the business environment in in Israel and throughout the world, instructions and requirements of the Bank of Israel, and in developments occurring worldwide in the subject of measurement and methods of managing risks and adapting them for the purposes of the Group and the Bank. The Bank manages exposures to market risks in a dynamic manner.

The market risk management policy prescribes limits on financial exposure. These 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 position to unexpected changes in the various risk factors, such as interest rates, the CPI, exchange rates, etc.

Market risks management at Group level is carried out at the overall level of both the banking portfolio and the trading portfolio. However, the Bank has specific limits for the trading portfolios and for each of the subsidiary companies.

During 2008-2009, a number of limits were made more stringent in the area of market risk management, including limits on nostro portfolio activity.

Taking into account the Bank's forecast of stabilization and moderate improvement in the economy for 2010, the Board of Directors authorized the taking of market risks and at a level slightly higher than in the years 2008-2009, which is expressed in changes in the limits.

The limits set at Board level were adapted to the risk appetite, the Bank's targets, and to a changing environment. On the one hand, limits that were effective in the light of targets set for 2010 were expanded, and on the other hand, limits found to be ineffective were made more stringent.

The Bank implements Proper Conduct of Banking Business Directive No. 339 of the Supervisor of Banks, in the matter of market risk management of the Group. The directive stipulates basic principles for the manner of managing and controlling risks, including the responsibility of Management and the Board of Directors, definition of means of control and the tools for measuring risk, and means of control and supervision of these risks.

In 2008, the Bank of Israel published a Provisional Order based on guidelines of the second pillar of Basel II, including a directive for managing interest rate risk. During 2008-2009, the Bank carried out a gap analysis and prepared an action plan to close the gaps. Most of the gaps were dealt with in 2009 and the remainder will be dealt with during 2010.

Part of the information in this chapter is "forward looking information". For the meaning of this term, see the section "Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report" on page 51.

3.2 Structure and Organization of the Market Risk Management Function

The Management Committee for Current Matters headed by the President and Chief Executive Officer, which meets every week, reports on the situation of exposures and compliance with the limits determined by the Board of Directors for exposure to market and liquidity risk. The President and Chief Executive Officer reports to the Board of Directors once every month to six weeks in the framework of the CEO's Report to the Board of Directors.

Group risk management policy is discussed, formulated and controlled in the framework of the Assets and Liabilities Committee (ALCO) headed by the Manager of Market Risks and with participation of the members of the committee appointed by the CEO.

The committee deals with the following subjects:

- Formulates principles for market risk management in the Group.
- Verifies that the daily business activity is carried out in accordance with the principles of market risk management.
- Examines the mix of assets and liabilities, from the perspectives of repayment date, liquidity and changes required in it.
- Ascertains that limits on market risk, including liquidity risk, are appropriate and complied with continuously (including the delegation of limits to the various units).
- Examines matters of principle connected with asset and liability pricing policy, while referring to the financial margin, changing market conditions, customers, etc.
- Verifies the implementation of Group risk policy in the various subsidiary companies.
- Discusses the financial investment policy of the Bank and the subsidiary companies.
- Examines the possible implications of customer activity and changes in the domestic or international business environment on the market risk of the Bank and the Group.
- Examines the activity, recommendations and effectiveness of the Market Risk committees of the subsidiary companies.
- Verifies that the procedure for starting an activity that involves new risk is implemented from the perspective of market risk.
- Discusses methods of measuring market risk.
- Discusses various subjects defined by the Senior Risk Management Committee.
- Makes decisions arising from the activity of the Committee and follows up their implementation.
- Challenges capital model estimates on relevant matters.

The policy formulated by the above committee is discussed and controlled in the framework of the Senior Risk Management Committee headed by the President and Chief Executive Officer with the participation of all the Risk Managers (credit, market, operational and legal), the Chief Internal Auditor and the Chief Risk Controller.

The Chief Risk Controller, who reports to the President and Chief Executive Officer, examines both the methodology and compliance with limits determined by the Board of Directors and Bank Management, and the possible damage to the capital of the Bank under extreme scenarios. These are reported to the President and Chief Executive Officer, the Market Risk Manager and to the Board of Directors, in the framework of the Report of the CEO. Exposures to market risks, limits determined for them and authorities for managing them are summarized in the "Exposures Document". The document includes the actual position of market risk at Bank and Group level, methodologies for measuring risk and reporting on limits and compliance with them. The document is distributed to members of the Board of Directors in the framework of the quarterly discussion on market and liquidity risk. Once a quarter there is a detailed discussion in the Risk Management Committee of the Board of Directors on market risk exposure policy, a report is given on the current situation of compliance with limits at Group level, and also of the damage likely to occur to the Bank from extreme scenarios. In addition, every new activity in financial instruments that differs significantly from existing instruments is brought for discussion and approval by the Committee in the framework of the "New Product" procedure. The results of discussions of the Risk Management Committee of the Board of Directors, policy, limits on scope of exposures of the various types and changes in them are reported and approved by the plenum of the Board of Directors. When the quarterly and annual financial statements are approved, the Market Risk Manager reports to the plenum of the Board of Directors on compliance with the limits determined.

The limits determined at Group level include all the subsidiary companies in Israel and aboard. Subsidiary companies abroad determine market risk management policy in coordination with the Bank in Israel with the frameworks for exposure to market risk being determined in a uniform format by the Bank and approved by the Bank's Market Risk Managers.

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 (Table 10 - Basel II):

	31 December 2009**	31 December 2008*
	NIS millions	
Capital requirements in respect of		
Interest risks	**432**	350
Share price risk	**36**	4
Exchange rate risk	**161**	78
Options	**39**	61
Total capital requirement in respect of market risks	**668**	493

* As per Basel I
** As per Basel II – Pillar 1

4. The Main Risks in Market Risk

4.1 Basis Exposure

According to accounting principles, 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. Exposure to the basic risks is measured as a percentage of the exposed capital of the Group.

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 exposure to basis risk is expressed as the loss that 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.

Management policy is to manage risks deriving from basis exposure in a controlled manner within the framework of the limits set by the Board of Directors, and to establish 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, as well as changes in prices, inflation and anticipated relative prices in the various sectors.

Exposure limits approved by the Board of Directors are allocated in accordance with considerations of expected return and risk to trading rooms, ALM and to subsidiary companies. The ALM position and the trading rooms are managed on a routine daily basis, having additional limits at the level of the risk, the instrument and the type of activity.

The subsidiaries abroad and in Israel 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 at low volumes, based on policies anchored in resolutions of their local boards of directors, and coordinated with the Bank in Israel.

Certain changes from the accounting approach and reporting are made for the purpose of ongoing management, which take into account the Bank's economic approach to basis risks. The principal changes are set out below:

- "Non-performing loans in foreign currency" – are reported as a non-linked Shekel asset, as they are not sensitive to fluctuations in exchange rates, and not as a foreign currency asset as in the accounting approach.
- "Deferred taxes" in respect of pension obligations – according to the accounting approach, these are reported in the unlinked shekel sector, as opposed to their presentation as a CPI-linked asset from the economic perspective, according to the obligation in respect of which the tax is recorded.
- "The general provision for doubtful debts" – according to the accounting approach, this provision is deducted proportionately from the linkage sectors, while from the economic perspective, this provision constitutes a quasi-capital obligation in unlinked shekels.
- The adjustment to market value of debentures in the available-for-sale portfolio – according to the accounting perspective, this adjustment is deducted/added to the balance of the portfolio according to linkage sector, while from the economic viewpoint, this provision constitutes a quasi-capital item.
- Embedded shekel options – the options inherent in index-linked instruments and shekel instruments of the "election" type are calculated in terms of the basis asset and reported separately. These options are subject to specific limits determined for them and are not part of the overall limit of basis exposure.

4.1.1 Basis Exposure and Compliance with Limits

The state of the basis exposure, calculated in accordance with generally accepted accounting principles, is reported in Note 16 to the Financial Statements.

The following table shows 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 (1)	
	Maximum surplus or (deficit)	**31 December 2009**	31 December 2008
		%	
Unlinked	**50%-(100)%**	**1.5**	(25.0)
CPI-linked	**100%-(50)%**	**0.3**	26.1
Foreign currency (4)	**25%-(10)% (3)**	**(1.8)**	(1.1)

(1) Not including index/shekel options inherent in financial instruments. When taking this exposure into account in terms of the *delta*, the index-linked deficit at 31 December 2009 will increase by 15% and the index-linked surplus at 31 December 2009 will decrease by 15%.

(2) In addition, the Bank and subsidiaries have limits on the maximum position allowed for investment in each currency.

(3) From the beginning of 2010 the limit is 15%-(15%).

(4) The short position in foreign currency arises mainly from the tax in respect of overseas investments.

During 2009, an average of some 2.3% of the exposed capital was invested in the CPI-linked sector, which ranged during the year between 23.8% and (12.0)%. Since a relatively low volume of capital was channelled 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, unlike exchange rate differentials for sources of financing, and thus there is an asymmetry with respect to exchange rate differentials. 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. The Bank carries out hedging against the tax exposure in respect of investments overseas.

The actual effect of the exchange rate differentials in 2009 is reported on page 181 under the contribution of the consolidated companies abroad to Group profit. In addition, changes in exchange rates have an effect on current income in foreign currency. Hedging activity was carried out at the beginning of 2010 against about half of expected net income.

During 2009, 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 2009. 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:

	US$	Euro	£	CHF	Yen
	NIS millions				
Increase of 5% in exchange rate	(20)	19	4	(7)	1
Increase of 10% in exchange rate	(36)	38	10	(14)	3
Decrease of 5% in exchange rate	14	(18)	(6)	1	1
Decrease of 10% in exchange rate	22	(37)	(11)	(1)	3

This data does not take into account the effect of changes in the exchange rates on the income and expense cash flows in foreign currency.

4.2. 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 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. As of the end of 2009, the exposure was to an increase in interest at a rate lower than that inherent in the sharp yield curves. This exposure derives mainly from subordinated notes (used as Tier II capital at Group level) issued for long terms.

In the foreign currency and unlinked shekel sectors, the interest exposure is lower, since most of the activity is at floating interest rates. In the foreign currency sector, the existence of financial instruments in the international markets facilitates the reduction of the exposure.

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 2009, this interest rate was 2.36%.
- 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 bear 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.

[(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.

Prime interest is 1.5% higher than the monetary interest rate. The prime interest rate at the end of 2009 and at the time of writing this report was 2.75%.

- In the foreign currency sector, a large portion of the activity is based on the LIBOR (London Interbank Offered Rate). The LIBOR is the interest rate in the interbank market in London on interbank deposits for the relevant period, and is published daily at 11:00 a.m. (London time) by the Reuters news service. At the end of 2009, the US$ LIBOR rate for three months was 0.25%.

The exposure to an unexpected change of 1% in the rate for all periods is measured in each of the sectors individually and in all the sectors together.

- The potential erosion of economic value – the difference between the present value of assets and liabilities. When calculating present value, cash flows of the risk-free yield curve are deducted from the yields of government debentures.
- The potential erosion of the accounting profit for the year as a result of change in the value of transactions assessed at market prices (derivative instruments and trading portfolios) as well as balance sheet items (loans and deposits) repayable during the year and recycled at new interest rates.

Interest risk is measured and managed in practice based on various behavioural assumptions as to repayment dates of assets and liabilities. Below are the principal assumptions:

- In the index-linked sector, an estimate is taken into account regarding early repayments and withdrawals at points of exit in savings plans. The assumption regarding potential withdrawals is based on previous customer behaviour.
- According to previous accumulated experience, there is a balance in non-interest bearing current accounts, in a long-standing stable amount. Therefore, for the purposes of measuring and managing interest exposure, Bank policy is to relate to part of the non-interest bearing current account balances as long-term liabilities. Periodically the change in non-interest bearing current account balances is examined in order to decide how to spread it.
- Leumi Mortgage Bank – exposure management takes into account assumptions with regard to early repayments of loans and deposits. Assumptions regarding index-linked loans at fixed interest rely on a statistical model for forecasting early repayments. The model forecasts future repayments, based on parameters typifying the loans in the credit portfolio, including; age of the mortgage, period of the original mortgage and management's estimate regarding the effect of changes in interest. The model is built on statistical methods relying on past experience (early repayments actually carried out previously).

This statistical model is examined on a routine basis and its assumptions are updated in accordance with management expectations of early repayments over the next few months, based on economic parameters and on developments in the capital markets (interest rates, debenture prices, and the rate of inflation).

From the beginning of 2010, it has been decided to adopt a new improved model, including sensitivity of early repayments in the index-linked sector, to the level of interest over the forecast period.

4.2.1 Interest Exposure and Compliance with Limits

The following table shows the exposure to interest changes at Group level, calculated according to accounting principles. During 2009, 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.

	31 December 2009 (2)			31 December 2008 (1)		
	Unlinked	**CPI-linked**	**In and linked to foreign currency**	Unlinked	CPI-linked	In and linked to foreign currency
Average duration (in years):						
of assets	**0.61**	**3.03**	**0.62**	0.45	3.33	0.55
of liabilities	**0.62**	**3.65**	**0.55**	0.36	4.18	0.39
The gap in duration in years	**(0.01)**	**(0.62)**	**0.07**	0.09	(0.85)	0.16
Difference in the internal rate of return (%)	**(0.12)**	**1.25**	**3.05**	2.35	0.97	2.20

(1) Excluding forward transactions and options.
(2) Including forward transactions and options, and based on fair value figures of financial instruments.

Beginning in December 2009, there was a change in the method of calculation and presentation of the report of exposure to changes in interest rates, pursuant to new directives by the Bank of Israel n the matter. Instead of total data for balance sheet balances, Exhibit D brings fair value figures of financial instruments reported in Note 18C regarding "Balances and Estimates of Fair Value of Financial Instruments". The internal rate of return also changed accordingly. Instead of the internal rate of return deducting expected cash flows for the balance sheet balance, the internal rate of return is reported deducting expected cash flows from the fair value.

In addition, instead of reporting the average duration which was based on contractual amounts of assets and liabilities, in 2009 the effective average duration was reported, based on the change in fair value resulting from a change in the internal rate of return of assets and liabilities.

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 behaviour of the savers. The average duration of liabilities, according to the original cash flow of the savings schemes is longer, and reaches 3.66 years, while the gap in the internal rate of return (IRR) amounts to 1.13.

The data presented above takes into account early repayments of CPI-linked mortgages, pursuant to a statistical model that estimates expected repayments on the basis of the borrowers' past behavior. The average duration of assets at the end of 2009, according to the original cash flow, without taking into account early repayments, is longer, and reaches 1.13 years, and the IRR gap amounts to some 3.50.

Current account balances are reported 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 0.72 years in unlinked shekels and 0.61 years in foreign currency deposits, with the IRR gap reaching 1.19 and 3.37 respectively.

Interest exposure is managed on the basis of 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 Israeli 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 of 1%.

The following table shows 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 2009**	31 December 2008	**31 December 2009**	31 December 2008
Actual	**656**	321	**356**	320
Limit***	**1,000**	1,000	**600**	600

* In the direction causing harm to the Bank

** The maximum erosion of the annual profit based on an examination of the next three years.

*** The new limits for 2010 are NIS 1,100 million in economic value, and NIS 500 million in profit for the year.

During 2009, the potential erosion of the economic value ranged between NIS 321 million and NIS 656 million, and the potential erosion of the annual profit ranged between NIS 255 million and NIS 428 million.

The potential erosion of the economic value of the capital resulting from a 1% change in interest rates as at December 2009 doubled itself in comparison to that in December 2008. The increase in exposure to a decline in interest, as with the exposure to a rise in interest lower than that forecast in market interest rates, derived mainly from the raising of long-term capital notes (NIS 3.5 billion in the index-linked sector and NIS 1.5 billion in the unlinked shekel sector), a shortening of the duration of the available-for-sale portfolio and extending the duration of shekel deposits.

The exposure to interest in Leumi Mortgage bank included in the report at Group level is based on a model of early repayments of index-linked mortgages that has been in use over recent years. From the beginning of 2010, a new improved model was adopted. The main effect of measuring exposure by means of the new model is an increase of the exposure of the economic value to rises in interest at a rate lower than that inherent in the index-linked yield curve of about NIS 130 million (before tax) at Group level.

The potential erosion of the accounting profit resulting from a 1% change in interest rates increased moderately from the beginning of the year by some NIS 36 million and totalled NIS 356 million at the end of December 2009. The exposure to the profit is affected mainly by estimated activity according to market prices (derivative transactions and trading portfolios). During the year, the trend towards an unexpected change in interest rates 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 rise lower than forecast in interest rates in the market, since a large portion of the futures transactions in shekels (with a long-term CPI-linked obligation) was left without offset. In the unlinked shekel sector – the exposure derived mainly from the structure of the balance sheet, in which the balance of loans based on prime is larger than deposits on the same basis.

During 2009, 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.

Below is the impact of potential changes in interest rates on the economic value of the financial instruments of the Bank and its consolidated subsidiaries, excluding non-monetary items:

The fair value of financial instruments before the effect of changes in interest, as at 31 December 2009, in NIS millions:

	Israeli currency		Foreign currency including Israeli currency linked to foreign currency		
	Unlinked	CPI-linked	US$	Euro	Others
Financial assets	151,443	61,644	57,961	20,031	15,478
Amounts receivable in respect of off-balance sheet derivative financial instruments	131,448	2,825	113,331	25,966	41,641
Financial liabilities	130,944	52,286	72,806	23,570	11,484
Amounts payable in respect of off-balance sheet derivative financial instruments	134,756	11,056	97,793	20,815	52,188
Net fair value of financial instruments	17,231	1,127	693	1,612	(6,553)

The fair value of financial instruments after the effect of changes in interest, as at 31 December 2009, in NIS millions (Table 14 – Basel II):

	Israeli currency		Foreign currency including Israeli currency linked to foreign currency		
Change in interest rates	Unlinked	CPI-linked	US$	Euro	Others
Immediate parallel rise of 1%	17,441	1,621	754	1,623	(6,596)
Immediate parallel rise of 0.1%	17,252	1,176	699	1,613	(6,557)
Immediate parallel drop of 1%	16,995	604	650	1,593	(6,510)

5. 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 back testing, 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. As stated, the VAR in the Bank is measured for a period of two weeks and with a probability of 99%. The back testing process examines after a period of two weeks the theoretical change in the value of the Bank on the assumption that the positions do not change and changes are only in market prices.

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 of economic value		**VaR of mark-to-market portfolios**	
	31 December 2009	31 December 2008	**31 December 2009**	31 December 2008
Actual	**359**	243	**188**	204
The limit	**600**	600	**500***	500

* The new limitation on VAR of mark-to-market portfolios is NIS 400 million

During 2009, the VAR of the economic value increased by some NIS 116 million. The increase derived mainly from the increase of the exposure to a drop in interest in the CPI-linked and shekel sector, and a rise in volatility of shares despite the reduction in total investments in this portfolio (sale of shares in Union Bank, Bezeq, and Hot) and was partially offset by the drop in the index-linked basis and from price changes that expressed themselves mainly in the decrease in index-linked interest rates. It should be noted that the parametric VAR of interest rates quoted above 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 2009, the VAR of the economic value ranged between a maximum of NIS 389 million and a minimum of NIS 236 million.

The exposure in terms of VAR on the mark-to-market portfolios during 2009 decreased by NIS 16 million. The decrease derived mainly from the increased exposure to interest in the MTM portfolio and on the other hand was partially offset by the decrease in the index-linked surplus and from price changes.

During 2009, the VAR on the mark-to-market portfolios ranged between a maximum of NIS 228 million and a minimum of NIS 82 million.

During 2009, the Group complied with all the VAR limits set by the Board of Directors.

6. Monitoring risks and how they are managed

6.1 Monitoring risks at Bank and Group level is carried out by the Manager of Market Risks and in the Financial Management Department. The Department carries out monitoring and trend analysis, formulates proposals for managing exposures, and examines possible results of future activities from the perspective of exposure to risks and compliance with limitations.

6.2 In order to perform continuous risk-adjusted management, monitoring and management elements meet at least once a week. Financial exposures are examined, and guidelines and frameworks are determined for current activity in the framework of the weekly meeting headed by the Manager of Market Risks. The market risk exposure position is reported and discussed in the Current Matters Committee, which meets every week and which includes members of Bank Management and is headed by the President and Chief Executive Offices.

6.3 The Market Risk Management Committee (ALCO) headed by the Market Risk Manager meets at least once a quarter, and is responsible for verifying that business activity is carried out in accordance with determined policy, for examining the mix of assets and liabilities, for discussing Group investment policies and for verifying the full implementation of Group risk policy in subsidiary companies in Israel and overseas.

6.4 The Market Risk Management Control function examines independently the level of risk and the risk management process.

The Senior Risk Committee headed by the CEO of the Bank discusses at least four times a year market and liquidity risk management of the Bank and the Group. Exposure limits for market risks are approved by the plenum of the Board of Directors once a year or as necessary. The exposure position is reported to the Board of Directors in the framework of the CEO's Report every month to six weeks. Every quarter there is a discussion on market and liquidity risk management in the Risk Management Committee of the Board of Directors and afterwards in the plenum of the Board of Directors. Planned policy for managing market and liquidity risk is discussed and approved in the framework of discussions of the annual work plan, first by Bank Management and then by the Board of Directors.

6.5 The main measures for reducing risk are:

- Monitoring economic developments in Israel and worldwide.
- Measurement, monitoring and analysis of trends and formulating alternative plans for action on a routine basis.
- Making adjustments to the nostro available-for-sale portfolio.
- Controlling activity and on-going monitoring of the traded portfolio.
- Reducing exposures in trading rooms by means of lowering limits.
- Carrying out hedging transactions by means of derivative financial instruments.
- Ongoing adjustment of prices for all operating segments, including adjustment of interest rates for raising sources of funds, adjusting transfer prices (the basis interest rates to which is added the margin for credit risk) on loans, and adjusting prices of derivative instruments.

7. 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 behaviour. 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 various stress scenarios. These include all risk factors to which the Bank is exposed and represent a part of the ICAAP process described on page 237.

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 in market risk. 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 2009.

Stress tests at Leumi are built by the Stress Tests Committee headed by the Chief Risk Controller. The Committee is responsible for the periodic definition and updating of the stress tests. The Committee meets generally at least once a month. The set of stress scenarios includes reference to aspects of market risks, credit risks, operating risk, and includes combined scenarios of types of risk. In meetings of the Committee, scenarios are examined and updated in accordance with developments and various assessments.

The Committee is comprised of representatives of various units specializing in managing various risks and also representing the business side. If necessary, the Committee makes use of opinions of additional experts for purposes of assessing specific risks which are not within the direct expertise of members of the Committee.

In the framework of the activity of the Committee, a set of stress tests has been defined at Group level, whose aim is to cover a large number of serious to reasonable scenarios, to which the Bank is exposed during the course of its activity as a going concern and to identify concealed risks not at times of crisis. The Stress Tests Committee has prepared a preliminary prioritization of the scenarios, which in its opinion are the most significant for the Group, either because of the seriousness of the scenario or because of the probability of its occurrence (or a combination of both).

In order to ensure the Bank's survival as a going concern which continues to conduct its business also in the event of serious but reasonable stress scenarios, the Bank verifies that the minimum capital adequacy ratio will not be less than the minimum required by the Supervisor of banks (presently 9%) at any moment in time during a stress scenario.

These requirements exist for all stress scenarios examined by the Group, and especially the most serious scenario, including a significant worsening in non-banking indices and a marked rise in provisions for doubtful debts. The collapse of a foreign bank to which the Group is materially exposed and the collapse of a group of borrowers (as defined in Proper Conduct of banking Business Directive No. 311 with all its implications and the "drying up" of the domestic and global bond market.

The material stress scenarios were examined against the three-year program and it was found that the Leumi Group complies with all the limits it set for itself as described above without the need for updating the work plan.

8. Liquidity Risk

8.1 "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.

Against the backdrop of the negative developments on the money markets abroad, the Bank beginning in 2008 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. 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.

Responsibility for managing liquidity risk in units overseas devolves on the units themselves, together with advice, coordination and professional support of the ALM Department in Israel. For every overseas unit of the Bank, the liquidity management policy is approved by the local Board of Directors. The risk management policy of overseas units is determined in accordance with Group policy and subject to directives of local regulations in every unit. In this framework, limits are set, and compliance with limits is examined in the framework of the market and liquidity risk management committees both at the units and in Israel.

In the framework of preparations for Basel II, and in accordance with Group risk and liquidity management policy, the manner in which liquidity risk was managed in the units continued to be examined in 2009. In this framework and as part of policy for coordinating liquidity risk management on a group basis, the liquidity model in overseas units was improved, and the need of reliance by overseas units on the Bank in Israel was quantified in the event of a stress scenario in the unit. For such a scenario, the Board of Directors of the Bank approved a back-up line for Leumi Romania in the amount of $50 million and for Leumi UK in the amount of £120 million.

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:

1. 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.

2. 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 historical observations for all business days over the last year.

3. 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:

   3.1 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.

   3.2 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 principles on which the model is based state that the more liquid assets there are (for example, cash, deposits at the bank of Israel, a realizable bond portfolio, and credit expected to be repaid) in relation to liabilities expected to be realized under the model, the Bank ensures its capability of meeting all of its liquidity requirements.

For this purpose, assets are classified by liquidity level and liabilities by probability of realization.

The rate of change in the balance of deposits and loans for every repayment period under various scenarios is determined by various parameters in accordance with the level of severity of the scenario. Based on the decisions of the business parties, who are assisted by historical data, behavioural functions are defined which bring into account parameters such as the size and nature of the deposit in accordance with which expected cash flows are calculated.

It should be noted that the stress scenarios are more severe than those experienced by the Bank in the past, and thus assumptions for these scenarios are based on the opinion of senior professional parties in the bank more than on historical data.

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 additional 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," pricing 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.

During 2009, the Bank formulated an action plan for implementation of the guidelines. Most of the guidelines were implemented in 2009 and the remainder will be carried out under the action plan during 2010.

In December 2009, the Basel Committee published draft guidelines dealing with international standards for measuring and monitoring liquidity risk. During 2010, Leumi will examine the implications of the draft guidelines on liquidity risk management.

8.2 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 8.1).

The following table shows 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 (without connection between sectors*):

	Israeli currency for one month		Foreign currency for one month	
	Gap	Ratio	Gap	Ratio
Scenario/period	NIS billions			
Regular	45.4	29.6	19.0	5.1
Statistical	36.1	4.3	14.7	2.6
Stress at Leumi	20.5	1.6	6.9	1.3
Systemic stress	30.2	2.3	5.3	1.2

*Bank Leumi assumes that in stress situations the foreign currency sector if it has a liquidity surplus can assist the Israel currency sector and *vice versa*.
Regarding the monetary measures that the Bank of Israel instituted to improve liquidity in the system, see page 248 of the Report.

In 2009, the Bank complied with the prescribed liquidity limits.

9. 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.

Leumi is a leading bank in the volume of activity in the field of shekel-based derivatives and it is a market-maker 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 a market-maker format (as accepted worldwide). 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.

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. A member of Management was therefore appointed as Chief Financial Instruments Officer, professionally responsible for this activity and for supervision of this field.

The following table shows a summary of open transactions as at 31 December 2009, compared with the previous year (par value in NIS millions):

	31 December 2009	31 December 2008
Hedging transactions	**1,409**	1,514
ALM and other transactions:		
Interest contracts	**170,313**	159,668
Currency contracts	**186,909**	185,135
Contracts re shares, share indices and goods	**18,882**	14,197
Total	**377,513**	360,514

For details regarding accounting policies for recording of balances, income and expenses from these types of instruments, see Note 1(L) – Significant Accounting Policies to the Financial Statements.

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

9.1 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 page 52 in the section on Critical Accounting Policies.
Consequently, there is considerable volatility in profit and loss. For details, see page 62 of the Report.

9.2 Structured Products

During 2009, 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.

9.3 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.

9.4 Credit Risks and Counterparty Risks in Financial Instruments with Customers

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.

Reduction of counterparty risks in activity with foreign banks is achieved by means of set-off agreements of the ISDA type on which the Bank has signed with the banks with which it is active. In 2009 and the beginning of 2010 the Bank signed on an ISDA agreement also with three Israeli banks with which it is active in derivatives. In addition, the Bank has Credit Support Annex (CSA) Agreements with foreign banks.

9.5 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 by all trading rooms, a duty of reporting to the Board of Directors was decided for a cumulative loss (daily/monthly) of $ 5 million and above.

During 2009, all activity in derivatives was within the limits set by the Board of Directors.

10. 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."

Operational risks are managed in the following way:

A. An Operational Risks Manager 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. The Operational Risks Committee headed by the Operational Risks Manager examines risk management policy, methodologies for mapping out and assessing risks, and the calculation of operational risk capital. Responsibility for taking operational risk is on the business and operations units. 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. The bank has a risk appetite document for operational risks. The document defines the concept of risk tolerance in terms of operational risk, and sets out qualitative and quantitative declarations of risk appetite at the level of the Board of Directors and Senior Management. The main qualitative declarations are:

   - The Bank will carry out operational risk management as part of the ongoing business management process and will allocate resources to it.

   - Operational risk management will be carried out while examining cost benefit consideration for lines of business and activities.

- In all the significant activities of Leumi Group there must be segregation between the risk-taking unit and an independent unit controlling the risk.

- The Bank attached great importance to the prevention of fraud and embezzlement and invests the resources necessary for this. The Bank develops and reinforces tools for monitoring and reducing these risks. Fraud and embezzlement risk management is examined independently also by the external auditors.

- There will be a correlation between IT strategy and the business strategy of the Bank. IT systems will support providing a response to requirements of Bank customers in Israel and worldwide and to the maintaining of continuous and efficient business activity.

- Leumi will appoint trained professional manpower with appropriate qualifications for the activities it carries out, in relation to the risk inherent in the activities and for the benefit of the business objectives of the Bank.

- The Bank will not enter new markets, approach new types of customer or operate new products, and will not carry out changes to existing work processes, the organizational structure or products, without fully examining the operational risks involved in them, and taking the appropriate decisions to hedge the risks.

- Leumi will focus its exposures only in activities for which it has the required expertise for managing and assessing risks.

- Leumi will maintain and strengthen proper systems and procedures of internal control on financial reporting, the effectiveness of internal controls on financial reporting will be assessed on a routine basis, both by the Bank and the external auditors. If necessary additional/missing controls will be assimilated in financial reporting in order to minimize reporting risk.

D. 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.

E. 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.

F. 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.

G. 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.

H. 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.

I. 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 is making 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.

11. 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 statutory provisions on the prohibition of money laundering and the prohibition of the financing of terrorism.

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.

In 2006 Bank Management appointed a committee which formulated an operating plan for the Compliance Department and compliance officers in the Group, to ensure conformance with international standards and the Basel Committee requirements, and carried out 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.

Based on the recommendations of the committee, a compliance model was set up, which 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*, regional compliance officers were appointed to the business divisions, and 50 full-time compliance officers were appointed in 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 approved by the Board of Directors in 2009.

12. Prohibition of Money Laundering and the Financing of Terrorism

During 2009, 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 amongst employees of the Bank. 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.

During 2009, the Memorandum Prohibition of Money Laundering (Various Amendments) Law, 2009, and a Proposed Prohibition of Money Laundering (Amendments No.7),) Law, Draft Amendments to the Prohibition of Money Laundering Order applying to banking corporations, and Draft Amendments to Proper Conduct of Banking Business Directive No. 411 – Prevention of Money Laundering and the Financing of Terrorism and Identification of Customers. The said Draft was approved and the amendments to Directive 411 included in it will come into effect on 1 July 2010. The Bank has made preparations for the implementation of these amendments.

13. 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 counselling or according to deficient legal counselling, 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.

14. 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 does not take into account the effect of taxes in the event of a positive or negative gap between the fair value and the book value of assets and/or liabilities presented on an accrual basis.

The data appearing in Note 18D to the Financial Statements show that the fair value of the financial assets at the end of 2009 was NIS 2,056 million higher than the balance sheet value (in 2008, higher by NIS 922 million), while the fair value of financial liabilities was NIS 4,379 million higher than the balance-sheet value (in 2008, higher by NIS 2,261 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 2009 derives mainly from the decrease in interest rates in the economy, and particularly, in the unlinked shekel segment, similar to the decrease in 2008.

15. Exposure and Management of Credit Risks in Credit to the Public

Credit risk exposure by principal types of credit exposure (Table 4(b) – Basel II):

Type of credit exposure	31 December 2009 Gross credit risk exposures	Average cross credit risk exposures*
	NIS million	
Credit	**246,409**	**247,395**
Debentures	**45,879**	**39,299**
Others	**13,138**	**12,932**
Guarantees and liabilities on account of customers	**95,393**	**95,680**
Transactions in derivative financial instruments	**9,956**	**10,948**
Total	**410,775**	**406,254**

* The average is calculated based on the five preceding quarters.

Following are the weighted balances of the credit risk (Basel I):

	December 31, 2009 **Balance-sheet balances**	**Weighting rates** **0%**	**20%**	**50%**	**100%**	**200%**	**Deduction from capital**	**Risk balances**
	In NIS millions							
Assets								
Cash and deposits in banks	**42,933**	**29,059**	**13,874**	**-**	**-**	**-**	**-**	**2,775**
Securities	**57,505**	**35,114**	**16,629**	**-**	**5,162**	**109**	*** 491**	**8,704**
Securities borrowed or purchased under buy-back agreements	**744**	**744**	**-**	**-**	**-**	**-**	**-**	**-**
Credit to the public	**205,002**	**12,893**	**860**	**15,507**	**175,742**	**-**	**-**	**183,667**
Credit to the government	**407**	**398**	**-**	**-**	**9**	**-**	**-**	**9**
Investments in companies included on equity basis (a)	**2,178**	**-**	**-**	**-**	**2,089**	**-**	**89**	**2,088**
Buildings and equipment	**3,553**	**-**	**-**	**-**	**3,553**	**-**	**-**	**3,553**
Other assets	**9,786**	**1,205**	**3,386**	**-**	**5,134**	**-**	**81**	**5,792**
Total assets	**322,108**	**79,413**	**34,749**	**15,507**	**191,669**	**109**	**661**	**206,588**

	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 equity basis (a)	1,842	-	-	-	1,772	70	1,772
Buildings and equipment	3,445	-	-	-	3,445	-	3,445
Other assets	13,529	1,361	5,473	-	6,423	272	7,518
Total assets	311,125	56,634	36,298	14,761	203,090	342	217,730

(a) Balances of investments in shares and subordinated capital notes of financial companies are deducted from the capital, and therefore from the balance of securities and from investments in companies included on equity basis.

The following table shows the weighted balances of the off-balance-sheet credit risk:

	December 31, 2009						
	Par value balances	**Book value**	**Weighting rates**				**Risk balances**
			0%	**20%**	**50%**	**100%**	
	NIS millions						
Off-balance-sheet instruments							
Transactions whose balance represents a credit risk	**94,698**	**28,039**	**3,188**	**824**	**-**	**24,027**	**24,192**
Derivatives	**290,758**	**29,571**	**1,044**	**19,648**	**-**	**8,879**	**12,809**
Others	**1,769**	**177**	**-**	**-**	**-**	**177**	**177**
Total off-balance-sheet instruments	**387,225**	**57,787**	**4,232**	**20,472**	**-**	**33,083**	**37,178**

	December 31, 2008						
	Par value balances	Book value	Weighting rates				Risk balances
			0%	20%	50%	100%	
	NIS millions						
Off-balance-sheet instruments							
Transactions whose balance represents credit risk	96,273	25,252	2,870	1,290	-	21,092	21,350
Derivatives	250,939	25,472	448	15,987	-	9,037	12,234
Others	1,595	159	-	-	-	159	159
Total off-balance-sheet instruments	348,807	50,883	3,318	17,277	-	30,288	33,743

Credit risk in accordance with the standardized approach (Table 5 – Basel II):

Distribution of exposures by risk weight	31 December 2009	
	Amount of exposure before deduction of credit risk	Amount of exposure after deduction of credit risk
	NIS million	
0%	**51,409**	**54,380**
20%	**26,624**	**23,834**
35%	**32,594**	**32,592**
50%	**21,385**	**21,838**
75%	**77,722**	**73,559**
100%	**189,084**	**181,686**
150%	**11,845**	**11,322**
350%	**65**	**65**
Amounts deducted from equity	**47**	**47**
Total	**410,775**	**399,323**

Strategies for Managing Credit Risk[1]

Once a year the credit policy document is updated and approved by the Bank in the Board of Directors. The document outlines policy for activities of the bank in Israel, except for certain areas in which the policy is at the level of Leumi Group as a whole. The credit policy document is presented against the background of a short description of the state of the economy worldwide and in Israel and includes a variety of subjects. Most of the subjects presented in the policy document are: Bank strategy in the area of credit risk management against the background of regulatory and internal limitations approved by the Board of Directors, outlining activities and sectors of the economy, reference to the various lines of business and credit authorities, presenting tools for managing and controlling credit, and details of various broad-based methodologies outlining the method of financing of different types.

The credit policy document is sent for information purposes to subsidiary companies in Israel and abroad and is a guideline for credit policy in use by them. Each of the subsidiary companies defines an indecent credit policy approved by their authorized bodies and is sent for the approval of its board of directors. The credit policy document of each of the subsidiary companies is submitted to the Credit Risk Management Committee in Israel.

The credit policy of the Bank is based on the dispersal of risks and their controlled management. This is expressed in the decentralization of the Bank's loan portfolio between the various economy sectors and over a large number of borrowers.
In its central role of financing the Israeli economy, the Bank adopts a strategy of being involved in the principal operating segments of the economy, and provides credit to the various types of manufacturing and commercial segments, the different parts of the public segment, individuals and households.

The credit policy of the Bank is derived from its overall risk management policy. One of the basic elements of the overall policy is the "risk appetite" of the Leumi Group as defined from time to time by the Board of Directors of the bank. The 'risk appetite"decided upon obligates compliance with a number of principles of risk policy which have implications for credit policy, whose aim is to improve the quality of the loan portfolio and to manage its inherent risk.

The principles guiding the Bank include:

- Management of risks including their identification, measurement, supervision and control in a consistent and complete manner in the whole Group, in accordance with the Group's risk tolerance. In particular assessment is to be made of credit risk in a quantitative manner and a risk rating defined for each customer.
- Focusing on exposures in activities where the Bank has the expertise required to assess and manage the inherent risks.
- Involvement with credit of varying types with the aim of achieving the spreading of risk.
- Managing the loan portfolio with reference to different areas of concentration (concentrations by economy sector, single borrower/group of borrowers) while setting limits for the loan portfolio and measurement of concentrations in their respect in terms of risk as well as in terms of exposure.
- Creating limits for every risk defined as able to be measured.
- For each risk asset there should be segregation between the risk taking unit and an independent unit controlling the risk. The segregation process has not yet been completed.
- Preparation of a risk analysis before entering new lines of business or launching new products.
- Dividing the treatment of customers between lines of business is carried out on accordance with the activity turnover of the customer and the size of the credit facility available to him, and in accordance with the complexity/expertise of the type of transaction.

[1] The qualitative discussion of credit risks from page 218 to 224 are referenced to by the Bank of Israel in Pillar 3 of Basel II as Table 4(a).

- Every unit in the Bank creating exposure to credit risk and its manager must be aware of the risks in the area of its operations and responsible for their routine management.
- Leumi's objective is to measure performance of units responsible for taking risk in terms of return against risk.
- Carrying out routine and periodic control of credit exposures with the aim of identifying weaknesses as early as possible and to taking the appropriate steps.

Managing the loan portfolio in the Bank requires *inter alia* having a quantitative assessment of the risk level of the borrowers. To achieve this aim, models are built in the Bank and automatic systems to support the process of examining the risk level of the borrower, the expectancy of loss and the return required for these risks.

The Bank is in process of setting up an advance system for managing the loan portfolio with the aim of upgrading its abilities to control the various risks, and especially various concentration risks, to maintain limits over the risk factors in the area of credit, to direct activities with the objective of improving the ratio of return on risk and to facilitate a more accurate pricing system of credit risks.

As stated, the Bank's Board of Directors approves the Bank's credit and collateral policy, as well as sectorial and other limits.

Borrower and Borrowing Group Concentrations:

Since the beginning of 2007, the Bank received the Bank of Israel's approval according to which 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 2009, the indebtedness of the largest group of borrowers reached 15.2% of the Bank's capital. The indebtedness of the largest single borrower reached 6.1% of the Bank's capital. The indebtedness of the six largest groups of borrowers reached 69.1% of the Bank's capital.

Changes in the Israeli Economy and their effect on Leumi Group:

The Israeli economy was affected indirectly and in the short term by the global crisis beginning in the fourth quarter of 2008, and its activities were characterized by "drying up" of the capital market, as well as a slowdown in growth which became negative for a short and limited period.

In addition to the creation of the above there was great caution in granting bank credit and lack of alternative financing from the non-banking market.

To the parameters affecting the domestic market were added at the beginning of 2008 a temporary weakening of the exchange rate of the dollar against the shekel, which created great difficulties for the activities of export-based industries and also manufacturers dealing with competition from imports.

Beginning at the end of the second quarter of 2009, recovery was felt in the markets in Israel (a rise in prices on the Stock Exchange, a reawakening of the capital market and demand in the residential real estate sector). The recovery is a consequence of the expansive monetary policy which also contributed to the sharp rise in prices in financial markets and worked towards a moderation of the negative effects of the world crisis.

As a rule, and particularly in periods of economic slowdown, the Bank adopts a cautious credit policy in relation to the various sectors of the economy and credit segments.

From the beginning of the financial crisis at the end of 2008, the Bank took serious steps to identify borrowers and segments of the population which were sensitive to the new situation, including:

- Exporters and/or bodies with a high dependence on foreign currency proceeds.
- Manufacturers dealing with competition from imports.
- Firms operating on "luxury" sectors which are the first to suffer from a decline in demand in periods of economic slowdown.

- Borrowers raising index-linked credit in Israeli currency and whose proceeds were intended for investments abroad (such as real estate companies active overseas.
- Borrowers who raised source of funds in recent years in the capital market, and who intended to base their future sources of repayment on raising funds in the Stock Exchange and/or an exit from existing investments.
- Borrowers whose debts are based on shares representing a material part of their asset value and/or the collateral on which the Bank is relying and so on.

The Bank maintains strict control on a routine basis over the effects of erosion and the exposure generated for the relevant borrowers and which also result from the crisis, including in-depth discussion of customers 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. In addition, the Bank has expanded the preliminary examinations before transactions may be executed, fixed strict criteria in relation to the types of transactions and set minimum requirements, such as equity and collateral requirements that are needed for the various types of financing.

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 lines of business.

With increasing signs of recovery in certain segments and populations, the Bank is adopting a broader policy, to provide a suitable response to cover the needs of customers in the various operating segments. This is also with a broadening of the risk appetite, and a relaxation of criteria and parameters in the area of credit, with an emphasis on financing sectors of the economy typified by growth potential and not with a high level of risk.

On 31 December 2007, the Banking Supervision Department issued to banking corporations an amendment to the regulations for reporting to the public on the subject of “Measurement and Disclosure of Impaired Debts, Credit Risk and Provisions for Credit Losses.” This regulation will be applied commencing 1 January 2011.

For details, see Note 1(Y) 3 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 ongoing examinations of the risk level of the bank’s customers.

Processes:

The Bank periodically defines an outine of its activities, as follows:

Outline by sector of the economy

By defining 3 categories by sectorial risk rating – the sectors that the Bank is interested in financing for growth, sectors for selective lending, and sectors in which to avoid increased exposure.. This outline is updated on a routine basis by a periodic analysis of the various sectors and segments of the economy according to the risks and prospects inherent in each sector, which enables the definition of the appropriate credit policy for each branch of the economy.

Activities in the Construction and Real Estate Sector

This is defined on the basis specific sub-activities - 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 below in the section “Structure and Organization of Risk Management Functions”.

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.

Credit risk exposure by counterparty (by main types of credit exposure – (Table 4(d) – Basel II):

	31 December 2009					
	Credit	Bonds	Others	Guarantees and other obligations	Transactions in financial derivatives	Total
	NIS millions					
Sovereign risk	27,309	25,587	-	983	-	53,879
Debts of public-sector entities	3,324	5,446	-	130	-	8,900
Debts of banking corporations	14,579	12,226	-	1,608	5,105	33,518
Debts of securities companies	-	-	-	-	-	-
Debts of corporations	103,532	1,539	-	59,669	4,851	169,591
Debts collateralized by commercial real estate	16,317	-	-	780	-	17,097
Retail exposures to individuals	23,352	-	-	25,371	-	48,723
Loans to small businesses	13,816	-	-	4,070	-	17,886
Housing mortgages	44,180	-	-	2,782	-	46,962
Securitization	-	1,081	-	-	-	1,081
Other assets	-	-	13,138	-	-	13,138
Total credit risk	246,409	45,879	13,138	95,393	9,956	410,775

Distribution of portfolio by repayment period and by main types of credit exposure – (Table 4(e) – Basel II):

	31 December 2009					
	Credit	Bonds	Others	Guarantees and other obligations	Transactions in financial derivatives	Total
	NIS millions					
Up to one year	**141,293**	**8,578**	**3,234**	**63,034**	**4,541**	**220,680**
From one to five years	**67,516**	**20,989**	**790**	**19,735**	**2,099**	**111,129**
More than five years	**37,600**	**16,312**	**793**	**12,624**	**2,637**	**69,966**
Non-monetary items	**-**	**-**	**8,321**	**-**	**679**	**9,000**
Total	**246,409**	**45,879**	**13,138**	**95,393**	**9,956**	**410,775**

Financing transactions for the acquisition of means of control (Non Recourse)

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 as of 31 December 2009 (in NIS millions):

Economic sector	Balance sheet and off-balance sheet credit*
	NIS millions
Industry	2,297
Trade	331
Real estate	1,428
Communications	1,037
Finance and holding companies	1,668
Total	6,761

* Less provisions for doubtful debts and collateral that 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.

Management and Control Processes:
In the area of credit management, control and management processes have been improved, inter alia, by increasing segmentation of business customers between suitable lines of business and in the framework of specialist branches.

The review of credit facilities of the large borrowers in the Bank, approving transactions or passing them for discussion by the appropriate credit committee is carried out by the credit risk management units in the Credit Department in the Corporate and Commercial Banking Divisions. These units were set up, after thorough research, with the aim of tightening controls on credit, and improving the quality of the loan portfolio of the bank and service to customers. For details see under the section "Structure and Organization of the Credit Management Function".

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.

Tools for Measuring Risk:

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, which is typified by a range of products provided to a wide range of customers with a large geographic distribution, 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 at the end of the period 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. A scoring model is planned for borrowers and commercial customers. The Bank has made preparations for the assessment of economic capital "representing" transaction risk, with the aim of arriving at a calculation of Return on Risk-Adjusted Capital (RORAC) and Economic Value Added (EVA) of the customer. This assessment and the adaptation of the borrower rating system as a whole is based on principles of Basel II directives.

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 52 in the section on Critical Accounting Policy.

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 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 Manager of Credit Risks – The Head of the Corporate Division also serves as the Group's Manager of Credit Risks.

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 Sub-Committee - works under the leadership the Head of the Credit Department in the Corporate Division and comprises elements from all the relevant units in the Bank. The Committee meets at least once a quarter and when circumstances make it necessary, and it holds discussions on a range of current subjects with some connection with credit risks.

There is a process of passing information between the above credit risk management committees, in which each Head of Commi9ttee raises important matters for discussion as he thinks fit.

The Credit Risks Manager reports once a quarter to the Senior Credit Risk Management Committee on important subjects and those of principle discussed drying the previous quarter in the Credit Risk Management Committee chaired by her.

The Consumer Credit Risk Management Committee - chaired by the Head of the Banking Division. This committee convenes quarterly and discusses all issues associated with consumer credit risks such as: models and methodologies for managing and reviewing risk in the consumer credit portfolio, quality indices in the consumer credit portfolio, working procedures and work programs, Basel II etc., with an overview of customer credit in the Bank and the relevant subsidiary companies (Leumi Card, Arab Israel Bank, Leumi Mortgage Bank).

Credit policy in the subsidiaries is brought for discussion also 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 (CRMU) – 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. Reporting to the Real-Estate CRMU is an "Appraisals Department", whose duties, *inter alia*, are to examine and validate appraisals of properties pledged to the Bank, carried out by certified appraisers, and to determine the maximum collateral value of the properties.

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.

The section is engaged with developing methodological and advanced computerized tools to allow for the best possible performance of the above tasks.

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, sectorial risks and risks pertaining to sensitive accounts and problem loans at the Bank.

Credit Management and Control Section – operates within the framework of the Credit Department and is responsible, *inter alia*, for the method of managing the various credit committees in the Bank, the format for submitting material for discussion at credit committee meetings, letters of 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.

The Credit Risk Management Unit in the Commercial Division (Commercial CRM) - In the Commercial Division operates a unit with similar characteristics to the Corporate CRM Department described above, which reviews and analyses the bulk of the loan portfolio of the Division. Recently a further unit was set up in the Commercial Division, with organizational and professional responsibility to the Head of the CRM in the Division, to be responsible for examining customers of Principal Branch, Tel-Aviv. The objective of the unit is to broaden the circle of customers examined objectively as usual by the CRM.

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.

Beginning in mid-2009 a new organizational structure was established in the Department, in the framework of which there are 2 units operating. One deals with active customers, and the second with inactive customers.

Credit Risk Management Control Department

This reports directly to the President and Chief Executive Officer and within which, *inter alia*, are the following units:

A. Loan Review and Credit Risk Management Control Unit

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.

The Loan Review Unit performs independent ongoing evaluations of the level of risk of the Bank’s principal business customers and determines the credit rating of these borrowers. This unit operates independently and separately from the Bank’s credit teams.

The Unit 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.

B. Model and Credit Risk Measurement Section

This section is responsible for the development of methodologies and construction of quantitative models and tools for measuring and controlling credit risks in the Leumi Group. These methodologies, which are approved by the Credit Risk Management Committee, support 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 section deals with the validation of credit rating models in use or in the final stages of development in the Banking Division, Leumi Mortgage Bank and Arab Israel Bank.

C. Overall Risk and Models Section

The section deals with 3 areas:

- Independent validation and control of models in use or in final stages of development.
- Leading the ICAAP process.
- Developing models in various areas, including the economic capital model on which the ICAAP is based.

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.

Reports to 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.

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 has made preparations to add the estimated economic capital allocation according to the types of risks and the levels thereof. For the purpose of pricing the credit and banking services, tools are 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.

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.

The Credit Risk Manager of the Bank is authorized to set business criteria for receiving collateral, the manner of determining the rate of reliance on the collateral, courses of action when receiving them, methods and timing for updating them, and means of follow up and control, and to distribute them through working procedures, circulars, and operating instructions.

It should be noted that rates of reliance on securities are updated periodically by the Capital Markets Division.

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. Appraisals must be independent and addressed to the Bank.

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 special transactions, and in cases when shares of a corporation serve as the main collateral and/or the main source of repayment of a loan, an updated appraisal and an examination of the ability of the corporation as a debt repayment source are required. The appraisal is carried out by one of several acceptable methods in the Bank, taking into account the circumstances of the matter, such as: the description of the corporation, the economy sector and economic environment in which the acquired corporation operates. The appraisal can be carried out by an expert unit in the Bank or by and external appraiser included in the list of appraisers authorized from time to time by the Board of Directors of the Bank. If the appraisal is carried out by an external appraiser, an audit review will be carried out on it by business elements and expert units in the Bank.

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. In special cases, when the borrower's characteristics allow, the Bank will be satisfied with a negative pledge only.

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.

The principles on which the rates of reliance for collateral are determined are derived from the degree of liquidity and negotiability of the collateral, ways of realizing the collateral and the speed of realization, the degree of volatility in the value of the collateral, the appraisal of the collateral (internal or external), the degree of control, monitoring and supervision the Bank has over the collateral, the suitability of the type of collateral to the type of financing, and the dependence of the value of the collateral on the state of the client.

Special emphases regarding specific collaterals are reported also in the Credit Policy document of the Bank.

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).

Reduction of credit risk (Table 7) – Basel II):

	31 December 2009	
	Total exposure covered by eligible financial collateral	Total exposure covered by guarantees/credit derivatives
	NIS millions	
Sovereign risk	1	-
Debts of public-sector entities	3	2,968
Debts of banking corporations	48	-
Debts of securities companies	-	-
Debts of corporations	6,121	589
Debts collateralized by commercial real estate	968	-
Retail exposures to individuals	2,408	3
Loans to small businesses	1,781	21
Housing mortgages	122	-
Securitization	-	-
Other assets	-	-
Total	11,452	3,581

16. Credit Risk in Activity in Derivative Instruments

Below are credit risk balances to third parties (Table 8 – Basel II):

	31 December 2009				
	Par value balances	Gross positive fair value of contracts	Set off benefits	Eligible collateral	Net credit exposure of derivatives
	NIS millions				
Interest contracts	154,261	2,987	-	-	2,987
Foreign currency contracts	157,482	5,578	-	-	5,578
Contracts in respect of shares	8,198	679	-	-	679
Commodities and other contracts	2,156	712	-	-	712
Credit derivative transactions	831	-	-	-	-
Total	322,928	9,956	-	-	9,956

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 2009	31 December 2008
Derivatives hedging a positive gross fair value	**47**	75
ALM derivatives with a positive gross fair value	**6,993**	9,972
Total fair value	**6,440**	10,047
Total collateral held	**643**	86

The following table shows credit exposure with respect to the fair value of derivatives, according to counterparties to the contract (reported under other assets), as at 31 December 2009, in NIS millions:

	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Under B-	Unrated	Total
Foreign banks							
United States	**11**	**534**	**-**	-	-	**-**	**545**
Euro zone	**219**	**745**	**-**	-	-	**3**	**967**
Great Britain	**222**	**498**	**8**	-	-	**-**	**728**
Other	**81**	**138**	**-**	-	-	**-**	**219**
Total foreign banks	**533**	**1,915**	**8**	-	-	**3**	**2,459**
Israeli banks	**2**	**418**	**390**	**-**	**-**	**17**	**827**
Corporate customers, according to branches of economy							
Financial services							**1,484**
Industry							**595**
Construction and real estate							**480**
Transportation and storage							**85**
Trade							**66**
Electricity and water							**183**
Business services							**3**
Private individuals							**34**
Communications and computer services							**24**
Others							**6**
Total corporate customers							**2,960**
Others*							**194**
Total exposure							**6,440**

* Reverse transactions carried out by the customers and offset for risk purposes according to branch of economy.

17. Management of Bank 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.

18. Evaluation of Exposure to Risk Factors in the Leumi Group

In the framework of preparations for Basel II, Leumi Group developed a Capital Adequacy Assessment Process (ICAAP). The aim of the process is to examine the capital required to support the various risks to which the Group is exposed and to verify that the capital of the Group exceeds the said capital requirements at all time. The risk appetite and risk-tolerance capability were defined in the process, a comprehensive process took place of mapping out and evaluating risks to which the Group is exposed, a comprehensive framework was developed for analyzing stress scenarios in the framework of managing the Group as a going concern, and risk management processes and the Group risk management structure were reviewed.

The assessing of the various risks to which the Group is exposed, combined with determining the risk appetite facilitates decisions on methodology for classifying exposures to the various risks, described in the Table of Severity of Risk Factors. The level of severity defined below is calculated for stress scenarios which may occur once in 25 years, and allows for the presentation of the level of consistent exposures with the risk appetite of the Group on three levels, Low, Medium and High. In addition, there is a fourth, critical level of severity, describing a deviation from the Group risk appetite as a result of sudden change in market conditions in severe crisis conditions. In the event of such a deviation, a plan will be put into operation to reduce exposures immediately.

Following the ICAAP process, which included the specific definition of the risk appetite and a change in the measurement and definition of risks, a change occurred in the evaluation of severity of the various risks in relation to previous years. This change does not reflect material changes at the levels of actual exposure.

19. Definition of severity of risk factors

The risk appetite of the Group includes qualitative and quantitative declarations on the degree of exposure to risk. The risk appetite is expressed in values of maximum loss the Bank is prepared to bear under certain probabilities, and thus restricts the maximum probable loss in different operating areas. From the definition of the risk appetite it is possible to derive the degree of severity in exposure to different risk factors, defined as the level of unexpected loss received when a stress scenario occurs (serious but logical) which may occur for a probability of once in twenty five years. A special committee for the subject of stress scenarios developed, in the framework of the ICAAP, a comprehensive set of stress scenarios at different levels of severity, including the risks to which the Group is exposed in the framework of its business activity. Exposure to each risk factor is examined in the most severe scenario relevant to the risk factor.

The thresholds for levels of severity were phrased in terms of a decrease in original capital adequacy to risk assets. Original capital is Tier 1 capital without hybrid capital instruments representing the first cushion for absorbing losses. The calculations were carried out for the level of capital at the end of 2009. Below are the definitions of the level of severity of risk factors as reflected by the risk appetite of the Bank:

- Low level of severity: the occurrence of a stress scenario[2] in a risk factor will not lead to a decrease of more than 1[*] %in original capital adequacy as at the end of 2009. In this case the original capital adequacy will still be above 7.33%.

- Medium level of severity: the occurrence of a stress scenario in a risk factor will lead to a decrease of less than 2% in original capital adequacy as at the end of 2009. In this case the original capital adequacy will be more than 6.33% (in a range of 6.33%-7.33%).

- High level of risk: the occurrence of a stress scenario in a risk factor will lead to a decrease of more than 2% in original capital adequacy as at the end of 2009. In this case the original capital adequacy will be less than 6.33%. In any event the level of risk matching the risk appetite of the Group will not lead to a decrease from the level of original capital ratio to risk assets of 6%.

- Critical level of risk: the occurrence of a stress scenario in a risk area will cause the original capital adequacy to go below 6%. This level of severity is not consistent with the risk appetite, and may be caused following exceptional changes in market conditions. Leumi Group will take immediate steps to reduce exposures in the area in which the level of severity of the risk reached a critical level

These calculations take into account that the loss in a stress scenario will not prevent the Bank from recording deferred taxes in its books in respect of the loss created in the stress scenario. In the Table of Severity of Risk Factors brought below, an evaluation of the severity is shown for each of the different risks derived from the consequences of stress scenarios. We should point out that none of the exposures to risk factors is defined as critical, and the distribution of risks received is appropriate to the risk appetite and the targets of the Group.

It should be noted that the risk appetite and the methodology of defining levels of risk in different banks are not necessarily identical or even similar to each other. As a consequence, the severity of different risk factors, which is a result of the risk appetite and the above mentioned definition methodology, are not comparable between different banks. Thus differing levels of severity of risk factors are decided by each bank, in accordance with the risk appetite of that bank.

Details of Risk Factors and Exposure to them

Based on the risk appetite of Leumi and an analysis of stress scenarios in the framework of the ICAAP process, a comprehensive process was carried out to identify and map out all the risk s to which the Group is exposed. The Table below includes the types of risk to which the Group is exposed. For each risk in the Table an assessment of severity was carried out according to the criteria for assessing the severity of risk factors shown above.

[2] This means a scenario which may occur in a cycle of 1in 25 years (96 percentile) or “once in a career”.

[*] According to figures for 31.12.09, any decrease of 0.1% in original capital adequacy ratio reflects a loss of NIS 258 million.

Table of severity of risk factors:

	Risk	Definition	Level of Severity
1	Overall credit risk [3]	Negative results connected to failure or failure to honour loan instrument or participation contracts due to deterioration in credit quality of the counterparty	Medium
1.1	Single borrower and collateral risk	Total risk described by probability of failure, loss in the event of failure and exposure at the time of failure of single borrowers	Medium
1.2	Concentration risk	Credit risk deriving from exposure to group of business entities with common characteristics	Low
1.2.1	Large borrower concentration risk	Credit risk deriving from relative size of the borrowers in the loan portfolio	Low
1.2.2	Sector and segment concentration risk	Credit risk deriving from concentration of borrowers in certain sectors and segments of the economy	Low
1.2.3	Infection risk	Credit risk deriving from joint failure of assets connected by way of ownership or partnership relationships, guarantees or other business dependency	Low
1.3	Settlement risk	The risk that a third party will not transfer securities or their value in money after execution of the part of the Bank in the transaction	Low
2	**Overall credit risk**	**Risk deriving from changes in the fair value of a financial instrument or in cash flow resulting from changes in market conditions**	**Low**
2.1	Market risk – general	Market risk which can be hedged by quoted financial instruments.	Medium – Low
2.1.1	Options risk	Special risks for ordinary options	Low
2.1.2	Basis risk	The risk following movements in exchange rate including inflation (trading and banking portfolio)	Low
2.1.3	Interest risk	The risk following movements in interest rates (trading and banking portfolios)	Low
2.1.4	Margin and share price risk	The risk following movements in share and debenture prices in the trading portfolio for assets appraised at market price	Low
2.2	Liquidity risk	The risk of lack of inability to deal with uncertainty in relation to the possibility of raising sources of funds and/or realizing assets, in an unexpected manner and within a short period of time, without causing material loss	Low
2.3	Interest structureds risk	Interest risk that cannot be hedged and are structured in commercial banking activity	Low
.3	**Operational risk**	**Risk of loss deriving from deficiencies or failure of processes, internal individuals or systems, or external events. This risk includes legal risk, but does not include strategic risk or reputational risk**	**Low**
3.1	Operational risk – general	Risk of loss resulting from failure of internal processes, individuals or systems, or as a result of external events	Low
3.2	Legal risk	The risk deriving from activity not in accordance with legislation (civil), legal errors and class actions carried out against the Bank.	Low
4	**Strategic risk**	**Risk deriving from strategic decisions, including inaction or lack of adjustment to changing conditions**	**Low**
5	**Reputational risk**	**The risk that negative publicity will cause a decrease in the customer base, a decrease in revenue or high legal costs**	**Low**
6	**Regulatory risk**	**The risk that can derive from non-compliance with regulatory requirements, such as minimum capital adequacy ratio**	**Low**
7	**Systemic risks**	**Risks caused by external events which may lead to the occurrence of a number of risks at the same time**	**Medium**

[3] Including credit to the public, deposits with banks, debentures, activity in derivatives, etc.

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, investments in debentures, and holdings in equity.

The severity of overall credit risk is Medium, and is derived from loan losses in a very severe stress scenario in the set of scenarios of the Group (see further details on risk management on page 218). Below are details of sub-risks included under the definition of credit risk according the Group map:

1.1 Risk in respect of borrowers and collateral: risk in respect of the entry of a counterparty into default, leading to not meeting contractual monetary obligations. The risk includes:

- Entry into default of counterparty in derivatives.
- Residual risk in respect of inability to realize collateral when there is default of a counterparty.
- Country risk deriving from the exposure of borrowers operating in foreign countries: and
- Credit risk in shares deriving from the exposure to risk in respect of holding shares for investment purposes.
- The assessment of the severity of the risk was carried out by examining the distribution of the portfolio of credit to the public in the framework of a very severe stress scenario in this category. The level of severity is defined as Medium.

1.2 Concentration risk: Credit risk in a significant exposure to counterparties with similar economic characteristics or engaged in similar activities, which may lead, in a situation of change in the economic situation, to a similar effect on the ability to meet debt repayments of those counterparties. Below are details of sub-risks included in the definition acceding to the Group map:

1.2.1 Significant exposure to a large borrower. The severity of the risk level is defined as Low;
1.2.2 Sectorial or segmental exposure. The severity of the risk is defined as Low;
1.2.3 Exposure to a group of borrowers (infection). The level of risk is defined as Low.

- The severity of the overall risk and sub-risks was examined in the framework of stress scenarios which examined what was the damage in respect of concentrations of credit in the portfolio as a result of the occurrence of a serious crisis. The severity of overall concentration risk is estimated as Low.

1.3 Settlement risk: the risk that a counterparty will not carry out his part of an intra-day settlement transaction as a result of entering into default. The risk exists when proceeds are not transferred simultaneously. The maximum loss in a stress scenario is derived from the risk exposure limits. We carry out settlement through banks with very high rating, and there is intra-day monitoring of the condition of the clearing banks facilitating changing a clearer if there is suspicion of deterioration in the state of one of the clearing banks. Since the probability of default of clearing banks is very low, and combined with the fact that the exposure to settlement is intra-day, there is a very low probability that settlement exposures will be harmed. For these reasons, the level of severity of the risk is defines as Low.

2. Market risk

Market risk is defined as a risk of exposure of Group assets because of uncertainty of changes in exchange rates, interest, inflation and shares, the correlation between them an d their level of volatility. The severity of overall market risk is medium-low and is derived from market losses in a very severe stress scenario in the set of scenarios of the Group (see further details on risk management on page 192). Below are details of sub-risks included under the definition of credit risk according the Group map:

2.1 Market risks – general: risk of exposure of the Group's assets to uncertainty of changes in market factors that can be hedged against. This definition includes:

2.1.1 Risk of activities in options. The severity of the risk is defined as low;
2.1.2 Basis and interest risk. The severity of the risk is defined as low;
2.1.3 Margin and share price. The severity of the risk is defined as low.

The severity of the general risk and sub-risks was assessed according to the most severe stress scenario in the set of scenarios. The level of severity of the risk is defined as low.

2.2. 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, without causing materials loss. 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. Monetary damage in a very severe liquidity scenario is also low.

2.3 Structured interest risk: the risk of exposure of the Group's assets as a result of uncertainty of market factors which cannot be hedged against but are structured in banking activity. The risk includes behavioral options inherent in loans and deposits which cannot be hedged (for example early repayment of option) and a risk of repricing as a result of unexpected changes in the terms of financing. The level of damage is assessed in the framework of a special stress scenario for the risk. The severity of the damage is defines as low.

3. 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."

3.1 Operational risk – general: In the Bank economic capital is calculated according to an internal model (LDA) for calculating the annual damage deviating in the 96 percentile, namely in a probability of once in 25 years. From this calculation and from a review of historical events, the level of severity of the risk is defines as low. (See further details on risk management on page 211.)

3.2 Legal risk

The risk of loss resulting from the inability to legally enforce the performance of an agreement or contingent liability. 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. (See further details on risk management on page 214.)

4. Strategic risk

The risk of deviating from expected profitability when deciding to enter into new lines of business, less credit and market risks. The risk includes:

- Remote external environment: the risk derives from changes in the political, economic, social, technological or regulatory environment.
- Close external environment: the risk derives from changes in the competitive environment in which the Bank operates.
- Internal environment: the risk derives from decisions/processes/actions taken or not taken by the Bank, which have a significant effect of the bank's results.

The maximum damage in a strategic stress scenario is lower than the average return and so the level of severity of the risk is defines a slow.

5. 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. Group products and services are of the highest quality in the economy, and the financial results show that the Group meets the expectations of shareholders and the public at large. The treatment of employees and customers is manifest by the minimal number of complaints. In addition, there are detailed contingency plans for dealing with reputational events. The Group's reputational risk is categorized as low.

6. Regulatory risk

The risk which may derive from non-compliance with regulatory requirements, new regulatory requirements and reforms which may cause damage to the Bank. Reforms carried out in the past and also those implemented currently, for example Basel II guidelines, show that the Bank has the ability to adapt itself in a relatively short period of time both to capital adequacy requirements and to carrying out complex bank-wide processes. Therefore, the severity of regulatory risk is defined as low.

7. Systemic risks

Risks deriving from economic, political, and geopolitical events in Israel or abroad, that may endanger the stability of the Group, such as a war or a global economic crisis. The assessment of the risk is based on the total loss in a very severe stress scenario in the Group set of scenarios. The degree of severity is classified as medium.

Credit Exposure to Foreign Financial Institutions

The following table presents the credit exposure to foreign financial institutions [(1)] as at 31 December 2009:

	Balance sheet credit risk [(2)]	Securities [(3)]	Current off-balance sheet credit risk[(4)]	Current credit exposure
	NIS millions			
External credit rating [(5)]				
AAA to AA–	3,540	3,454	111	7,105
A+ to A–	10,862	10,353	464	21,679
BBB+ to BBB–	89	426	10	525
BB+ to B–	156	18	2	176
Lower than B–	-	-	-	-
Unrated	663	242	46	951
Total current credit exposure to foreign financial institutions	15,310	14,493	633	30,436
Balances of problem loans	4	186	-	190

(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 2,907 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.

Exposures by country are broken down as follows: the United States 38%; Europe (Germany, France, Italy, Spain and the Benelux countries) 23%; United Kingdom 17%; other countries 22%.

The exposure includes mainly deposits in foreign banks, some 76% 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 and 2009, the Bank significantly reduced the list of banks with which the Bank and its overseas subsidiaries make deposits, and reduced the maximum volume of exposure to them approved for the Bank.

During the fourth quarter of the year, 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 107.

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 exposure is in respect of customers active in those countries (Table 4(c) – Basel II):

	31 December 2009		
	Balance sheet credit risk	Off-balance sheet credit risk	Total credit risk
	NIS millions		
USA	**24,433**	**11,155**	**35,588**
UK	**8,475**	**7,869**	**16,344**
France	**4,611**	**2,348**	**6,959**
Holland	**3,514**	**216**	**3,730**
Germany	**4,717**	**2,004**	**6,721**
Others	**16,173**	**4,273**	**20,446**

* In connection with exposure to foreign countries, see also Exhibit G.

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	57,890	26,629	84,519	94.10%	2,041
High-income countries	1,589	265	1,854	2.10%	-
Countries with mid-high income	2,197	691	2,888	3.20%	125
Countries with mid-low income	243	254	497	0.60%	1
Countries with low income	4	26	30	-	-
Total	61,923	27,865	89,788	100.00%	2,167

The countries are rated according to national income per capita as follows:

High income - exceeding US$ 11,906 per capita.

Mid-high income - from US$ 3,856 to US$ 11,905 per capita.

Mid-low income - from US$ 976 to US$ 3,855 per capita.

Low income – up to US$ 975 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 investment 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.

In 2009 there was an increase of some NIS 10 billion in total deposits from the public (including subordinated notes and capital notes), in total credit to the public there was a decrease of NIS 9 billion, in debentures and increase of some NIS 13 billion and in credit to banks an increase of some NIS 9 billion.

During 2009, there was a significant increase in the liquidity balances of the Bank in shekels which manifested itself in that about 16% of total assets of the Bank are deposited for short terms in banks and/or invested in quoted securities, mainly government bonds. This resulted from a policy directed to raising stable and varied sources of funds, by means of public and private offers and raising deposits from a large number of customers for various periods including long-term. The high liquidity reflects also the expansive monetary policy of the Bank of Israel in 2009.

Against the backdrop of liquidity surpluses in the system, total liquid assets in 2009 were significantly higher than total short term liabilities and the Bank complied with all liquidity limits for the various scenarios. This was in accordance with the policy whose aim is to ensure stability also in extreme theoretical stress scenarios, more difficult than situations the Bank underwent in the past.

The following are the main changes that took place during 2009 in the liquidity position, as shown in the distribution of assets and liabilities according to repayment periods and divided according to linkage sectors:

The unlinked shekel sector

Some 48% of assets at the end of 2009 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 2009 by NIS 4 billion, some 4.3%, as a result of the increase in granting of mortgage credit in the unlinked shekel sector.

In 2009 there was an increase in the volume of deposits of NIS 7 billion or 6.3%. This increase included the issue of capital notes and subordinated notes of NIS 1.3 billion, of which NIS 1 billion are recognized by the Supervisor of Banks as Upper Tier 2 capital, and NIS 0.3 billion as Lower Tier 2 capital. In addition, there was an increase in the Bank's sources as a result of activity in shekel/foreign currency futures transactions, in which shekels were received for foreign currency. The increase in sources from the public contributed towards the increase in liquidity surpluses in shekels.

In 2009 the equity invested in the sector increased by some NIS 4 billion.

An examination of the distribution by repayment periods shows that during 2009, for periods of up to a year, because of the low interest rates in the shekel sector, there was a move of time deposits to current accounts. For periods from one to five years there was an increase in the surplus of assets over liabilities as a result of investment of long-term funds raised during the year in short-term and liquid assets. For longer periods there was an increase in the surplus of assets over liabilities as a result of the sharp increase in loans granted as mortgages in the shekel sector, as mentioned above.

The CPI-linked sector

Most of the transactions in this sector are for periods longer than a year.

In comparison with 2008 there was a decrease of some NIS 2 Billion in the equity invested in the sector. The decrease in total equity is a result of the issue of index-linked subordinated capital notes recognized as Upper Tier 2 capital in the amount of NIS 2 billion and the index-linked subordinated notes recognized as Lower Tier 2 capital in the amount of NIS 1.5 billion. In addition, the balance of credit to the public in the sector at the end of 2009 amounted to some NIS 49.3 billion, compared with NIS 53.5 billion at the end of 2008, a decrease of NIS 4.2 billion, or 8%. Transactions in derivative instruments in the direction of purchasing index-linkage protection by the public decreased net by about NIS 1 billion (16%).

An examination of the distribution by repayment periods shows that at the end of 2009 the surplus of assets over liabilities was NIS 1.5 billion higher for periods of up to one year than at the end of 2008. For repayment periods of over one year to five years, the surplus of assets decreased by some NIS 2 billion. The decrease in surplus assets for periods over one year of some NIS 7 billion derives from a reduction in the volume of long term loans, and also as a result of an increase in total liabilities resulting primarily from issues of subordinated notes and capital notes, as explained above.

Foreign currency and foreign-currency linked sector

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.

During 2009, because of the low interest rates in the foreign currency sector, there was a move from term deposits of up to one month to current deposits and deposits for periods of up to three months and one year.

Since the beginning of 2009, a decrease in the amount of NIS 1 billion (0.8 %) was recorded in the volume of deposits of the public in foreign currency. After the effect of changes in exchange rates is neutralized, the decline was at the rate of 1.5%.

Credit to the public, which constitutes only some 47% of the deposits of the public in this sector, fell by about NIS 9 billion – a decrease of 15%, and after the effect of changes in the exchange rate is neutralized, credit fell by 16%.

Investments in foreign currency securities amounted to some NIS 27 billion, an increase of NIS 1 billion compared with 2008.

Futures transactions activity was of material significance on liquidity in the foreign currency sector. The increase in the volume of futures transactions in which foreign currency is delivered against the receipt of shekels amounted in 2009 to some NIS 9 billion. There was a much more moderate decrease in deposits with banks. As a result, the surplus of foreign currency liabilities over assets for a period of up to one year declined by the amount of some NIS 6 billion.

The following table sets out a summary of the assets and liabilities classified by linkage basis divided by 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 2009**			
	Unlinked Israeli currency	**CPI-linked**	**Foreign currency including foreign currency linked**	**Total**
Period remaining to maturity:	**NIS millions**			
Up to 1 month	**(16,453)**	**(300)**	**(30,585)**	**(47,338)**
From 1 month to 1 year	**2,499**	**2,310**	**(5,959)**	**(1,150)**
From 1- 5 years	**23,618**	**(173)**	**30,157**	**53,602**
From 5 - 10 years	**12,093**	**(6,357)**	**7,220**	**12,956**
More than 10 years	**9,087**	**7,110**	**839**	**17,036**
Without maturity date	**2,068**	**(215)**	**290**	**2,143**
Total	**32,912**	**2,375**	**1,962**	**37,249**

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	(14,564)	(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

* 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 191 to 218.

B. Liquidity Position and Funding

The liquidity Position of the Banking System -

In 2009, the Bank of Israel increased the volume of *Makam* tenders by some NIS 14 billion, to a level of some NIS 85 billion.

The balance of the banking system's monetary deposits with the Bank of Israel increased to some NIS 105 billion at the end of December 2009, compared with some NIS 44 billion at the end of December of 2008.

The average volume of these balances was at a level of some NIS 98 billion in the last quarter of the year and at an average of some NIS 75 billion for the whole of 2009.

Leumi's balance of monetary deposits with the Bank of Israel at the end of December 2009 amounted to some NIS 24 billion, compared with some NIS 13 billion at the end of 2008.

The average volume of Leumi's balances with the Bank of Israel was at a level of some NIS 24 billion in the last quarter of the year and at an average of some NIS 19 billion for the whole of 2009.

The significant increase in the balances of the banking system in 2009 resulted from, *inter alia*, the following actions taken by the Bank of Israel:

- In 2009 the Bank of Israel continued its program (which began in 2008) to increase the levels of the foreign currency balances though purchases of dollars. On 3 August 2009, the Bank of Israel announced that beginning on that day it would take action in the foreign currency market in the event of exceptional fluctuations in the exchange rate, which were not appropriate to basic economic conditions, or when the foreign currency market was not functioning normally. On 10 August 2009, the Bank of Israel announced that it would discontinue the program of fixed daily purchases of $ 100 million. In the whole of 2009 the Bank of Israel purchased some $ 20 billion.

- Beginning on 17 February 2009, the Bank of Israel acted in the open market and carried out transactions in government debentures in the secondary market. According to an announcement by the Bank of Israel at the end of March 2009, the rate of purchases of government debentures – shekel and index-linked – was NIS 200 million per day. On 7 July 2009 the Bank of Israel announced the discontinuation of government debentures purchases in the secondary market commencing on 5 August, and that it did not intend selling the securities it had acquired.

Against the backdrop of large liquidity surpluses in the system, the Bank of Israel announced on 21 September 2009 the discontinuation of repo tenders with the Bank of Israel until further notice. In its announcement, the Bank of Israel made it clear that after regulating the repo market it would be possible to execute repo transactions by means of the central clearing system of the Stock Exchange and "over the counter".

The Liquidity Position of 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, including long term. It is also the result of the expansive monetary policy practiced by the Bank of Israel. Some 45% of the assets are deposited in banks and/or are invested in securities, primarily in debentures.

The Bank has cash and deposits in banks amounting to some NIS 72 billion, of which some NIS 29 billion in Leumi Mortgage Bank.

The Bank also has a securities portfolio of some NIS 49 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 41% of the Bank's total assets as at 31 December 2009, compared with 33.3% as at 31 December 2008.

The ratio of credit to the public to deposits of the public on 31 December 2009 was 57.6% - compared with 65.5% on 31 December 2008.

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 205 of the Report.

This year, against the backdrop of negative developments in money markets overseas, the Bank adopted a policy of increasing business liquidity, reducing liquidity risk, and strengthening controls on the management of liquidity balances. In this framework, the Bank increased its investment in securities issued by countries with the highest credit rating, and increased its deposit base in the central banks of these countries. In addition, for purposes of strengthening control over management of liquidity balances, more conservative limits were set than in the past for the management of credit risks and settlement risks involved in activity with banks abroad.

For additional details regarding the liquidity status, see the Risk Management section on page 208.

Sources and Uses in the Bank

In 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. In 2009 on the other hand, a slow return to the capital market could be seen.

The balance of deposits of the public at the Bank rose during 2009 by NIS 9.7 billion, or 4.3%. Most of the increase was in the unlinked sector, which rose by 7.4%.

During April-May 2009, the Bank issued some NIS 1 billion of index-linked subordinated capital notes (non-quoted) classified as Upper Tier 2 capital, and through Leumi Finance Company, a further NIS 1.5 billion of index-linked subordinated notes classified as Lower Tier 2 capital were issued to the public.

In August 2009, Leumi Finance Company issued some NIS 2 billion of subordinated capital notes classified as Upper Tier 2 capital, of which NIS 1 billion index-linked at 5% fixed interest, and NIS 1 billion in unlinked shekels at variable interest with a margin of 2% above the one-year *Makam* yield. In addition, Leumi Finance Company issued subordinated notes in the amount of NIS 0.3 billion classified as Lower Tier 2 capital at a shekel interest rate of 7%.

In February 2010, additional subordinated capital notes, classified as Upper Tier 2 capital, were issued in the amount of NIS 2.3 billion, of which NIS 1.3 billion index-linked and NIS 1 billion in unlinked shekels.

The capital notes were issued for a period of 50 years, with an option for the Bank of early repayment every year after the end of 11 years, if certain conditions exist.

In 2009, the volume of credit to the public fell by NIS 12 billion, or 8.3%. The decrease was in all linkage segments. Foreign currency credit declined by 22.6%, and after neutralizing the effect of the exchange rate, foreign currency credit decreased by 23.8%.

Basel II

The figures in Leumi's financial statements, the calculation of risk assets and the capital adequacy ratio as of 31 December 2009 include, for the first time, like the whole banking system in Israel, the figures of Leumi Group in accordance with the standardized approach of Basel II. During 2009, when capital adequacy data was reported in accordance with the principles of the standardized approach in Basel II as well as those according to the principles of Basel I, a significant increase was recorded in the level of the capital adequacy ratio of the Group, to some 14.09% at 31 December 2009, in comparison with some 10.47% at 31 December, 2008.

The minimum capital adequacy ratio required by the Supervisor of Banks is 9%, of which 8% is in respect of the First Pillar. The results reported by Leumi as at 31 December 2009, according to a preliminary assessment by the Bank, cover the capital required in respect of the First Pillar and the Second Pillar including stress scenarios used by the Bank in its internal preparations.

This assessment is preliminary and has not undergone the supervisory process of the Supervisor of Banks.

Since 2006, 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.

At the core of the instructions and requirements under the directives of the standardized approach is the Bank of Israel's Basel II Provisional Directive. This directive was published on 31 December 2008, and is based mostly on the Basel Accord. The directive also includes changes and adjustments required by the Supervisor of Banks.

The Basel II directives are divided into 3 main Pillars:

The first pillar
This includes details of the various approaches for calculating risk assets. In accordance with the decision of the Supervisor of Banks the Israeli banking system is implementing, as mentioned, the standardized approach for credit, market and operational risks. For operational risks, the Supervisor allowed \a transition period of 3 years during which the basic indicator approach will first be implemented, due to the lack of data for previous periods required by the standardized approach in the matter of operational risks.

The second pillar
This refers to the Supervisory Review Process (SRP) and also includes processes for the banking corporation's risk management, with a central part of the second pillar being the ICAAP (Internal Capital Adequacy Assessment Process) which is based, *inter alia*, on the use of methodology of stress scenarios, calculation of economic capital etc., in accordance with the instructions of the Supervisor of Banks as will be described below.

The third pillar
This refers to disclosure principles and details of qualitative and quantitative data to be reported to the public concerning banking corporations' risk management.

For the purposes implementing the Basel II guidelines, the Supervisor published a list of documents, instructions and requirements based mostly on Basel Committee documents, and, in addition, draft documents and instructions for consultation with the banking system. The Supervisor also publishes various instructions and clarifications on the Bank of Israel internet site, in a list of questions and answers, that are updated quarterly, in which reference is made to issues raised by the banking system.

As part of the Group's preparations for the initial official publication of capital adequacy ratios based on Basel II principles and regulations as of 31 December 2009, a number of required directives have been implemented:

- Study of the requirements in the Basel and Bank of Israel documents requirements the carrying out of gap analyses prepared required by them.
- Intensified activity at Bank and Group level for closing and reducing the gaps which were identified.
- On 10 January 2010 the Bank submitted a report to the Supervisor of Banks showing the status of gaps remaining to be dealt with in the framework of the 18 guidelines of the second pillar. The report included data from the Bank and four subsidiaries in Israel.

Below are the 18 second pillar guidelines and the number of gaps remaining to be dealt with according to the number of the guideline (in parentheses): The timetable for closing most of the gaps is during 2010.

	Name of Directive (Guideline)
1	Management of Derivative Risk
2	Sound Practices for Banks with Leveraged Institutions
3	Instructions of the Supervisor for Managing Collection Risk in Transactions in an Emergency
4	Principles for Proper Management of Liquidity Risk and Supervision by the Authorities
5	Sound Practices for Liquidity Management
6	Principles for Managing Interest Rate Risk and Supervision by the Authorities
7	Sound Practices for the Management and Supervision of Operational Risk
8	Core Principles for the Effective Banking Supervision
9	Principles for the Implementation of Stress Tests
10	Enhancing Corporate Governance
11	Enhancing Corporate Governance in Banking Organizations
12	Principles for the Management of Credit Risk
13	Internal Audit in the Supervisor's Banks and Relations with Auditors
14	Due Diligence of Customers in Banks
15	Framework for Internal Audits
16	Cross-Border Management and Supervision of Cross-Border Electronic Banking Activities
17	Risk Management Principles for Electronic Banking
18	Proper Assessment of Credit Risk and Measurement of Debts

- Adjustments to the infrastructure systems through purchase and upgrading of risk management and capital calculation systems have been purchased or upgraded, and linking them to existing systems. These systems upgrade and significantly improve the Bank's ability with regard to effective risk-focused management.

- Data collection and the establishment of databases required for the assessment of risk variables.

- Organizational and process changes in the area of credit risk management, including examination of the subject of the Chief Risk Officer function in the Bank.

- Model development processes, in credit risks for assessing risk components.

- Surveying and mapping of operational risks as part of a three year program to implement the standardized approach also for operational risks, as well.

- Carrying out required adjustments in risk management policy and guidelines (credit, market and operational risk policy and non-banking investments).

- Measurement of the profitability of lines of business also on the basis of models for adjusted return on risk – RORAC (Return on Risk Adjusted Capital) and EVA (Economic Value Added) in when adopting the standardized approach.

In the context of these preparations for implementation as at 31 December 2009, many procedure business adjustments and computer system adjustments were carried out at the Bank and Group level, in order to meet the requirements of the standardized approach.

To this end, the Bank relies on a number of central computer systems purchased and adapted for this purpose. The systems are used for calculating risk assets and capital requirements and for managing the Group loan portfolio.

Without detracting from the preparations for the implementation of the standardized approach and in accordance with its priorities, the Bank is investing efforts and resources in improving and upgrading credit risk management processes. This investment includes collection of data, construction of data bases, formulating processes for the development of internal models for internal rating, improving existing models for assessing PD (probability of default) and of the severity of the LGD (loss given default) and EAD (exposure at default). This process also involves the replacement and upgrading of systems used to rate retail and corporate borrowers both in the Bank and in various units wuithin the Group.

Leumi Group's preparations for the implementation required under the directives emphasize a number of points:

1. Enhanced corporate governance, internal control, audit and compliance.
2. Changed thinking and corporate culture in the transfer to effective management of the loan portfolio, the pricing of risks and measuring performance at the Bank and the line of business level on a risk-adjusted basis.
3. Segmentation of lines of business in accordance with business activity and the allocation of capital required for each of the lines of business.
4. Upgrading activity by product managers and activities for increasing the management and monitoring of risks.
5. Combining all information systems for risk management into an integrated system by synchronizing the different systems.
6. Changing and upgrading policy and organization-wide procedures together with business cooperation between lines of business and synchronizing the different activities.
7. Establishing the ICAAP process as a central management tool.
8. Improving the Bank's strength as a result of adopting advanced risk evaluation methodologies.
9. Improving profitability as a result of raising the quality of risk management and advanced methodologies for identifying and evaluating risks.
10. Creating a clear link between the risk profile of the corporation, in the light of the risk appetite that had been defined, and the quality of risk management for the allocation of the required capital.

Banking corporations have also been required by the Supervisor of Banks to determine capital adequacy targets for 2010 on the basis of the principles of the standardized approach of Basel II. Together with the calculation of capital adequacy ratios in accordance with the Basel II principles, as described above, banking corporations are also required to continue reporting data also in accordance with Basel I principles, during 2010.

Page 31 of the Report presents Leumi's capital adequacy targets as approved by the Board of Directors.

ICAAP (Internal Capital Adequacy Assessment Process)

The aims of the process are to examine the capital required to support the various risks to which the Group is exposed, to identify risks of which it was unaware, to verify that the effective capital of the Group is larger than capital requirements at all times, and to improve risk management in the Group. In the framework of the process, the risk appetite and the risk-bearing ability were defined, a comprehensive and forward-looking process was undertaken to map out and evaluate risk to which the Group is exposed, a comprehensive framework was developed for analyzing stress scenarios in the framework of managing the Group as a going concern, and risk management processes and the structure of risk management in the Group were examined.

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.

   In the framework of examining risk-bearing ability, the Group examines its survival capacity in different types of stress scenarios covering all material risks to which the Group is exposed, and at various levels of severity, such as a sectorial crisis, a mild or a severe recession. Stress scenarios are developed in a special committee for the subject comprising risk managers and content managers from various business areas and representatives of subsidiary companies, and the material results of the above discussions are reported to the Board of Directors and Management in the framework of their risk committees. Results of significant scenarios are examined against the present capital structure and the multi-year plan. It should be pointed out that, even under the most severe scenarios, according to preliminary internal calculations and before the subject goes through the Supervisory Review Process, the Group would not exceed the risk-bearing ability it has determined for itself. In the framework of the capital adequacy assessment process and as part of improving risk management, stress scenarios have become an integral part of routine risk management both at Group level and at the level of the business units and subsidiary companies.

2. An annual review of risk management in the Group, an examination of risk management according to the standard approach determined in the context of Basel II, the identification of strengths and weaknesses and the construction of work programs for the improvement and update of risk management processes. Also, *inter alia*, in the light of economic reviews and update of economic forecasts. The assessment of risk management processes is closely linked to capital adequacy assessment, since, without strong and adequate risk management, a larger allocation of capital is required as protection against losses.

The results of the process are collected in the ICAAP document. A first draft of the document was submitted to the Bank of Israel on 1 July 2009, and the annual document is expected to be submitted at the end of the second quarter of 2010. On the basis of the document to be submitted to the Bank of Israel, a dialogue will take place with the Supervisor of Banks with the aim of approving the capital adequacy determined by the Bank as a target in accordance with Basel II principles.

This process will be examined by the Supervisor of Banks as part of the Supervisory Review Process (SRP).

Circular on “Chief Risk Manager and Risk Management Function”

Following publication of the draft circular on 10 June, 2009, the Supervisor published the final and binding version of the circular on 22 December 2009. According to the circular, corporations are required to submit for approval of the Supervisor before 31 March 2010 the planned structure of the risk management function. The Bank has begun preparations for the matter while reviewing the recommended and appropriate structure at Bank and subsidiary companies level. The Group’s preparations for establishing the structure require the investment of significant management and financial resources. Establishing a Group risk management structure as required by the principles of the Supervisor’s circular, and in accordance with the business outlook of the Bank, will significantly improve and upgrade risk management processes on a broad-based level and from aspects of corporate governance, controls and risk management itself.

Preparations for 2010:

Below are the matters requiring implementation in the Group’s expected preparations planned for 2010:

1. **First pillar** – completion of subjects required by the standardized approach such as: computer implications, mapping out liabilities, the use of securities as collateral, the use of external ratings, etc., including intensive attention to enhancing data,

2. **Second pillar** – completion of treatment of gaps found in the 18 guidelines of the second pillar such as credit risk, the trading portfolio, cross-border electronic banking, etc.

   - Upgrading risk management as required by the guidelines.
   - The use and assimilation of ICAAP as a central tool in capital, planning and risk management.
   - The assimilation of the use of stress scenarios in the business area.
   - Synchronization of new systems coming online in 2010.

3. Formulation of an appropriate risk management system to include:

   - Active supervision on the part of the Board of Directors and Senior Management.
   - Appropriate policy, procedures and limitations.
   - Identifying, measuring, controlling, monitoring and reporting risks comprehensively and on time.
   - Management information system.

4. Organization for the implementation of corporate governance, in accordance with the Bank of Israel circular to the Chief Risk Officer.

5. Allocation of capital and its loading on the various profit centers and the measurement of risk-adjusted performance.

6. Formulation of the preferred method of treatment for risk management in overseas units from the aspects of advice, support and control.

Trends and Forward-looking Information

In December 2009, a discussion document was published by the Bank for International Settlements (BIS) on the subject of Basel II.

The trend indicated according to the various BIS discussion documents is for a stricter approach in risk management directives and their respective capital requirements, in 5 main areas:

1. Capital base – improvement of capital quality with emphasis on Tier 1 and a reduction of its components such as the proposal to cancel the tertiary capital component.

2. The trading portfolio – increasing capital requirements in this respect, as a result of the requirement of an extreme VAR calculation, the addition of tests for risks of downgrading of the security, etc.

3. Leverage ratio – its reporting as part of sensitivity to risk while increasing its components such as off-balance sheet instruments and preventing the deduction or offsetting of collateral.

4. Economic cyclicality – adjusting capital buffers to a complete business cycle.

5. Quantitative liquidity ratio – stricter directives such as the addition of a 30-day liquidity ratio.

The aim of the greater strictness proposed by the BIS is to bring about an improvement in the resilience capacity of banks in times of crisis, in view of the lessons of the 2008 crisis, while including improvements in the area of risk management and emphasis on:

- Improvement in capital quality.

- Adapting the measurement of risks to the risk level of the Bank.

- Strengthening supervision – determining better tools for adapting capital requirements for every bank in accordance with its risk profile.

- Lowering dependency of capital requirements on the financial situation.

- Increasing transparency of risk management methods.

At this stage it is not possible to assess the effect of the above recommendations if and when implemented on capital adequacy ratios and capital required, although it should be pointed out that the general trend worldwide is to strengthen financial regulation of the banking system.

Certain data required under the third pillar of Basel II has been expanded and/or added in the Directors' Report and Financial Statements in accordance with the directives of the Banking Supervision Department, as set out below:

Subject	Directors Report	Basel Requirement Table	Financial Statements
General	Page 13	1	-
Capital Structure (Qualitative and Quantitative)	Pages 27-28	2	Note 13
Capital Adequacy (Qualitative and Quantitative)	Pages 28-31	3	Note 13
Risk Exposures and Assessment – General Qualitative Disclosure	Pages 191-195		
Credit Risk Qualitative Disclosure	Pages 219	4(a)	-
Credit Risk Exposures by Main Types of Credit	Page 216	4(b)	
Exposures by Geographic Area to Foreign Countries	Page 243	4(c)	Exhibit F
Credit Risk Exposures by Third Party and Main Types of Credit	Page 223	4(d)	
Credit Exposures by Repayment Period	Page 223	4(e)	
Problematic Credit Risk Exposures and Provision for Doubtful Debts by Economic sector	-	4(f)	Exhibit E
Total Impaired Loans and Provisions by Geographic Area	-	4(g)	Exhibit F
Movement in Balances of Provision for Credit Losses	-	4(h)	Note 4C
Credit Exposures by Risk Weighting	Page 218	5	
Reduction of Credit Risk (Qualitative and Quantitative)	Page 232	7	-
Credit Exposures in Derivatives by Third Party (Qualitative and Quantitative)	Page 232	8	-
Securitization (Qualitative and Quantitative)	Page 109	9(f), 9(g)	Note 3
Market Risk (Qualitative and Quantitative)	Page 195-201	10	-
Operational Risk - Qualitative Disclosure	Page 210	12	-
Investments in Shares (Qualitative and Quantitative)	Pages 113-116	13	-
Investment in Shares of Companies Included on Equity Basis	Pages 161-164	13	-
Interest Risk	Page 201	14	Exhibit D

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, petitions 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.

For details regarding claims and petitions to approve class actions filed against the Bank, see Note 18 to the Financial Statements.

Claims in an amount that exceeds 1% of the Bank's shareholders' equity on 31 December 2009, some NIS 218 million, are detailed 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 19 July 2009, the Supreme Court handed down its judgment with the agreement of the parties, rejecting the appeal filed against the judgment of the Tel-Aviv District Court which denied the petition for leave to approve a class action in the amount of NIS 300 million, filed in February 2006 against the Bank. The plaintiff claimed that the Bank in the framework of the sale of "structured products" did not disclose the full pricing and thus charged hidden "commission", which is reflected in the financial margin created in favor of the Bank in the transaction.

1.4 On 9 June 2009, the Tel-Aviv District Court denied the claim and petition for its approval as a class action after receiving the petition of the plaintiffs to withdraw from the claim filed on 3 April 2008 against the Bank, Bank Hapoalim and Israel Discount Bank ("the Banks"), in the amount of between NIS 35 million and NIS 84 million. The plaintiffs claimed that the banks unlawfully enriched themselves at the expense of their customers by way of producing interest profits on amounts of tax deducted by them at source under section 164 of the Income Tax Ordinance, which are held by the banks until the date determined in the Ordinance and its regulations and are then transferred to the tax authorities, and not at the date when they were actually deducted.

1.5 On 30 November 2009, the Tel-Aviv District Court approved a settlement arrangement, in a claim and petition to recognize as a class action submitted on 15 June 2000 against the bank, in the amount of NIS 1 billion, claiming that the Bank in various publications promised depositors in direct banking channels of self-service shekel deposits, an additional benefit at the rate of 1% above the usual interest rate and that what was stated in the various publications as well as information given to the depositor at the time of the original deposit could mislead depositors into thinking that the additional benefit at the rate of 1% was also granted for periods after the automatic renewal of the deposit, and not only at the time of the original deposit, as actually happened. In December 2003, the Court approved the claim as a class action. The Bank appealed the decision in the Supreme Court whose decision in the matter has not yet been handed down. Under the settlement agreement, the Bank paid a total amount of NIS 370 thousand (partly by crediting the accounts, and the rest as a donation) for the final and complete resolution of any claim or complaint by the members of the group against the bank, without admitting obligation or responsibility.

1.6 On 17 February 2010, the Supreme Court accepted the petition of the plaintiff and ordered the striking-out of the appeal filed by the plaintiff against the judgment of the Tel-Aviv District Court rejecting the petition for approval as a class action against the bank in the amount of NIS 1.2 billion on 25 December 2007. The plaintiff claimed that the Bank charged him and all the bank's customers, unlawfully and in contradiction to exemptions appearing in the Bank's tariff, commissions for fixed account management fees, credit allocation fees and securities deposit management fees, and thus, according to the plaintiff's claim, the Bank unlawfully enriched itself.

1.7 On 18 February 2010, the Supreme Court handed down its judgment in the appeal submitted by the Bank and the Attorney-General against the judgment handed down on 10 June 2004 by the Jerusalem District Court, sitting as the Standard Contracts Tribunal, 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 Standard Contracts Law, 1982, and they should accordingly be annulled.

The Supreme Court accepted the appeal by the Bank in some of the matters and rejected most of the appeal by the Attorney-General. According to the judgment, the Bank has to amend the current account form in those maters requiring amendment under the judgment, within 60 days. Even before the judgment, the form had been amended with regard to changes which were not subject to appeal and changes which had been agreed between the Bank and the Attorney-General and which had been given the effect of a partial judgment.

1.8 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 of 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.

In February 2008, the court approved the petition to amend the claim and the addition of a further claim in the action, 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.”, for which the Bank is owed compensation. 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**

On 26 April 2009, a ruling of the Antitrust General Director was received at the Bank, pursuant to section 43(a) (1) of the Antitrust Law, 1988, according to which restrictive trade agreements, relating to the transfer of information regarding commissions, had existed between the Bank, Bank Hapoalim B.M., Israel Discount Bank Ltd., Mizrahi-Tefahot Bank Ltd. and the First International Bank of Israel Ltd., during the period from the beginning of the 1990's until the commencement of the Antitrust Authority's investigation of the matter, in November 2004. This is a civil ruling, which constitutes prima facie evidence of the matters therein determined in any legal proceedings. At this early stage, the effects of the ruling cannot be assessed. On March 24, 2010, the Bank submitted an appeal against this ruling.

For further details regarding contingent liabilities, see Note 18 to the Financial Statements.

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 13.

Material Contracts

1. 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"), which were published in 1992, and which have yet to be incorporated into legislative amendments:

   1.1 Specific provisions for doubtful debts are to be recognized as a tax expense in the year in which they are recorded, subject to paragraph 1.3 below.
   1.2 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.
   1.3 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 2007, specific monitoring was carried out for provisions for doubtful debts whose amounts are over NIS 50,000.
   1.4 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.

2. 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 parties gives a year's advance notice of its intention to propose changes to the agreement.
   For further details regarding this agreement, see page 262.

3. An agreement from April 2005 between the Bank and the Tax Authority in connection with an offset in respect of the profits of a foreign subsidiary.
   For further details, see Note 26L to the Financial Statements.

4. A special collective agreement from November 2005 between the Bank and employees' representatives in consequence of the process of privatization of the Bank.
   For further details, see Note 15A to the Financial Statements.

5. An agreement from September 2009 between Leumi Partners and GN Communication Industries Ltd. for the sale of shares in Keshet Broadcasting Ltd. For further details, see page 162 above.

6. Letters of Indemnity as detailed in Note 18J 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 it 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 1 July 2009, the Value Added Tax (Tax Rate for Non-Profit Organizations and Financial Institutions) Order, 2009, was published in the Official Gazette (*Reshumot*), raising the rates of salary tax and profit tax applying to financial institutions from 15.5% to 16.5%, from 1 July 2009 to 31 December 2009.

   On 31 December 2009, the Value Added Tax (Tax Rate for Non-Profit Organizations and Financial Institutions) Order, 2009, was published in the Official Gazette (*Reshumot*), reducing the rates of salary tax and profit tax applying to financial institutions from 16.5% to 16%, from 1 January 2010 to 31 December 2010.

   On 14 July 2009, the Knesset approved the Improved Economic Efficiency Law (Statutory Amendments for Implementation of the Economic Plan for 2009-2010), 2009, which, *inter alia*, gradually reduces the rate of companies tax from 25% in 2010 to 18% for the year 2016 and thereafter. The rates of companies tax applicable from the 2009 tax year and thereafter are as follows: for the 2009 tax year, the tax rate was 26%, for 2010 it will be 25%, for 2011 - 24%, for 2012 - 23%, for 2013 - 22%, for 2014 - 21%, for 2015 - 20%, and from 2016 and thereafter, the tax rate will be 18%.

   The Bank as a "financial institution" for the purposes of the Value Added Tax Law pays profit tax. The rate of profit tax in 2009 and 2010 is 16% and in 2011 and thereafter – 15.5%. 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 2009, the overall tax rate was 36.21%, for 2010 it will be 35.34%, for 2011 - 34.20%, for 2012 - 33.33%, for 2013 - 32.47%, for 2014 - 31.60%, for 2015 - 30.74% and from 2016 and thereafter, the overall tax rate will be 29.0%.

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.

5. See Note 1 to the Financial Statements for further details regarding the Bank's policy for recording deferred taxes.

6. The Bank has been issued with final assessments for the period up to and including the 2006 tax year. The principal consolidated companies have final assessments up to and including the 2005 tax year.

7. 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 2009, the number of positions in the Group decreased by 82, a decline of some 0.6% in relation to the number of positions in 2008. With regard to the average for the year, the number of positions increased by 231 positions, a rise of some 1.8%.

Most of the change in the number of positions in the Group in Israel derives from a decrease of 102 positions at consolidated subsidiaries abroad.

	Positions at year end		Average positions for the year	
	2009	2008	**2009**	2008
The Bank in Israel	**9,659**	9,711	**9,615**	9,548
Consolidated subsidiaries in Israel	**2,368**	2,291	**2,380**	2,145
Group total in Israel	**12,027**	12,002	**11,995**	11,693
Overseas: Bank branches and representative offices	**60**	65	**63**	69
Consolidated subsidiaries	**1,255**	1,357	**1,281**	1,346
Group total in Israel and overseas	**13,342**	13,424	**13,339**	13,108

* "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. The appropriate collective agreement was signed between the Bank and the Histadrut.

See page 281 for details of salary of senior officers.

Labor and Salary Costs (at the Bank)

	2009	2008	2007
	NIS thousands		
Cost per employee position (excluding bonus)*	**286.9**	293.9	289.3
Cost per employee position (including bonus)*	**307.4**	293.7	340.9
Salary per employee position (excluding bonus)*	**192.0**	187.4	180.1
Salary per employee position (including bonus)	**208.9**	187.2	223.2

* 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 67,000 training days in 2009 (similar to 2008).

Training activities in 2009 focused on raising the level of professionalism of the employees with emphasis being placed on core banking areas – credit, pension counseling and investment counseling, service, marketing 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.

At the end of 2009 the Bank's new training building was opened in the Keshev compound, one of the most advanced training buildings in Israel.

In 2009 activity was expanded in the area of organizational development and assisting units under change or being established. In addition, knowledge management at the Bank and independent learning at all the Bank’s units 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 2009, and during the year, about 87% of managers participated in Bank-wide management courses, professional development courses, and enrichment and 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 expanded significantly, in accordance with the needs of the units.

Education

The percentage of employees with university education at the Bank has been on a continuing upward trend. The percentage of university graduates at the Bank was 59.6% of all employees at the end of 2009, compared with 57.5% in 2008, and 26% in 1995. The percentage of graduates among the managerial staff reached 92.4% in 2009, in comparison with 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.

New Employees and Tenure

In 2009 the Bank recruited 200 highly qualified employees, compared with 403 in 2008. In 2009, tenure was granted to 313 employees, in comparison with 248 employees in 2008.

Organizational Culture - Leumi’s Code of Ethics

In 2005, Leumi launched its code of ethics, “The Leumi Way”. The code was launched by the President and Chief Executive Officer at the Financial Statements Conference and distributed to all Leumi employees.

During 2007, the heads of divisions at Leumi were designated as the parties responsible for assimilating the “Leumi Way” within their divisions, and during the years 2007-2008, comprehensive processes continued for the assimilation of the Code of Ethics amongst all Leumi employees.

In 2009, support in assimilation activity, which was carried out in the divisions, was expanded. During 2009, “Leumi Way” activity focused on retaining and continuing the existing cycles of assimilation and creating infrastructures allowing for stepping up the assimilation process during 2010, and reaching all Leumi employees directly and indirectly through management staff.

In addition, in 2009, recognizing that ethical dilemmas are an effective tool for assimilation, dilemmas were collected from the various divisions, with the process producing a bank of dilemmas, which will be used by us in our activities in 2010.

The “Leumi Way” is integrated into the study program at the Leumi training center in most of the existing courses, from the day of recruitment for new employees of the Bank and through senior management courses. The manner of integrating the subject in the different activities was examined in 2009, and adjustments were carried out from a career-path and procedural outlook.

The code of ethics was examined in the framework of the SOX controls and the Ma'ala rating, and is part of Leumi's Report on Corporate Responsibility which received international recognition from the international organization Global Reporting Initiative, the leading recognized body in the world in the field of formulating and promoting reports on social and environmental responsibility**.**

Involvement of Employees 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 2009, some 3,600 employees – from more than 115 units within the Bank - engaged in volunteer activity. It is estimated is that the employees contributed some 21,000 hours of volunteer work over the course of the year, an increase of some 50% compared with the corresponding period last year.

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 2009		Average positions in 2008	
	Managerial Staff	**Clerical Staff**	Managerial Staff	Clerical Staff
Households	**1,353**	5,500	1,405	5,548
Small businesses	**462**	1,424	398	1,356
Corporate banking	**462**	728	411	697
Commercial banking	**708**	1,166	725	1,206
Private banking	**417**	467	378	467
Financial management – capital markets	**234**	294	195	218
Other	**25**	99	18	86
Total	**3,661**	9,678	3,530	9,578

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.

Appointments

Yaakov Haber was appointed Head of Finance and Economics Division and as a member of the Bank's Management, as of 1 January 2009.

Adv. Nomi Sandhaus was appointed Chief Legal Advisor, Head of Legal Division and Manager of Legal Risks, as of 1 April 2009.

Adv. Yael (Ben Moshe) Rudnicki was appointed Group Secretary, as of 1 May 2009.

Avner Mendelson was appointed Head of the Office of the CEO and the Strategy Department, as of 1 February 2010.

Advocate Nahum Bitterman, Chief Legal Advisor, Head of Legal Division, Manager of Legal Risks and and member of the Bank's Management, ceased serving in these positions on 31 March 2009, and retired after 46 years with the Bank.

Adv. Jennifer Janes, Bank and Group Secretary, ceased serving in these positions on 30 April 2009, and retired after 35 years with the Bank.

Organizational Structure

The Leumi Group's organizational structure, according to lines of business and head-office services, as described below, combines the activity of companies in the fields of banking, finance, the capital market and financial services.

Lines of Business

Leumi is organized in five lines of business 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 lines of business:

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 sectorial 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 26 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 193 branches, which are organized in 8 districts on a geographic basis and by means of a variety of technological/direct distribution channels, including Leumi Call, which provides services to customers through the telephone, cellular phones and the 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 overseas mergers and acquisitions.

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 line of business, Leumi Group has head office units which provide services to the business units:

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 and managerial measurement; planning and management of the Group's capital resources; coordination of commissions policy, tax planning of the Bank and the Group and the insurance of the Bank and Group; 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 SOX 404 working process, calculating capital adequacy and reporting to the public in accordance with Basel II directives under the standardized approach.

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, professional development of investment advisors, development of systems in the investments field, the treatment of regulatory aspects in the area of counseling and adapting processes and procedures in this area to the directives of the regulator.

Marketing is responsible for Bank and Group marketing and marketing communications, for the spokesperson's office, regulation and public relations, corporate responsibility, charitable donations, sponsorships, and community relations.

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 and the management of legal risks in the Bank and the Group.

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. The Head of the Compliance Department reports to the Head of Human Resources.

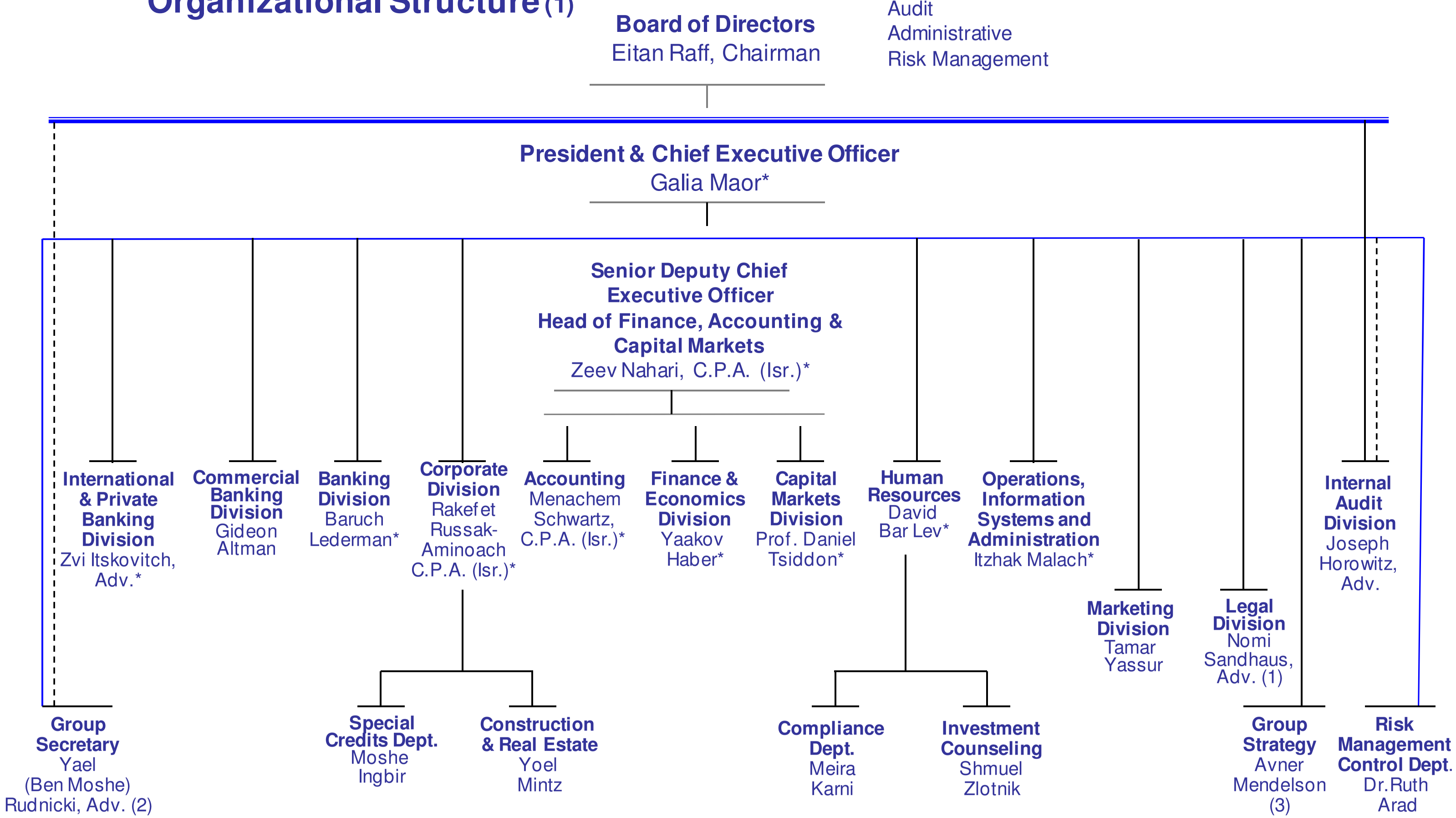
Risk Management Control Department is responsible pursuant to the framework of Proper Banking Management Directive No. 339 for mapping, identifying and measuring all the risks in the Group and creating an infrastructure for examining the risks inherent in new activities. The department carries out risk 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.

Group Strategy Department is responsible for assisting Group Management in the definition and planning of Bank and Group strategy and its validation, examination and analysis of subjects with strategic implications, and providing support and leadership of main projects in cooperation with the lines of business.

Bank Leumi le-Israel B.M.

Organizational Structure (1)

Committees of the Board of Directors
Credit
Financial Statements Review
Audit
Administrative
Risk Management



(1) From 30 April 2009
(2) From 1 May 2009
(3) From 1 February 2010

* Member of Management

Leumi for the Community – Social Involvement

The Leumi Group Report on Corporate Responsibility for 2007-2008 was published in May 2009. The Report includes reports on the five most significant subsidiaries in the Group, and received an A+ rating from the GRI. The Report gives details of socio-environmental investment by Leumi and the subjects of corporate governance and business ethics.

***Ma'ala* Social Responsibility Index**

The Ma'ala rating of corporate responsibility for 2009 was published at the beginning of June. Leumi was ranked in the highest group, and noted for excellence in the field of corporate governance.

Leumi's community activity continued in 2009 in areas chosen for focus by the Group: education, youth, culture and art, and individual assistance to populations in distress.

Leumi Scholarship Fund for Excellent Students

In 2009 the Leumi Scholarship Fund for Excellent Students awarded the total of some NIS 2.8 million to 530 outstanding students.

Leumi Center for Robotics at the Technion

The Leumi Center for Robotics has been launched at the Technion's Faculty of Mechanical Engineering. At the Center, high-school students and those studying there will qualify them and enable them to participate in national and international competitions in the field of robotics, thus obtaining important knowledge and skills in applied mathematics and science.

Sponsorship for the Center is for a period of seven years at a total cost of some $1.5 million for the whole period.

The "Turning-Point" Program in cooperation with the Buchmann-Mehta School of Music at Tel Aviv University, and the Israel Philharmonic Orchestra.

Together with the Arab Israeli Bank of the Leumi Group, the Group is collaborating with the renowned conductor , Maestro Zubin Mehta, for the purpose of promoting a future generation of young musicians, bringing together gifted Arab and Jewish youth.

The program, under the pedagogical leadership of the Buchmann-Mehta School of Music at Tel Aviv University and the Israel Philharmonic Orchestra, seeks to promote musical artists within Arab society and to create a future generation of children with high levels of musical talent. The program will focus on promoting classical Arab and Western music through the study of various instruments and master classes, workshops and music camps, as well as joint activities and exchange visits between students of the program in the Galilee and students of the campus of the Buchmann-Mehta School of Music. Mutual relations with the students at Tel Aviv University will create opportunities for connecting the center of the country with the outlying areas, as well as bringing Jews and Arabs together.

The sponsorship for the program is for a period of five years, and its financial scope is some NIS 2 million.

“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 eight years of operation. 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 associations and academic institutions throughout the country.

In 2009, some 17,000 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. In addition, the young people enjoyed an experience of enrichment and of education for leadership; they acquired values and were motivated to pursue a 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 and others.

In 2009 “Leumi Tomorrow” also conducted the *Kamcha de’Pascha* campaign, 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 250 thousand from the organization and with contributions from Leumi subsidiaries, employees and customers, in the amount of some NIS 355 thousand.

“Youth Leading Change – Tomorrow”

The organization works with the aim of cultivating young leadership and developing social involvement among young people. In the framework of the partnership with the “Youth Leading Change” organization, which began in 2002, “Leumi Tomorrow” invests in the “Leumi Aharai (Follow Me) Along The Way – To the IDF!” project – groups preparing for the IDF, and in the “Leumi Tomorrow – On our Way!” – groups of young people of Ethiopian origin, which focus on preparation for the IDF in addition to dealing with the community’s difficulties in integrating into Israeli society, and centers for learning matriculation for young people who had not been designated to participate in the matriculation examinations.

“Friends of Atidim”

Atidim is a wide-ranging product whose aim is cultivating excellence, maximizing human potential and strengthening the educational infrastructure in the outlying areas. The cooperation, which started in 2005, focuses on the “Pre-Atidim” program which takes place in high schools and junior high schools, with emphasis on personal empowerment, exposure to academia and the strengthening of skills in science-related subjects. In 2009 the program assisted about 13,000 young people from 145 schools in 60 towns.

Ma’ase

The organization initiates and operates high-quality frameworks for a year of voluntary work by young people during a year of service and National or Civil Service, with the aim of creating an infrastructure for meaningful social change in outlying settlements. Cooperation, which started in 2006, focuses on an educational program including improvement and completion of matriculation examinations, completion of psychometric examinations, and motivating young people to pursue academic studies. Some 400 young people participated in the program in 2009.

Program for Promoting Accessibility to Higher Education

Since 2002, the “Leumi Tomorrow” organization has supported a program for cultivating and promoting excellence among young people from the outlying areas, which is operated by the Ben Gurion University of the Negev, in which the Ministry of Education and Atidim are also partners. Excellent students from the South are granted extra tuition ahead of matriculation examinations in their schools and participate in academic science courses in the University. In 2009, the program assisted some 1,000 young people from 29 schools in 15 towns in the Negev and Eilat.

Strive Israel

The program was initiated by the JDC ("Joint") with the aim of training young people for personal and professional growth, for financial independence and a high feeling of personal ability, by means of developing an employment career. The program provides tools to assist in realizing personal employment potential. The program operates in Tel Aviv, Jerusalem and Haifa, and maintains an average rate for placement and continuation in the workplace of 85%-90% of the participants and graduates of the program.

In 2009, the program assisted some 120 young people.

Learning Centers for Ethiopian Immigrants

In 2006, the "Leumi Tomorrow" organization joined with the Ruth and Allen Ziegler Student Services Division in Tel Aviv University, in an initiative to help young people from Ethiopia and prepare them in an educational center framework for the matriculation examinations and expose them to academia..

In 2009, the program operated in two centers in the Ulpanot for Girls in Kfar Sava and in Bnei Brak, and assisted 71 students.

"Nirim" Youth Village

The "Leumi Tomorrow" organization joined this year with the "Nirim" organization and supports the activities of the "Nirim" Youth Village for Developing and Promoting Young People at Risk. A challenge-based program operates in the village, in a unique model for personal development and fulfillment for young people who have dropped out of traditional educational frameworks. In 2009, 65 students studied in the village.

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.

Leumi's contribution to the organization focuses on assisting in the operation of the program in the social and geographic outlying areas, together with the adoption of the program by branches of the Bank throughout Israel, and recruiting volunteer mentors from among employees of the Group.

This year (the 2009-2010 academic year), some 190 groups of young people are taking part in the program, in which they will learn about the establishment and management of a business and experience business entrepreneurship.

Leumi for the Arts

As part of its responsibility for promoting and cultivating talented young people in various fields, Leumi took upon itself to promote and cultivate original Israeli art, by means of several projects.

The Fourth "Secret Art" Exhibition

Leumi continued its tradition by holding for the fourth year a "Secret Art" Exhibition.

Works of art are displayed at the exhibition, most of them by young and unknown artists, and a few by famous artists. The public is invited to view the works of art and purchase them based on their appreciation of the work, and not on the name of the artist. As in every year, some original projects connected to the art world are displayed in the exhibition. One of the most exciting was a large artistic wall positioned in the lobby of Leumi House on which there were illustrations by 15 young artists participating in the Exhibition who received an assignment: to illustrate through their own eyes one of the poems of Ronny Somek.

The Exhibition is presented this year in two parts. The first, in which 35 works were shown, opened at the Israel Business Conference and was open throughout the Conference until its conclusion. The second and central part, in which 240 works were shown, takes place as always in the Leumi Management building.

The "Fresh Paint II" Fair

As part of the Leumi Group's support for young artists, and as part of its encouragement of original Israeli creativity, the "Fresh Paint II" Exhibition was held at the beginning of the year 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 were exhibited - those of unknown young artists alongside the works of well-known young artists, and hundreds of works were sold. In addition, the "Haunted House of Mani" Exhibition was opened in the Leumi Visitors' Center, comprising works of those exhibiting in the "Fresh Paint I" Fair that took place in 2008.

The sum of NIS 250,000 was contributed 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 60,000), etc. During the four days of the Exhibition, tens of thousands of art lovers and visitors came to see it, and purchased works in the amount of some NIS 1.5 million.

Summary of Leumi's Sponsorships and Donations in 2009

In 2009, the Leumi Group made donations and provided sponsorships for social and community purposes in the amount of some NIS 26.5 million, of which donations amounted to some NIS 22.7 million.

During the past five years (2005-2009), the Leumi Group's contributions and sponsorships for social causes amounted to some NIS 127 million.

Set out below is a breakdown of total donations and sponsorships in 2009 according to various categories:

Education, children and youth	- NIS 15.6 million;
Culture and art	- NIS 5.5 million;
Community and society	- NIS 4.3 million;
Health	- NIS 1.1 million.

Decisions with regard to the designation and amount of donations are made, as appropriate, 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 are referred to 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 subsidiary 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 118.3 positions on average for the year, as described below:

Average Positions of Auditors in the Leumi Group in Israel, including outsourcing	
The Bank	102.6
Subsidiaries in Israel	12.0
Overseas subsidiaries	3.7
Total	118.3

In addition, local auditors are employed in overseas subsidiaries in 22.8 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 2009, in NIS thousands:

2009									
	Compensation for services			Other compensation		Loans given on beneficial terms			
Holding in the capital of the Bank	Salary	Bonuses**	Social benefit provisions	Value of the benefit	Total *	Balance as at 31 December 2009	Average period until maturity (years)	Benefit provided over the year	Loans granted on regular terms
	NIS thousands								
0.0028%	1,318	1,000	1,229	166	3,713	424	0.5	17	-

* Excluding salary tax.
** Estimate – see Note 15H

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 2008 was submitted to the Audit Committee on 11 March 2009 and was discussed by it on 5 April 2009. The summary annual report for 2008 was submitted to the Audit Committee on 30 April 2009 and discussed by it on 3 May 2009. Annual reports of the Israeli and overseas subsidiaries were submitted on 2 June 2009 and discussed by the Audit Committee on 7 June 2009. The Chief Internal Auditor's report for the first half of 2009 was submitted to the Audit Committee on 19 October 2009 and was discussed by it on 22 October 2009.

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.

Disclosure Controls and Procedures for the Financial Statements

The Supervisor of Banks has published a circular, detailing 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 that 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 of the processes and sub-processes that is checked, and 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 checking 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.

As of 2009, the Bank, has been taking steps to implement the directive in the Leumi Group on a routine basis, together with consultants engaged for the purpose of carrying out the project.

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 annual 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 2009, no material change to 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.

No material weaknesses were found.

Remuneration of Senior Office Holders

For the year ending 31 December 2009

Below are details of the benefits and amounts paid or in respect of which provisions were recorded in the years 2009 and 2008, 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, are occasionally given benefits that are similar to those granted to Bank employees and in some cases, even exceed them.

2009												
Details of party receiving compensation (1)			Compensation for services(2)			Other compensation		Loans given on beneficial terms (8)				
Name	Position	Holding in the capital of the Bank	Salary	Bonuses (7)	Social benefit provisions (3)	Value of the benefit	Total *	Balance as at 31 December 2009	Average period until maturity (years)	Benefit provided over the year	Loans granted on regular terms
		%	NIS thousands								
Mr. E. Raff (4)	Chairman of the Board of Directors	**0.0082**	**1,671**	**3,509**	**3,023**	**93**	**8,296**	**606**	**0.58**	**24**	**1,123**
Mrs. G. Maor (5)	President and Chief Executive Officer	**0.0197**	**2,263**	**4,386**	**1,336**	**147**	**8,132**	**792**	**0.54**	**31**	**3**
Mr. Z. Nahari (6)(7)	Senior Deputy Chief Executive Officer	**0.0142**	**1,592**	**2,200**	**560**	**177**	**4,529**	**523**	**0.56**	**21**	**1,373**
Mr. U. Rosen (6)	Chief Executive Officer, Bank Leumi USA	**0.0088**	**2,356**	**570**	**1,132**	**11**	**4,069**	**-**	**-**	**11**	**-**
Mr. O. Grinbaum	Chief Executive Officer, Leumi Partners Underwriting	**-**	**513**	**3,194**	**133**	**58**	**3,898**	**-**	**-**	**-**	**-**
Mr. D. Bar-Lev (6)(7)	First Executive Vice President, Head of Human Resources	**0.0028**	**1,304**	**1,100**	**1,007**	**149**	**3,560**	**500**	**1.09**	**20**	**-**
Ms. R. Russak-Aminoach (6)(7)	First Executive Vice President, Head of Corporate Division	**0.0056**	**1,225**	**1,300**	**657**	**82**	**3,264**	**684**	**3.75**	**26**	**-**

* 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) There were no share-based payments in 2009

(3) 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.

(4) On 31 January 2010, the Audit Committee of the Board of Directors and, subsequently, the Board of Directors approved the terms of retirement of the Chairman of the Board subject to the approval of the next General Meeting of the Bank. For details of the terms of the retirement of the Chairman of the Board, see Note 15B(4) to the Financial Statements. Appropriate provisions have been included under Social Benefits Provisions in the above table.

(5) 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 (with the Bank having 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 15B(3)(a) to the Financial Statements.

(6) Senior employees of the Bank have personal and special employment contracts with the Bank.
For further details, see Note 15B(3)(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 341 million (NIS 383 million in 2008). 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 91 million (NIS 103 million in 2008). 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 15B(3)(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 9 million as of 31 December 2009; in 2008 – NIS 10 million.

(7) The Board of Directors and the Audit Committee have approved a long-term bonus program for senior managers in the Bank: the Chairman of the Board of Directors (subject to the approval of the General Meeting), the Chief Executive Officer and the other members of the Management of the Bank, for 2009 and onwards. The amounts of the grants in question are only an estimate, based mainly on data from the Bank and other banks that have published for the last three quarters of 2009. For further details, see Note 15H to the Financial Statements.

(8) Mainly loans granted to all the employees to purchase shares of the Bank, pursuant to an outline prospectus from 2006, and an extension of loans granted in the past under a prospectus from 2002.

(9) 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, as it is insignificant. The total premium amounted to NIS 2,559 thousand and relates to all officers in the insured group.

For further details see Note 15 to the Financial Statements.

2008												
Details of party receiving compensation			Compensation for services				Other compensation		Loans given on beneficial terms			
Name	Position	Holding in the capital of the Bank	Salary	Bonuses	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									
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	President and Chief Executive Officer	0.0197	2,174	-	2,078	57	125	4,434	772	1.54	54	8
Mr. Z. Nahari	Senior Deputy Chief Executive Officer	0.0142	1,481	-	997	37	155	2,670	513	1.56	35	1,438
Mr. U. Rosen	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	Acting Head of Commercial Banking Division	0.0015	868	-	1,790	16	69	2,743	300	2.26	21	10
Mr. B. Lederman	First Executive Vice President, Head of Banking Division	0.0027	1,349	-	1,126	31	97	2,603	787	3.70	42	666

* Does not include salary tax.

Auditors' Fees (1)(2)(3)

	Consolidated		Bank	
	2009	2008	**2009**	2008
	NIS thousands			
For auditing activity: (4)				
Joint auditors	**24,225**	23,829	**9,562**	8,317
Other auditors	**3,714**	3,049	**257**	148
Total	**27,939**	26,878	**9,819**	8,465
For audit related services: (5)(6)				
Joint auditors	**1,967**	2,750	**1,739**	2,661
Other auditors	**-**	8	**-**	8
For tax services: (5)				
Joint auditors	**1,909**	1,749	**612**	559
Other auditors	**344**	382	**-**	-
For other services:				
Joint auditors – SOX	**-**	1,783	**-**	1,067
Joint auditors	**2,765**	5,935	**1,965**	4,223
Other auditors	**201**	225	**-**	-
Total	**7,186**	12,832	**4,316**	8,518
Total auditors' fees	**35,125**	39,710	**14,135**	16,983
Joint auditors' fees from other engagements (7)	**-**	-	**-**	-

(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) Audit of annual financial statements and review of interim reports.

(5) Provided services related to prospectuses and tax advice.

(6) Audit related fees, including mainly: prospectuses, special certificates, comfort letters, forms and reports to authorities to which the signature of the auditors is required and audit of businesses purchased during the year.

(7) As reported by the auditors, pursuant to section 4 of the directives relating to a conflict of interests and impairment of independence in consequence of the auditors' other engagements, and included above.

Board of Directors

Below are the names of the Directors, their principal occupations and their positions in the Bank Leumi Group and in other bodies:

Name of Director	
Eitan Raff **Ramat Gan**	Chairman of the Board of Directors of the Bank and its subsidiaries, Bank Leumi USA, Bank Leumi le-Israel Corporation, Bank Leumi (UK) plc. Chairman of the Board of Directors, Aeronautics Ltd. Director, VeriFone Holdings, Inc. and Jarvinia Holdings Ltd. Director and Financial Consultant, Wolfson Clore Mayer Corp. Ltd. and its subsidiaries.
Reuven Adler, CPA (Isr.)* **Petach Tikva**	Certified Public Accountant, Business Consultant and Company Director. External Director on the Board of Directors of the Bank Chairman of the Board of Directors and controlling owner of Reuven Adler Economic Consultants Ltd. Consultant to a financial entity in the area of accounting. Member of the investment committee for insurance (Members), provident funds and pensions in an insurance company.
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., Ampa Capital Ltd., Tower Semiconductor Ltd., and Africa Israel Investments 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.
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.(in voluntary liquidation) External Director, Elron Electronic Industries Ltd., Isrotel Ltd., and Negev Ceramics Ltd. Director, Mer Telemanagement Solutions Ltd., Golden House Ltd., Tagor Capital Ltd., Renewable Minerals for Water Ltd., Renewable Resources Ltd. and related companies: Renewable Resources Technologies (2008) Ltd. And Recursos – Renoables Hidricos S.L.
Zipora Gal Yam* **Maalot**	Economic Consultant, Company Director. External Director, Direct Insurance – Financial Investments 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)
Prof. Arieh Gans* **Ramat Gan**	Professor of Accounting, Tel Aviv University and Company Director. Director, Middle East Tubes Corporation Ltd.
Moshe Dovrat **Tel Aviv**	Company Director. CEO, Director and Shareholder 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.
Moshe Vidman **Jerusalem**	Company Manager, Representative of Revlon in Israel. Owner, Moshe Vidman Ltd. and Moshe Vidman Holdings (2004) 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.

[*] External Director pursuant to Proper Banking Management Directive No. 301 of the Banking Supervision Department

Name of Director	
Doron Cohen **Reut**	CEO, Co-Op Blue Square Services Cooperative Ltd. (in liquidation), Director and Owner, Trigger D.C. Ltd. and Trigger D.C. Holdings Ltd. Chairman of the Board of Directors, H.A.L. Teshura Ltd. (company owned by the Histadrut National Labor Federation) and its subsidiaries. Director, Harel Insurance Investments & Financial Services Ltd. and Consumers Cooperative Fund Ltd. Economic and Business Consulting
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 Edmond and Nadine de Rothschild Israel Fund.
Adv. Jacob Mashaal **Moshav Neve Yaraq**	Company Manager. Chairman of the Board of Directors, CEO and Owner, IBECO Ltd., J. Mashaal & Sons Entrepreneurs Ltd. Chairman of the Board of Directors, CEO and Shareholder, A.V.M.S. Investments Ltd. and Lev Afek Ltd. Chairman of the Board of Directors and Shareholder, EURO-UP Ltd. and T.M.C. Tahbura Ltd. Member of Management Committee, Neve Yerak – Employees Cooperative Settlement Ltd.
Nurit Segal **Tel Aviv**	Business and Economic Consulting, Company Director. External Director, King Ltd. Director, Aspen Group Ltd.
Prof. Efraim Sadka* **Tel Aviv**	Henry Kaufman Professor of International Capital Markets, Tel Aviv University. Chairman of Remuneration of Heads of Higher Education Institutions Committee Chairman of the Executive Board, The Pinhas Sapir Center for Development, Tel Aviv University. Chairman of the Supervisory Board of Poalim Real Estate Fund. Member of the Executive Board of the Sapir Forum, Member of the Association and Chairman of the Audit Committee of the Israel Democracy Institute, Member of the Committee for Examining Ways of Maintaining Long-Term Financial Solidity of the National Insurance Institute, Member of the Public Committee for Re-examining the Common Formula in the Allocation of Balancing Grants, Member of the Steering Committee for Establishing a Medical School in the North and the Practical Research Institute in the Eastern Galil, Member of the Management of the Association for the Encouragement of Research, Literature and Art – AH"I – Association of Iraqi Immigrants to Israel, Member of the Professional Committee of the Israel Accounting Standards Board. Editor, The Economic Quarterly
Zvi Koren **Jerusalem**	Economic Consultant. Director and Shareholder, Teconomy 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"). 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 by-laws 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.

* External Director pursuant to Proper Banking Management Directive No. 301 of the Banking Supervision Department.

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.
8 directors currently serve on the Audit Committee, the legal quorum for its discussions being 5 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 the 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.
Reuven Adler, CPA (Isr.) (1)(2)	External Director on the Board of Directors of the Bank B.A. in Economics and Accounting, Tel Aviv University. 32 years' experience until October 2004 in banking, Recent positions: Senior Deputy President and Chief Executive Officer, Deputy President and Chief Executive Officer, Manager of Finance Division and Risk Manager in Bank Mizrahi Tefahot Ltd., responsible *inter alia* for the capital markets trading sector, the financial management sector, Accounting and Financial Statements Department, and the Planning and Economics Department. In the framework of responsibility for the above sectors and departments, was responsible for monetary management, ALM, liquidity and exposures, the dealing rooms of the bank, preparation of financial statements of the bank, prospectuses, budget, etc. In addition, served throughout the years as comptroller of the bank. Previously chairman of the board of directors, external director, and director of various companies.

Name of Director	Additional facts that qualify the Director as having Accounting and Financial Expertise
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.
Yaacov Goldman, C.P.A. (Isr.) (1)	C.P.A. (Isr.), B.A. in Accounting and Economics, Tel Aviv University. Senior Partner, Kesselman & Kesselman, (PriceWaterhouse Coopers), 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.
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. 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), 2003-2005. Dean of the Faculty of Law of The Hebrew University of Jerusalem, 1999-2002.
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 Auditors' Council. Director 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.
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.
Doron Cohen	B.A. in Economics and Business Administration and M.B.A. specializing in Finance, 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.

Name of Director	Additional facts that qualify the Director as having Accounting and Financial Expertise
	CEO of Co-Op Blue Square Services Cooperative Ltd. since 2000. Director of Mercantile Discount Bank Ltd., 2000-2006. 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 Auditors' Council, 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
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 Britannia – 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.
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.
Prof. Efraim Sadka (1)	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., 1989-2005; Chairman of the Board of Directors of K.G.M. Pension Fund, 1996-2000. Previously, member and chairman of various boards of directors.
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

(1) Member of the Financial Statements Review Committee
(2) Member of the Audit Committee

Changes to the Board of Directors

During 2009 and until the publication of the Report, the following changes have taken place in the composition of the Board of Directors:

At the Annual General Meeting held on 16 July 2009, Mr. Reuven Adler was elected as an external director for a period of three years from on 24 July 2009, in place of Mr. Meir Dayan who had completed his second term of service in accordance with the Companies Law, 1999 on 23 July 2009. Mr. Dayan has contributed much to the advancement of the business of the Bank and its betterment. In addition, Messrs. Zipora Gal-Yam, Doron Cohen and Efraim Sadka were reelected, after retiring by rotation and offering themselves for reelection.

On 26 April 2009, the Board of Directors of the Bank approved the continued service of Mr. Eitan Raff as Chairman of the Board of Directors for another year, subject to the approval of the shares committee of the Bank which was given on 25 May 2009.

On 24 January 2010 the Chairman of the Board of Directors, Mr. Eitan Raff since 1995, announced that he did not intend to offer himself for reelection at the General Meeting.

For further details concerning the convening of a Special General Meeting of the Bank see page 19 above.

For details concerning the Notice of the Bank's intention to convene the Annual General Meeting of the Bank see page 20 above.

At the Meeting of the |Board of Directors that took place on 24 March 2010, it was decided to approve and publish the audited consolidated financial statements of the Group as at 31 December 2009 and for the periods concluding on that date.

During 2009, the Board of Directors held 31 plenary meetings and 161 committee meetings.

The Board of Directors of the Bank expresses its appreciation and gratitude to the employees and managers of the Bank and Group companies in Israel and abroad, for their dedicated work and their contribution to the promotion of the business of the Group.

Eitan Raff
Chairman of the Board of Directors

Galia Maor
President and Chief Executive Officer

24 March 2010

Below are tables including detailed financial information by the following subjects, segments and periods:

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Balance Sheets as at end of years 2005-2009
Reported Amounts

Exhibit A:

	31 December				
	2009	2008	2007	2006	2005
	NIS millions				
Assets					
Cash and deposits with banks	**42,933**	33,130	42,329	47,609	35,381
Securities	**57,505**	44,910	47,169	46,375	47,825
Securities borrowed or purchased under agreements to resell	**744**	201	655	-	-
Credit to the public	**204,669**	213,215	198,557	183,800	180,881
Credit to governments	**407**	520	642	1,020	848
Investments in companies included on equity basis	**2,178**	1,842	1,873	1,251	2,064
Buildings and equipment	**3,553**	3,445	3,276	3,056	2,843
Other assets	**9,786**	13,529	7,650	6,230	6,277
Total assets	**321,775**	310,792	302,151	289,341	276,119
Liabilities and equity capital					
Deposits of the public	**250,418**	244,783	238,045	231,823	221,828
Deposits from banks	**3,785**	3,742	6,139	5,241	4,347
Deposits from governments	**712**	831	1,198	2,146	2,225
Securities loaned or sold under agreements to repurchase	**273**	549	231	-	-
Debentures, bonds and subordinated notes	**25,261**	20,636	19,248	15,622	17,253
Other liabilities	**19,182**	21,334	17,636	16,866	14,261
Total liabilities	**299,631**	291,875	282,497	271,698	259,914
Minority interest	**282**	245	105	152	205
Shareholders' equity	**21,862**	18,672	19,549	17,491	16,000
Total liabilities and equity capital	**321,775**	310,792	302,151	289,341	276,119

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statements of Profit and Loss for the years 2005-2009
Reported Amounts

Exhibit B:

	For the year ended 31 December				
	2009	2008	2007	2006	2005
	NIS millions				
Net interest income before provision for doubtful debts	**7,023**	6,380	7,648	6,922	6,629
Provision for doubtful debts	**1,517**	2,145	407	933	1,426
Net interest income after provision for doubtful debts	**5,506**	4,235	7,241	5,989	5,203
Operating and other income					
Operating commissions	**3,511**	3,538(a)	3,593(a)	3,013	2,819
Profits (losses) from investments in shares, net	**707**	(912)	461	128	43
Other income	**345**	174(a)	168(a)	740	865
Total operating and other income	**4,563**	2,800	4,222	3,881	3,727
Operating and other expenses					
Salaries and related expenses	**4,052**	4,118	4,218	4,552	3,627
Building and equipment maintenance and depreciation	**1,514**	1,397	1,274	1,220	1,168
Other expenses	**1,371**	1,488	1,445	1,495	1,285
Total operating and other expenses	**6,937**	7,003	6,937	7,267	6,080
Operating profit before taxes	**3,132**	32	4,526	2,603	2,850
Devaluation and adjustments	**-**	-	-	-	-
Operating profit before taxes	**3,132**	32	4,526	2,603	2,850
Provision for taxes on operating profit	**1,191**	421	1,722	1,320	1,193
Operating profit (loss) after taxes	**1,941**	(389)	2,804	1,283	1,657
Group's equity in after-tax operating profits (losses) of companies included on equity basis, net of related tax effect	**81**	249	184	171	378
Minority interest in after-tax operating (profits) losses of subsidiaries	**(36)**	(18)	(4)	-	24
Net operating profit (loss)	**1,986**	(158)	2,984	1,454	2,059
After-tax profit from extraordinary items	**28**	250	373	2,080	77
Net profit	**2,014**	92	3,357	3,534	2,136

(a) Reclassified.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statements of Profit and Loss for the years 2005-2009 (cont’d)
Reported Amounts

Exhibit B (cont'd):

	For the year ended 31 December				
	2009	2008	2007	2006	2005
Earnings per share					
Basic earnings:					
	(NIS)				
Net operating profit (loss)	**1.35**	(0.11)	2.11	1.03	1.46
After-tax profit from extraordinary items	**0.02**	0.17	0.26	1.47	0.05
Net profit	**1.37**	0.06	2.37	2.50	1.51
Diluted earnings:					
Net operating profit (loss)	**1.35**	(0.11)	2.08	1.03	1.46
After-tax profit from extraordinary items	**0.02**	0.17	0.26	1.47	0.05
Net profit	**1.37**	0.06	2.34	2.50	1.51

Bank Leumi le-Israel B.M. and its Consolidated Companies
Rates of Financing Income and Expenses (on Consolidated Basis) (a)
Reported Amounts

Exhibit C:

	2009				2008			
			Rate of income				Rate of income	
	Average balance (b)	Financing Income(expense)	excluding the effect of derivatives	Including the effect of derivatives	Average balance (b)	Financing Income(expense)	excluding the effect of derivatives	Including the effect of derivatives
	NIS millions		(%)		NIS millions		(%)	
Israeli currency - unlinked								
Assets (c) (d)	140,052	4,303	3.07		110,588	6,290	5.69	
Effect of embedded and ALM derivatives (e)	38,546	475			53,435	847		
Total assets	178,598	4,778		2.68	164,023	7,137		4.35
Liabilities (d)	123,772	(1,061)	(0.86)		109,287	(3,039)	(2.78)	
Effect of embedded and ALM derivatives (e)	35,879	(198)			43,647	(235)		
Total liabilities	159,651	(1,259)		(0.79)	152,934	(3,274)		(2.14)
Interest margin								
Israeli currency - linked to the CPI								
Assets (c) (d)	59,043	4,742	8.03		60,653	5,626	9.28	
Effect of embedded and ALM derivatives (e)	3,156	233			2,154	109		
Total assets	62,199	4,975		8.00	62,807	5,735		9.13
Liabilities (d)	47,009	(3,709)	(7.89)		44,242	(3,834)	(8.67)	
Effect of embedded and ALM derivatives (e)	12,569	(1,217)			11,559	(858)		
Total liabilities	59,578	(4,926)		(8.27)	55,801	(4,692)		(8.41)
Interest margin								
Foreign currency:								
(including Israel currency - linked to foreign currency)								
Assets (c) (d)	102,526	4,545	4.43		106,954	(28)	(0.03)	
Effect of derivatives (e):								
Effect of hedging derivatives	1,876	(1)			3,033	7		
Effect of embedded and ALM derivatives	117,651	1,419			81,020	(2,122)		
Total assets	222,053	5,963		2.69	191,007	(2,143)		(1.12)
Liabilities (d)	112,513	(2,107)	(1.87)		107,892	2,220	2.06	
Effect of derivatives (e):								
Effect of hedging derivatives	1,743	3			2,864	8		
Effect of embedded and ALM derivatives	111,988	(1,971)			82,011	1,951		
Total liabilities	226,244	(4,075)		(1.80)	192,767	4,179		2.17
Interest margin			2.56	0.89			2.03	1.05

See footnotes on page 300 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.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Rates of Financing Income and Expenses (on Consolidated Basis) (a) (cont'd)
Reported Amounts

Exhibit C (cont'd):

	2009				2008			
			Rate of income				Rate of income	
	Average balance (b)	Financing Income (expense)	Excluding the effect of derivatives	Including the effect of derivatives	Average balance (b)	Financing Income (expense)	Excluding the effect of derivatives	Including the effect of derivatives
	NIS millions		(%)		NIS millions		(%)	
Total:								
Monetary assets generating interest income (d) (f)	301,621	13,590	4.51		278,195	11,888	4.27	
Effect of derivatives (e):								
Effect of hedging derivatives	1,876	(1)			3,033	7		
Effect of embedded and ALM derivatives	159,353	2,127			136,609	(1,166)		
Total assets	462,850	15,716		3.40	417,837	10,729		2.57
Total monetary liabilities generating interest expenses (d)	283,294	(6,877)	(2.43)		261,421	(4,653)	(1.78)	
Effect of derivatives (e):								
Effect of hedging derivatives	1,743	3			2,864	8		
Effect of embedded and ALM derivatives	160,436	(3,386)			137,217	858		
Total liabilities	445,473	(10,260)		(2.30)	401,502	(3,787)		(0.94)
Interest margin			2.08	1.10			2.49	1.63
In respect of options		42				(201)		
In respect of other derivatives (excluding options, hedging derivative instruments, ALM derivative and embedded derivatives which have been separated (e))		13				(97)		
Financing commissions and other financing income (g)		1,470				(165)		
Other financing expenses		42				(99)		
Net interest income before provision for doubtful debts		7,023				6,380		
Provision for doubtful debts (including general and supplementary provision)		(1,517)				(2,145)		
Net interest income after provision for doubtful debts		5,506				4,235		
Total:								
Monetary assets generating interest income (d) (f)	301,621				278,195			
Assets derived from derivative instruments (h)	7,438				6,639			
Other monetary assets (d)	2,440				2,870			
General provision and supplementary provision for doubtful debts	(934)				(852)			
Total monetary assets	310,565				286,852			
Total:								
Monetary liabilities generating interest expenses (d)	283,294				261,421			
Liabilities derived from derivative instruments (h)	8,349				7,228			
Other monetary liabilities (d)	7,663				8,597			
Total monetary liabilities	299,306				277,246			
Total excess of monetary assets over monetary liabilities	11,259				9,606			
Non-monetary assets	8,844				10,846			
Non-monetary liabilities	354				473			
Total capital resources	19,749				19,979			

See footnotes on page 300 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.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Rates of Financing Income and Expenses (on Consolidated Basis) (a) (cont'd)
Reported Amounts

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 available for sale, has been deducted from (added to) the average balance of the assets as follows:

In the unlinked Israeli currency sector - the amount of NIS 151 million (31 December 2008 – NIS 55 million)

In the index-linked Israeli currency sector – the amount of NIS 232 million (31 December 2008 – NIS 43 million)

In the foreign currency sector (including Israeli currency linked to foreign currency) – the amount of NIS (1,497) million (31 December 2008 – NIS (952) million),.

(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 added to the average balance of the assets, in the amount of NIS 1,114 million in the various sectors for the year (31 December 2008 – NIS 854 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).

Bank Leumi le-Israel B.M. and its Consolidated Companies
Rates of Financing Income and Expenses (on Consolidated Basis) (a) (cont'd)
Nominal U.S. $

Exhibit C (cont'd):

	2009				2008			
			Rate of income				Rate of income	
	Average balance (b)	Financing Income(expense)	the effect of derivatives	the effect of derivatives	Average balance (b)	Financing Income(expense)	the effect of derivatives	the effect of derivatives
	NIS millions		(%)		NIS millions		(%)	
Foreign currency: Local activity (including Israel currency linked to foreign currency)								
Assets (c) (d)	16,058	408	2.54		18,953	836	4.41	
Effect of derivatives(e):								
Effect of hedging derivatives	474	1			845	7		
Effect of embedded derivatives and ALM	29,863	65			22,425	21		
Total assets	46,395	474		1.02	42,223	864		2.04
Liabilities (d)	19,539	(166)	(0.85)		20,641	(536)	(2.59)	
Effect of derivatives(e):								
Effect of hedging derivatives	440	-			797	(3)		
Effect of embedded derivatives and ALM	28,383	(47)			22,690	(149)		
Total liabilities	48,362	(213)		(0.44)	44,128	(688)		(1.56)
Interest margin								
Foreign currency: Foreign activity (integrated operations)								
Assets (c) (d)	9,997	270	2.70		10,952	549	5.02	
Effect of embedded derivatives and ALM (e)	90	9			97	52		
Total assets	10,087	279		2.76	11,049	601		5.44
Liabilities (d)	9,076	(104)	(1.15)		9,476	(323)	(3.41)	
Effect of embedded derivatives and ALM (e)	100	(13)			123	-		
Total liabilities	9,176	(117)		(1.28)	9,599	(323)		(3.36)
Interest margin								
Total:								
Monetary assets in foreign currency generating financing income (c) (d)	26,055	678	2.60		29,905	1,385	4.63	
Effect of derivatives(e):								
Effect of hedging derivatives	474	1			845	7		
Effect of embedded derivatives and ALM	29,953	74			22,522	73		
Total assets	56,482	753		1.33	53,272	1,465		2.75
Monetary liabilities in foreign currency generating financing expense (d)	28,615	(270)	(0.94)		30,117	(859)	(2.85)	
Effect of derivatives(e):								
Effect of hedging derivatives	440	-			797	(3)		
Effect of embedded derivatives and ALM	28,483	(60)			22,813	(149)		
Total liabilities	57,538	(330)		(0.57)	53,727	(1,011)		(1.88)
Interest margin								

(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$ (382) million (2008 – US$ (265) million).

(d) Excluding derivative instruments.

(e) Hedging derivative instruments (excluding options), embedded derivatives which have been separated, and ALM derivatives that constitute part of the Bank's asset and liability management system.

Note - Full details of the rates of financing income and expenses in each sector, for the various balance sheet categories, are available on request.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Exposure to Interest Rate Fluctuations - on Consolidated Basis
Reported Amounts

Exhibit D:

	31 December 2009					
	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
	NIS millions					
Israeli currency - unlinked						
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments						
Financial assets (a) (c)	116,229	10,484	16,299	5,294	1,324	893
Derivative financial instruments (excluding options)	29,704	38,344	34,513	14,480	4,883	6,014
Options (in terms of basis asset) (e)	825	731	1,950	9	-	-
Off-balance sheet financial instruments	-	-	-	-	-	-
Total fair value	146,758	49,559	52,762	19,783	6,207	6,907
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments						
Financial liabilities (a)	108,215	4,828	7,662	6,826	2,834	563
Derivative financial instruments (excluding options)	28,871	38,511	38,827	13,487	4,425	5,859
Options (in terms of basis asset) (e)	1,226	805	2,504	103	1	-
Off-balance sheet financial instruments	-	-	67	-	-	-
Total fair value	138,312	44,144	49,060	20,416	7,260	6,422
Financial instruments, net						
Exposure to interest rate fluctuations	8,446	5,415	3,702	(633)	(1,053)	485
Accumulated exposure in the sector	8,446	13,861	17,563	16,930	15,877	16,362
Israeli currency – linked to the CPI						
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments						
Financial assets (a)	2,074	3,411	16,587	17,632	9,663	9,014
Derivative financial instruments (excluding options)	-	369	2,362	-	94	-
Options (in terms of basis asset) (e)	-	-	-	-	-	-
Off-balance sheet financial instruments	-	-	-	-	-	-
Total fair value	2,074	3,780	18,949	17,632	9,757	9,014
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments						
Financial liabilities (a)	1,015	1,881	10,443	14,177	8,041	13,889
Derivative financial instruments (excluding options)	411	501	3,890	2,671	2,419	1,009
Options (in terms of basis asset) (e)	-	-	2	8	-	-
Off-balance sheet financial instruments	-	-	49	-	-	-
Total fair value	1,426	2,382	14,384	16,856	10,460	14,898
Financial instruments, net						
Exposure to interest rate fluctuations	648	1,398	4,565	776	(703)	(5,884)
Accumulated exposure in the sector	648	2,046	6,611	7,387	6,684	800

See notes on next page.

						31 December 2008	
Over ten years to Twenty Years	Over twenty years	Without fixed maturity	Total	Internal rate of return	Average maturity	Internal rate of return	Average Maturity
				%	Years	%	Years
400	-	520	151,443	3.24	0.30	5.52	0.45
35	-	-	127,973	-	0.98		
-	-	-	3,515	-	-		
-	-	-	-	-	-		
435	-	520	282,931	3.24	0.61		
7	-	9	130,944	3.36	0.30	3.99	0.37
70	-	-	130,050	-	0.97		
-	-	-	4,639	-	-		
-	-	-	67	0.00	0.50		
77	-	9	265,700	3.36	0.62		
358	-						
358	-						
2,914	254	95	61,644	3.67	3.14	4.92	3.33
-	-	-	2,825	0.00	0.73		
-	-	-	-	-	-		
-	-	-	-	-	-		
2,914	254	95	64,469	3.67	3.03		
2,597	243	-	52,286	2.41	3.93	3.95	4.18
96	-	-	10,997	0.00	2.32		
-	-	-	10	-	-		
-	-	-	49	0.00	0.50		
2,693	243	-	63,342	2.41	3.65		
221	11						
221	11						

Bank Leumi le-Israel B.M. and its Consolidated Companies
Exposure to Interest Rate Fluctuations - on Consolidated Basis (cont'd)
Reported Amounts

Exhibit D (cont'd):

	31 December 2009					
	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
	NIS millions					
Foreign currency and foreign currency						
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments						
Financial assets (a) (d)	49,371	24,126	6,986	7,515	3,352	1,714
Derivative financial instruments (excluding options)	44,144	38,955	31,466	10,899	6,056	5,783
Options (in terms of basis asset) (e)	11,052	9,739	15,588	3,340	1,120	2,562
Off-balance sheet financial instruments	-	-	-	-	-	-
Total fair value	104,567	72,820	54,040	21,754	10,528	10,059
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments						
Financial liabilities (a)	64,076	20,019	20,343	2,960	377	36
Derivative financial instruments (excluding options)	39,395	36,320	26,165	13,414	6,508	6,559
Options (in terms of basis asset) (e)	10,498	9,668	15,035	3,246	1,119	2,562
Off-balance sheet financial instruments	-	-	86	-	-	-
Total fair value	113,969	66,007	61,629	19,620	8,004	9,157
Financial instruments, net						
Exposure to interest rate fluctuations	(9,402)	6,813	(7,589)	2,134	2,524	902
Accumulated exposure in the sector	(9,402)	(2,589)	(10,178)	(8,044)	(5,520)	(4,618)
Total exposure to interest rate fluctuations						
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments						
Financial assets (a) (c)	167,674	38,021	39,872	30,441	14,339	11,621
Derivative financial instruments (excluding options)	73,848	77,668	68,341	25,379	11,033	11,797
Options (in terms of basis asset) (e)	11,877	10,470	17,538	3,349	1,120	2,562
Off-balance sheet financial instruments	-	-	-	-	-	-
Total fair value	253,399	126,159	125,751	59,169	26,492	25,980
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments						
Financial liabilities	173,306	26,728	38,448	23,963	11,252	14,488
Derivative financial instruments (excluding options)	68,677	75,332	68,882	29,572	13,352	13,427
Options (in terms of basis asset) (e)	11,724	10,473	17,541	3,357	1,120	2,562
Off-balance sheet financial instruments	-	-	202	-	-	-
Total fair value	253,707	112,533	125,073	56,892	25,724	30,477
Financial instruments, net						
Exposure to interest rate fluctuations	(308)	13,626	678	2,277	768	(4,497)
Accumulated exposure in the sector	(308)	13,318	13,996	16,273	17,041	12,544

(a) Excluding balance sheet balances of derivative financial instruments and fair value of off-balance sheet financial instruments.
(b) Weighted average according to fair value of effective duration.
(c) Including shares shown in the "Without fixed maturity" column.
(d) Including Israeli currency linked to foreign currency
(e) Duration less than 0.05 years.

						31 December 2008	
Over ten years to Twenty Years	Over twenty years	Without fixed maturity	Total	Internal rate of return	Average maturity	Internal rate of return	Average Maturity
				%	Years	%	Years
49	-	357	93,470	3.90	0.57	3.55	0.55
70	-	164	137,537	0.00	0.84		
-	-	-	43,401	-	-		
-	-	-	-	-	-		
119	-	521	274,408	3.90	0.62		
41	-	8	107,860	0.85	0.27	1.88	0.39
57	-	164	128,582	0.00	0.97		
-	-	-	42,128	-	-		
-	-	-	86	0.00	0.50		
98	-	172	278,656	0.85	0.55		
21	-						
21	-						
3,363	254	3,595	309,180	3.65	0.96		1.09
105	-	459	268,630	0.00	0.91		
-	-	-	46,916	-	-		
-	-	-	-	-	-		
3,468	254	4,054	624,726	3.65	0.86		
2,645	243	79	291,152	2.39	0.94		1.06
223	-	423	269,888	0.00	1.02		
-	-	-	46,777	-	-		
-	-	111	313	0.00	0.50		
2,868	243	613	608,130	2.39	0.90		
600	11						
600	11						

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 of each financial instrument, discounted at the interest rate used for discounting to fair value. For further details of assumptions used in calculating fair value of financial instruments, see Note 18C.

(3) The internal rate of return is the interest rate at which expected cash flows are discounted to fair value.

(4) Effective duration of a group of financial instruments represents and approximation of the change in percentages in fair value of the group of financial instruments which will be caused as a result of a small change (increase of 0.1%) in the internal rate of return.

(5) Instruments with options not separated from the host contract are not shown on a separate line but included with the remaining financial assets.

(6) Comparative figures as at 31 December 2008 are given in the format of the previous directive as reported in the Financial Statements for the year 2008.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Overall Credit Risk to the Public by Economic Sector - on Consolidated Basis
Reported Amounts

Exhibit E:

	31 December 2009				
Activities of borrowers in Israel	**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				
Agriculture	1,821	353	2,174	31	168
Industry	20,359	13,984	34,343	221	2,101
Construction and real estate	35,451	21,598	57,049	290	6,193
Electricity and water	1,207	418	1,625	-	2
Commerce	13,857	3,435	17,292	87	1,340
Hotels, catering services and food	3,595	288	3,883	48	1,599
Transport and storage	3,890	1,290	5,180	53	888
Communications and computer services	4,318	1,875	6,193	45	378
Financial services	13,808	10,382	24,190	128	1,470
Other business services	4,267	1,403	5,670	39	341
Public and community services	6,159	1,072	7,231	1	235
Private individuals - housing loans	44,715	2	44,717	(12)	791
Private individuals - other	23,105	25,365	48,470	300	952
Total	176,552	81,465	258,017	1,231	16,458
Credit risk included in the various economic sectors:					
Settlement movements (d)	2,843	910	3,753	10	776
Local authorities (e)	3,307	140	3,447	-	87

	31 December 2009				
Activities of borrowers abroad	**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				
Agriculture	83	25	108	-	2
Industry	6,495	3,820	10,315	33	637
Construction and real estate	6,090	2,162	8,252	15	1,083
Electricity and water	164	150	314	-	-
Commerce	7,384	3,156	10,540	135	703
Hotels, catering services and food	882	22	904	(1)	99
Transport and storage	362	182	544	51	80
Communications and computer services	199	165	364	-	-
Financial services	12,520	2,308	14,828	20	677
Other business services	1,959	624	2,583	19	42
Public and community services	1,181	136	1,317	-	2
Private individuals	2,739	720	3,459	53	85
Total	40,058	13,470	53,528	325	3,410

(a) Credit to the public in the amount of NIS 172,930 million in respect of activity in Israel and NIS 32,514 million in respect of activity abroad, investments in debentures of companies in the amount of NIS 1,051 million in respect of activity in Israel and NIS 7,155 million in respect of activity abroad, and other assets in respect of derivative instruments which represent transactions of the public in the amount of NIS 2,571 million in respect of activity in Israel and NIS 389 in respect of activity abroad.

(b) Credit risk on off-balance sheet financial instruments as calculated for the purpose of per single 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 - Credit risk and balances of problematic debts are stated net of specific provisions for doubtful debts.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Overall Credit Risk to the Public by Economic Sector - on Consolidated Basis
(cont'd)

Reported Amounts

Exhibit E (cont'd):

Activities of borrowers in Israel	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)
	31 December 2008				
	NIS millions				
Agriculture	2,018	385	2,403	(44)	256
Industry	23,940	14,447	38,387	596	3,031
Construction and real estate	34,257	18,579	52,836	420	6,807
Electricity and water	1,203	186	1,389	1	5
Commerce	16,190	3,447	19,637	47	1,260
Hotels, catering services and food	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	339	2,539
Other business services	5,126	1,386	6,512	28	352
Public and community services	5,539	1,804	7,343	7	330
Private individuals - housing loans	40,904	1,742	42,646	97	979
Private individuals - other	22,374	24,169	46,543	227	1,345
Total	182,353	76,813	259,166	1,769	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	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)
	31 December 2008				
	NIS millions				
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, catering services and food	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	54	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	303	3,355

(a) Credit to the public in the amount of NIS 177,261 million in respect of activity in Israel and NIS 36,783 million in respect of activity abroad, investments in debentures of companies in the amount of NIS 1,089 million in respect of activity in Israel and NIS 7,115 million in respect of activity abroad, and other assets in respect of derivative instruments which represent transactions of the public in the amount of NIS 4,003 million in respect of activity in Israel and NIS 593 in respect of activity abroad.

(b) Credit risk on off-balance sheet financial instruments as calculated for the purpose of per single 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 - Credit risk and balances of problematic debts are stated net of specific provisions for doubtful debts.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Country Exposure
Reported Amounts

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

	31 December 2009					
	Balance sheet exposure					
	Cross-Border Balance Sheet Exposure			Net Foreign-office Claims on Local Residents		
	To governments (a)	To banks	To others	Balance sheet exposure before deducting local liabilities	Deduction for local liabilities	Balance sheet exposure after deducting local liabilities
Country	NIS millions					
United States	105	8,114	6,294	17,300	7,380	9,920
United Kingdom	677	3,575	1,104	4,927	1,808	3,119
France	2,196	1,884	516	19	4	15
Holland	-	1,591	1,923	-	-	-
Germany	109	3,438	1,170	-	-	-
Others	217	9,151	5,868	2,592	1,655	937
Total exposure to foreign countries	3,304	27,753	16,875	24,838	10,847	13,991
Total exposure to LDC countries	148	244	1,169	2,100	1,217	883

	31 December 2009					
	Total balance sheet exposure		Off-balance sheet exposure			
					Cross-Border Balance Sheet Exposure	
					Repayment period	
		Balance of problematic debts (b)	Total off-balance sheet exposure	Of which: Problematic off-balance sheet credit risk	Up to one year	Over one year
	NIS millions					
Country						
United States	24,433	923	11,155	-	5,801	8,712
United Kingdom	8,475	525	7,869	3	3,138	2,218
France	4,611	13	2,348	-	1,579	3,017
Holland	3,514	12	216	-	1,429	2,085
Germany	4,717	-	2,004	-	2,704	2,013
Others	16,173	694	4,273	-	9,665	5,571
Total exposure to foreign countries	61,923	2,167	27,865	3	24,316	23,616
Total exposure to LDC countries	2,444	126	971	-	1,108	453

(a) Including governments, official institutions and central banks.

(b) Balance of problematic debts less debts covered by collateral eligible for deduction for purposes of single borrower and group borrower debt limitations. Does not include off-balance sheet risk components

Bank Leumi le-Israel B.M. and its Consolidated Companies
Country Exposure
Reported Amounts

Exhibit F (cont'd):

	31 December 2008					
	Balance sheet exposure					
	Cross-Border Balance Sheet Exposure			Net Foreign-office Claims on Local Residents		
	To governments (a)	To banks	To others	Balance sheet exposure before deducting local liabilities	Deduction for local liabilities	Balance sheet exposure after deducting local liabilities
Country	NIS millions					
United States	3,516	6,466	8,801	20,504	9,367	11,137
United Kingdom	8	6,391	967	5,253	1,812	3,441
France	566	1,759	521	18	5	13
Holland	-	1,849	1,445	-	-	-
Germany	-	2,195	1,177	-	-	-
Others	320	9,597	5,095	3,614	2,132	1,482
Total exposure to foreign countries	4,410	28,257	18,006	29,389	13,316	16,073
Total exposure to LDC countries	264	596	1,029	1,752	1,000	752

	31 December 2008					
	Total balance sheet exposure		Off-balance sheet exposure			
					Cross-Border Balance Sheet Exposure	
					Repayment period	
		Balance of problematic debts (b)	Total off-balance sheet exposure	Of which: Problematic off-balance sheet credit risk	Up to one year	Over one year
	NIS millions					
Country						
United States	29,920	904	12,599	40	7,785	10,998
United Kingdom	10,807	378	10,758	-	5,079	2,287
France	2,859	33	1,698	-	1,630	1,216
Holland	3,294	147	846	-	2,138	1,156
Germany	3,372	36	661	-	2,123	1,249
Others	16,494	737	3,830	-	9,176	5,836
Total exposure to foreign countries	66,746	2,235	30,392	40	27,931	22,742
Total exposure to LDC countries	2,641	16	623	-	1,542	347

(a) Including governments, official institutions and central banks.

(b) Balance of problematic debts less debts covered by collateral eligible for deduction for purposes of single borrower and group borrower debt limitations. Does not include off-balance sheet risk components

Bank Leumi le-Israel B.M. and its Consolidated Companies
Country Exposure (cont'd)
Reported Amounts

Exhibit F (cont'd):

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, after the effect of guarantees, liquid collateral and credit derivatives.
- 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 as calculated for purposes of single borrower debt limitations.

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 5,080 million relating to: Belgium, Switzerland and Canada (at 31 December 2008 a total of NIS 2,455 million relating to Belgium only).

Part C – The amount of exposure to foreign countries with liquidity problems as defined by the Bank of Israel (a country receiving financial aid from the IMF or whose obligations are rated with a credit rating of CCC or lower) totaled NIS 298 million and relates to 14 countries.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Quarterly Consolidated Balance Sheets – Multi-Quarter Data
Reported Amounts

Exhibit G:

Year	2009				2008			
Quarter	4	3	2	1	4	3	2	1
	NIS millions							
Assets								
Cash and deposits with banks	42,933	43,934	39,390	38,712	33,130	29,027	31,229	36,580
Securities	57,505	58,381	56,944	47,677	44,910	41,566	43,494	44,641
Securities borrowed or purchased under agreements to resell	744	1,823	1,081	229	201	483	742	864
Credit to the public	204,669	203,971	207,214	212,878	213,215	207,489	201,717	200,174
Credit to governments	407	430	452	500	520	512	531	576
Investments in companies included on equity basis	2,178	1,908	1,862	2,048	1,842	2,031	1,895	1,899
Buildings and equipment	3,553	3,544	3,528	3,513	3,445	3,368	3,317	3,331
Other assets	9,786	9,639	8,875	12,495	13,529	9,335	9,077	10,158
Total assets	321,775	323,630	319,346	318,052	310,792	293,811	292,002	298,223
Liabilities and equity capital								
Deposits of the public	250,418	249,433	253,254	254,565	244,783	225,952	221,752	228,187
Deposits from banks	3,785	5,395	2,904	3,181	3,742	6,457	8,966	6,575
Deposits from governments	712	719	741	852	831	827	833	1,128
Securities loaned or sold under agreements to repurchase	273	1,316	1,174	193	549	549	372	385
Debentures, bonds and subordinated notes	25,261	25,471	22,917	20,567	20,636	22,257	21,920	21,985
Other liabilities	19,182	19,955	17,871	19,603	21,334	17,978	17,506	20,121
Total liabilities	299,631	302,289	298,861	298,961	291,875	274,020	271,349	278,381
Minority interest	282	274	263	255	245	229	225	109
Shareholders' equity	21,862	21,067	20,222	18,836	18,672	19,562	20,428	19,733
Total liabilities and equity capital	321,775	323,630	319,346	318,052	310,792	293,811	292,002	298,223

Bank Leumi le-Israel B.M. and its Consolidated Companies
Quarterly Consolidated Statements of Profit and Loss – Multi-Quarter Data
Reported Amounts

Exhibit H:

Year	2009				2008			
Quarter	4	3	2	1	4	3	2	1
	NIS millions				NIS millions			
Net interest income before provision for doubtful debts	**1,812**	**1,923**	**1,926**	**1,362**	976	1,491	1,953	1,960
Provision for doubtful debts	**381**	**443**	**339**	**354**	1,090	495	316	244
Net interest income (expense) after provision for doubtful debts	**1,431**	**1,480**	**1,587**	**1,008**	(114)	996	1,637	1,716
Operating and other income								
Operating commissions	**925**	**915**	**840**	**831**	(a)867	(a)887	(a)882	(a)902
Profits (losses) from investments in shares, net	**236**	**286**	**90**	**95**	(434)	(363)	(44)	(71)
Other income	**94**	**91**	**83**	**77**	(a)112	(a)16	(a)26	(a)20
Total operating and other income	**1,255**	**1,292**	**1,013**	**1,003**	545	540	864	851
Operating and other expenses								
Salaries and related expenses	**1,188**	**1,052**	**929**	**883**	969	1,043	975	1,131
Building and equipment maintenanc	**404**	**366**	**380**	**364**	377	353	344	323
Other expenses	**383**	**340**	**331**	**317**	455	350	343	340
Total operating and other expenses	**1,975**	**1,758**	**1,640**	**1,564**	1,801	1,746	1,662	1,794
Operating profit (loss) before taxes	**711**	**1,014**	**960**	**447**	(1,370)	(210)	839	773
Provision for (benefit from) taxes on operating profit (loss)	**241**	**499**	**409**	**42**	(423)	61	400	383
Operating profit (loss) after taxes	**470**	**515**	**551**	**405**	(947)	(271)	439	390
Group's equity in after-tax companies included on equity basis, net of related tax effect	**81**	**30**	**(64)**	**34**	(222)	191	193	87
Minority interest in after-tax operating (profits) losses of subsidiaries	**(7)**	**(11)**	**(7)**	**(11)**	(15)	(5)	7	(5)
Net operating profit (loss)	**544**	**534**	**480**	**428**	(1,184)	(85)	639	472
After-tax profit (loss) from extraordinary items	**-**	**-**	**27**	**1**	1	1	250	(2)
Net profit (loss) for the period	**544**	**534**	**507**	**429**	(1,183)	(84)	889	470

(a) Reclassified.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Quarterly Consolidated Statements of Profit and Loss – Multi-Quarter Data (cont'd)
Earnings per Share for Each Quarter for the Years 2008-2009
Reported Amounts

Exhibit H (cont'd):

Year	2009				2008			
Quarter	4	3	2	1	4	3	2	1
	(בש"ח)							
Basic earnings per share:								
Net operating profit (loss)	0.37	0.36	0.33	0.29	(0.82)	(0.06)	0.44	0.33
After-tax profit from extraordinary items	0.00	0.00	0.02	0.00	0.00	0.00	0.17	0.00
Net profit (loss) for the period	0.37	0.36	0.35	0.29	(0.82)	(0.06)	0.61	0.33
Diluted earnings per share:								
Net operating profit (loss)	0.37	0.36	0.33	0.29	(0.82)	(0.06)	0.44	0.33
After-tax profit from extraordinary items	0.00	0.00	0.02	0.00	0.00	0.00	0.17	0.00
Net profit (loss) for the period	0.37	0.36	0.35	0.29	(0.82)	(0.06)	0.61	0.33

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 2009 (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.

24 March 2010

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 2009 (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.

24 March 2010

Zeev Nahari
Senior Deputy Chief Executive Officer
Senior Member of Management
for 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 2009, 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 2009, 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 2009 was audited by the Bank's Auditors, Kost Forer Gabbay & Kasierer and Somekh Chaikin, as stated in their Report on page 317, which includes an opinion regarding the effectiveness of the Bank's internal control over financial reporting as at 31 December 2009.

Eitan Raff
Chairman of the Board of Directors

Galia Maor
President and Chief Executive Officer

Zeev Nahari
Senior Deputy Chief Executive Officer
Senior Member of Management
for Finance, Accounting and Capital Markets

24 March 2010

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 2009, 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 2009, 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 2009 and 2008, 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 2009 and our report of 24 March 2010 included an unqualified opinion on the consolidated financial statements.

Kost Forer Gabbay & Kasierer
Certified Public Accountants (Isr.)

Somekh Chaikin
Certified Public Accountants (Isr.)

Joint Auditors

24 March 2010

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 2009 and 2008, 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 2009. 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 as at 31 December 2009 and 2008, respectively, and whose net interest income before provision for doubtful debts included in the consolidated statements of profit and loss constitutes some 2%, some 0.1% and some 2% of the total consolidated interest income before provision for doubtful debts for the years ended 31 December 2009, 2008, and 2007, 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 2009 and 2008, 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 2009, 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:

1. that stated in Note 18.G.(2) and (4-6), regarding claims against the Bank and against consolidated companies, including applications for their approval as class actions;
2. that stated in Note 18.P. regarding a determination by the Antitrust Commissioner;
3. 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 2009, 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 24 March, 2010 included an unqualified opinion thereon.

Somekh Chaikin
Certified Public Accountants (Isr.)

Kost Forer Gabbay & Kasierer
Certified Public Accountants (Isr.)

Joint Auditors

24 March 2010

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Balance Sheet as at 31 December 2009
Reported Amounts

		31 December 2009	31 December 2008
	Note	NIS millions	
Assets			
Cash and deposits with banks	2, 14	42,933	33,130
Securities	3, 14	57,505	44,910
Securities borrowed or purchased under agreements to resell		744	201
Credit to the public	4	204,669	213,215
Credit to governments	5	407	520
Investments in companies included on equity basis	6	2,178	1,842
Buildings and equipment	7	3,553	3,445
Other assets	8	9,786	13,529
Total assets		321,775	310,792
Liabilities and equity capital			
Deposits of the public	9	250,418	244,783
Deposits from banks	10	3,785	3,742
Deposits from governments		712	831
Securities lent or sold under agreements to repurchase		273	549
Debentures, bonds and subordinated notes	11	25,261	20,636
Other liabilities	12	19,182	21,334
Total liabilities		299,631	291,875
Minority interest		282	245
Shareholders' equity	13	21,862	18,672
Total liabilities and equity capital		321,775	310,792

The accompanying notes are an integral part of the consolidated financial statements.
For condensed financial statements of the Bank only – see Note 30.

Eitan Raff	Prof. Efraim Sadka	Prof. Israel Gilead	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 approval of the financial statements: 24 March 2010

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Profit and Loss
for the year ended 31 December 2009
Reported Amounts

	Note	2009	2008	2007
		NIS millions		
Net interest income before provision for doubtful debts	20	**7,023**	6,380	7,648
Provision for doubtful debts	4	**1,517**	2,145	407
Net interest income after provision for doubtful debts		**5,506**	4,235	7,241
Operating and other income				
Operating commissions	21	**3,511**	(a) 3,538	(a) 3,593
Profits (losses) from investments in shares, net	22	**707**	(912)	461
Other income	23	**345**	(a) 174	(a) 168
Total operating and other income		**4,563**	2,800	4,222
Operating and other expenses				
Salaries and related expenses	24	**4,052**	4,118	4,218
Building and equipment maintenance and depreciation		**1,514**	1,397	1,274
Other expenses	25	**1,371**	1,488	1,445
Total operating and other expenses		**6,937**	7,003	6,937
Operating profit before taxes		**3,132**	32	4,526
Provision for taxes on operating profit	26	**1,191**	421	1,722
Operating profit (loss) after taxes		**1,941**	(389)	2,804
Group's equity in after-tax operating profits of companies companies included on equity basis, net of related tax effect	6	**81**	249	184
Minority interest in after-tax operating profits of subsidiaries		**(36)**	(18)	(4)
Net operating profit (loss)		**1,986**	(158)	2,984
After-tax profit from extraordinary items	27	**28**	250	373
Net profit		**2,014**	92	3,357
Earnings per share				
Basic earnings:		NIS		
Net operating profit (loss)		**1.35**	(0.11)	2.11
After-tax profit from extraordinary items		**0.02**	0.17	0.26
Net profit		**1.37**	0.06	2.37
Diluted earnings:				
Net operating profit (loss)		**1.35**	(0.11)	2.08
After-tax profit from extraordinary items		**0.02**	0.17	0.26
Net profit		**1.37**	0.06	2.34
		(Thousands)		
Weighted average of the number of shares for calculation of basic earnings		**1,473,551**	1,462,252	1,414,233
Weighted average of the number of shares for calculation of diluted earnings		**1,473,551**	1,470,961	1,433,803

(a) Reclassified

The accompanying notes are an integral part of the consolidated financial statements.

For condensed financial statements of the Bank only – see Note 30.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Statement of changes in Shareholders' Equity
for the year ended 31 December 2009
Reported Amounts

	Share capital	Premium	Capital reserves in respect of share-based payment transactions and others (a)
	NIS millions		
Balance as at 1 January 2007	7,000	-	405
Net profit for the year	-	-	-
Proposed dividend	-	-	-
Dividend declared after date of the balance sheet	-	-	-
Benefit in respect of share-based payment transactions	-	-	205
Adjustments in respect of presentation of securities available for sale at fair value	-	-	-
Profits in respect of securities available for sale that were realized and/or charged to profit and loss (c)	-	-	-
Related tax effect	-	-	-
Adjustments arising from translation of financial statements of companies included on equity basis	-	-	-
Loans to employees for purchase of the Bank's shares	-	-	-
Balance as at 31 December 2007	7,000	-	610
Net profit for the year	-	-	-
Shares issued	59	855	(300)
Dividend paid	-	-	-
Benefit in respect of share-based payment transactions	-	-	(26)
Other overall profit in companies included on equity basis charged directly to reserves	-	-	-
Adjustments in respect of presentation of securities available for sale at fair value	-	-	-
Losses in respect of securities available for sale that were realized and/or charged to profit and loss (c)	-	-	-
Related tax effect	-	-	-
Adjustments arising from translation of financial statements of companies included on equity basis	-	-	-
Loans to employees for purchase of the Bank's shares	-	-	-
Balance as at 31 December 2008	7,059	855	284
Net profit for the year	-	-	-
Expiration of options	-	117	(117)
Benefit in respect of share-based payment transactions	-	-	30
Other overall profit in companies included on equity basis charged directly to reserves	-	-	-
Adjustments in respect of presentation of securities available for sale at fair value	-	-	-
Profits in respect of securities available for sale that were realized and/or charged to profit and loss (c)	-	-	-
Related tax effect	-	-	-
Adjustments arising from translation of financial statements of companies included on equity basis	-	-	-
Loans to employees for purchase of the Bank's shares	-	-	-
Balance as at 31 December 2009	**7,059**	**972**	**197**

(a) Including NIS 10 million other capital reserves.
(b) Adjustments from translation of financial statements autonomous overseas companies included on equity basis (see Note 1E(3) and F(2).
(c) Including provision for impairment

	Total share capital and capital reserves	Total other overall profit (loss) — Adjustments in respect of presentation of securities available for sale at fair value	Total other overall profit (loss) — Translation adjustments(b)	Retained earnings	Dividend declared after balance sheet sheet date	Loans to employees for purchase of the Bank's shares	Total shareholder's equity
	7,405	623	(403)	10,343	-	(477)	17,491
	-	-	-	3,357	-	-	3,357
	-	-	-	(1,414)	-	-	(1,414)
	-	-	-	(270)	270	-	-
	205	-	-	-	-	-	205
	-	116	-	-	-	-	116
	-	(326)	-	-	-	-	(326)
	-	89	-	-	-	-	89
	-	-	(42)	-	-	-	(42)
	-	-	-	-	-	73	73
	7,610	502	(445)	(d) 12,016	270	(404)	19,549
	-	-	-	92	-	-	92
	614	-	-	-	-	-	614
	-	-	-	-	(270)	-	(270)
	(26)	-	-	-	-	-	(26)
	-	-	-	(110)	-	-	(110)
	-	(3,636)	-	-	-	-	(3,636)
	-	1,852	-	-	-	-	1,852
	-	634	-	-	-	-	634
	-	-	(57)	-	-	-	(57)
	-	-	-	-	-	30	30
	8,198	(648)	(502)	(d) 11,998	-	(374)	18,672
	-	**-**	**-**	**2,014**	**-**	**-**	**2,014**
	-	**-**	**-**	**-**	**-**	**-**	**-**
	30	**-**	**-**	**-**	**-**	**-**	**30**
	-	**-**	**-**	**164**	**-**	**-**	**164**
	-	**2,357**	**-**	**-**	**-**	**-**	**2,357**
	-	**(876)**	**-**	**-**	**-**	**-**	**(876)**
	-	**(524)**	**-**	**-**	**-**	**-**	**(524)**
	-	**-**	**28**	**-**	**-**	**-**	**28**
	-	**-**	**-**	**-**	**-**	**(3)**	**(3)**
	8,228	**309**	**(474)**	(d) **14,176**	**-**	**(377)**	**21,862**

(d) Including NIS 984 million not available for allocation as dividend (31 December 2008 – NIS 1,638 million, 31 December 2007 – NIS 987 million). The balance of the amount for distribution is subject to Bank of Israel directives and limitations detailed in Proper Conduct of Banking Business directives.

The accompanying notes are an integral part of the consolidated financial statements.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Cash Flows
for the year ended 31 December 2009
Reported Amounts

	2009	2008	2007
	NIS millions		
Cash flows generated by operating activities:			
Net profit for the year	**2,014**	92	3,357
Adjustments required to cash flows generated by operating activities:			
Equity in undistributed profits of companies included on equity basis (a)	**(79)**	(128)	(120)
Minority interest in profits of consolidated companies	**36**	18	8
Benefit in respect of share-based payment transactions	**-**	24	201
Depreciation of buildings and equipment	**612**	520	460
Amortization	**21**	17	15
Provision for doubtful debts	**1,517**	2,145	407
Provision for decrease in value of assets transferred to the Group's ownership	**-**	10	5
Net gain on sale of securities available for sale	**(1,085)**	(52)	(354)
Realized and unrealized loss (gain) from adjustment of held for trading securities to fair value	**(240)**	446	24
Gain on receipt of shares without payment	**(1)**	(27)	**-**
After-tax gain on realization of investments in companies included on equity basis	**-**	(17)	-
Net gain from sale of companies on the capital market	**-**	-	(357)
Net (gains) losses, after tax, on sale of buildings and equipment	**(28)**	2	(18)
Provision for impairment of debentures available for sale	**200**	1,328	28
Provision for impairment of shares available for sale	**9**	576	-
Cancellation of special provisions in connection with fixed assets	**-**	(2)	(5)
Deferred taxes in respect of operating profit, net	**166**	33	23
Increase (reduction) in excess of provisions for severance pay and pensions over amounts funded	**(309)**	672	(30)
Gain on issue of shares to third party in subsidiary	**-**	(234)	-
Other, net	**(6)**	(1)	16
Net cash generated by operating activities	**2,827**	5,422	3,660

(a) After deducting dividend received.

The accompanying notes are an integral part of the consolidated financial statements.

For condensed financial statements of the Bank only, see Note 30.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Cash Flows
for the year ended 31 December 2009
Reported Amounts

	2009	2008	2007
	NIS millions		
Cash flows generated by activities in assets:			
Net decrease (increase) in deposits with banks for an initial period exceeding three months	**(562)**	5,380	(1,338)
Acquisition of debentures held to maturity	**(68)**	(32)	(26)
Proceeds from redemption of debentures held to maturity	**725**	(a) 104	973
Acquisition of securities available for sale	**(36,231)**	(46,165)	(37,531)
Proceeds from sale of securities available for sale	**14,880**	5,810	7,701
Proceeds from redemption of securities available for sale	**9,102**	(a) 41,530	29,028
Net decrease (increase) in securities held for trading	**1,213**	(3,241)	(1,091)
Net decrease (increase) in credit to the public	**7,212**	(16,615)	(15,429)
Net decrease in credit to governments	**113**	122	378
Additional investments in shares of consolidated companies	**-**	-	(18)
Issue of shares to third party in subsidiary	**-**	360	-
Proceeds from sale of investment in companies included on equity basis	**-**	29	-
Acquisition of shares in companies included on equity basis	**(39)**	(13)	(35)
Acquisition of buildings and equipment	**(759)**	(715)	(697)
Net decrease (increase) in securities borrowed or purchased under agreements to resell	**(543)**	454	(655)
Proceeds from sale of buildings, after deduction of related tax	**42**	45	58
Proceeds from realization of assets transferred to Group ownership	**43**	9	-
Net proceeds from sale of companies on the capital market	**-**	-	357
Net (increase) decrease in other assets	**3,388**	(5,781)	(1,361)
Net cash used for activities in assets	**(1,484)**	(18,719)	(19,686)
Cash flows generated by activities in liabilities and capital			
Net increase (decrease) in:			
Deposits of the public	**5,635**	6,738	6,222
Deposits from banks	**43**	(2,397)	898
Deposits from governments	**(119)**	(367)	(948)
Issue of debentures, bonds and subordinated notes	**4,806**	5,089	4,233
Redemption of debentures, bonds and subordinated notes	**(865)**	(3,701)	(607)
Net increase (decrease) in other liabilities	**(1,318)**	4,838	1,851
Net increase (decrease) in securities loaned or sold under agreements to repurchase	**(276)**	318	231
Issue of shares to employees	**-**	614	-
Dividend paid to shareholders	**-**	(1,684)	(2,500)
Dividend paid to minority shareholders in consolidated companies	**-**	-	(45)
Repayment of loans to employees for purchase of the Bank's shares	**1**	30	73
Net cash generated by activities in liabilities and capital	**7,907**	9,478	9,408
Increase (decrease) in cash	**9,250**	(3,819)	(6,618)
Balance of cash at beginning of year	**31,005**	34,824	41,442
Balance of cash at end of year	**40,255**	31,005	34,824

(a) Reclassified

The accompanying notes are an integral part of the consolidated financial statements.

For condensed financial statements of the Bank only, see Note 30.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Cash Flows
for the year ended 31 December 2009
Reported Amounts

Appendix A - Transactions not involving cash:

In 2009:

(1) During the year, shares were transferred from the available for sale portfolio to credit to the public, in the amount of NIS 359 million, due to lending of securities.
(2) During the year, assets were transferred from credit to the public to other assets, in the amount of NIS 65 million, in respect of loans that were repaid.

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 lending 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.

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 conclusion of lending of securities.
(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.

The accompanying notes are an integral part of the consolidated financial statements.

For condensed financial statements of the Bank only, see Note 30.

Index to Notes

Note 1 - Significant Accounting Policies

A. General

The financial statements have been prepared in accordance with generally accepted accounting principles in Israel (Israeli GAAP) 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 only appear in Note 30.

B. Definitions

In these financial statements -

Consolidated companies - companies of which the financial statements are fully consolidated, directly or indirectly, in the statements of the Bank.

Companies included on equity basis - companies, other than consolidated companies, and companies consolidated under relative consolidation including a partnership or joint enterprise, in which the Bank's investment is included, directly or indirectly, in the financial statements on equity basis.

Investee companies - consolidated companies, companies consolidated under relative consolidation, or companies included on equity basis.

Overseas units - representative offices, agencies, branches or consolidated companies of the Bank outside Israel.

Functional currency - the currency of the main economic environment in which the Bank operates; generally, this is the currency of the environment where the corporation produces and spends most of its cash funds.

Reporting currency - the currency in accordance with which the financial statements are reported.

Related parties - as defined in Opinion No. 29 of the Institute of Certified Public Accountants in Israel, except for interested parties.

Interested parties - as defined in paragraph 1 of the definition “Interested Party, in a Corporation” in Paragraph 1 of the Securities Law, 1968.

Index - the Consumer Price Index in Israel published by the Central Bureau of Statistics.

Adjusted amount - an historical nominal amount that was adjusted to the December 2003 CPI, in accordance with the provisions of Opinions 23 and 36 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.

Nominal financial report - financial report based on reported amounts.

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.

C. 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 of 1 January 2004 the Bank applies the provisions of Accounting Standard No. 12 and the transitory directives of the Supervisor of Banks. The Bank prepared its financial statements in the past on the basis of historical cost adjusted to the Consumer Price Index.

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. Commencing on 1 January 2004, additions carried out during the period were included in nominal values. Therefore, financial statements as at dates and for reporting periods after 31 December 2003 are shown in reported amounts in accordance with the accounting standards of the Israel Accountancy Standards Board and the directives of the Supervisor of Banks.

Amounts of non-monetary assets do not necessarily show a realizable value or a current economic value, but only the amounts reported for those assets.
In the financial statements "cost" means cost in a reported amount.

(2) Balance Sheet

- Non-monetary items (mainly buildings and equipment; investments in non-quoted shares; amortizable expenses relating to issuance of debentures, bonds and subordinated notes) and share capital are shown in reported amounts.

- Monetary items are shown in the balance sheet at their historical nominal values as at the balance sheet date.

- The equity value of investments in companies included on equity basis is determined based on the financial statements of these companies.

(3) 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 Bank's share in the operating results of investee companies and the minority interest in the results of consolidated companies is determined based on the financial statements in reported amounts of these companies.
- Other components of the profit and loss statement are shown at their nominal values.

(4) Statement of changes in shareholders' equity

Dividend declared in the year of the report is stated in nominal values.

D. 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.
  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.

Note 1 - Significant Accounting Policies (cont'd)

(3) Data on representative exchange rates and CPI and the percentage of change therein:

	31 December			Rate of change in		
	2009	2008	2007	**2009**	2008	2007
	NIS			%		
Exchange rate of the:						
U.S. dollar	**3.775**	3.802	3.846	**(0.7)**	(1.1)	(9.0)
Euro	**5.442**	5.297	5.659	**2.7**	(6.4)	1.7
Pound Sterling	**6.111**	5.548	7.710	**10.2**	(28.0)	(7.0)
Swiss franc	**3.667**	3.565	3.420	**2.9**	4.2	(1.3)
Currency basket	**4.433**	4.383	4.543	**1.1**	(3.5)	(5.8)
Consumer Price Index for the month of -	(Points)					
November – known index	**105.2**	101.3	97.0	**3.8**	4.5	2.8
December – index for the month	**105.2**	101.2	97.5	**3.9**	3.8	3.4
Revaluation (devaluation) in real terms of NIS in relation to -						
Exchange rate of the dollar				**(4.4)**	(4.8)	(12.4)
Exchange rate of the currency basket				**(2.7)**	(7.1)	(9.2)

E. 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.

Note 1 - Significant Accounting Policies (cont'd)

F. Principles of consolidation and implementation of equity method

(1) Principles of consolidation

Subsidiary companies are entities controlled by the Bank. Control exists when the Bank has the ability to determine the financial and operating policy of the entity in order to obtain benefit from its resources and activities. Control exists when the Bank holds, directly or indirectly, shares granting more than 50% of the voting rights in the subsidiary and the rights to appoint the majority of the members of its Board of Directors, unless there are reasons which clearly prevent the parent company from implementing actual control.

The consolidated financial statements include the audited financial statements of the Bank and of entities in which the Bank has control. The financial statements of subsidiary companies are included in the consolidated financial statements from the date control is obtained until the date control ceases. The accounting policy of subsidiary companies was amended as necessary in order to adapt it to the accounting policy adopted by the Bank, except in those cases when the Supervisor of Banks shall otherwise permit.

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) at the time of acquisition constitutes goodwill. 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. Goodwill is shown in the consolidated balance sheet under "Other Assets". Surplus cost attributed to assets and liabilities will be charged to the relevant items in the balance sheet.

Intercompany balances and transactions between consolidated companies are eliminated 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 only.

(2) Companies included on equity basis

Investments in shares of companies included on equity basis, as defined in Opinion 68, are stated according to the equity method based on the audited financial statements of the companies. Investments include goodwill calculated at the date of acquisition and shown after deducting losses from impairment. The accounting policy of companies included on equity basis which is implemented by them is in accordance with accepted accounting principles in Israel.
The Bank's share in the operating results of the said companies is shown after amortization of the cost generated on their acquisition. Excess cost attributed to the assets and liabilities is amortized over the useful life of the asset. Goodwill and negative goodwill are amortized on a straight line basis over 10 years.

The statement of changes in shareholders' equity includes the Bank's share in "translation adjustments" of units held by companies included on equity basis, as units whose activity is in a functional currency differing from the functional currency of the Bank.

The Bank examines the necessity, in each reporting period, of recording impairment in companies included on equity basis - see U. below.

Note 1 - Significant Accounting Policies (cont'd)

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.

G. 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 which the Bank intends and is able to hold until redemption date. 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 held for trading

Securities which were acquired and are held with the aim of selling them in the near future. Securities held for trading are stated at fair value at the date of the report. The fair value is determined on the basis of market prices quoted in active markets. Unrealized gains and losses are included in the statement of profit and loss.

(c) Securities available for sale

Securities not classified as debentures held to redemption or as securities held for trading. Securities available for sale are stated in the balance sheet at their fair value except for shares, options and funds in respect of which the fair value is not available, in which case they are stated at cost. The fair value is based on market prices quoted in active markets. If a quoted market price is not available, an estimate of fair value is based on the best available information. The fair value estimate takes into account prices of similar assets or liabilities and results of various methods of evaluation.

In determining fair value of securities and other financial instruments traded in an inactive market, significant use is often made of discretion, including examining if the transactions were made under conditions of pressure or coercion.
In those cases where there is no available price quotation in an active market, fair value is debated according to acceptable pricing models, based on evaluations received from experts in evaluating financial instruments or based on an independent system of the Bank. Evaluation methods include the use of various parameters such as interest curves, currency prices and standard deviations, and take into account assumptions about various factors.

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 calculation is based mainly on prices of transactions in active markets. The remainder of

the portfolio is revalued on the basis of quotations by brokers, by the creators of the instruments or based on the Bank's systems.
Differences between the fair value and the adjusted cost are shown in a separate item within shareholders' equity, under total other accumulated profit, net of the tax effect.
Impairment in value which is not of a temporary nature is charged to the profit and loss statement as detailed in paragraph (3) 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.

(2) Dividend income, accumulated interest, linkage and price differences, amortization of premium or discount (in accordance with the effective interest method), as well as losses from impairment in value not of a temporary nature, are recorded to the profit and loss statement.

(3) Impairment

The Bank examines the necessity, in each reporting period, 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 tests:

- 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 within a short period of time before the publication of the report to the public.
- A debenture for which there was a significant decrease in the rating (less than BBB- only) between the rating of the debenture at the date of acquisition by the Bank and the rating of the debenture at the date of publication of the report.
- A debenture which was classified as problematic by the Bank after its acquisition.
- A debenture in respect of which there was a credit failure which was not rectified within a reasonable 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. The objective evidence and the relevant factors include parameters such as: an increase in value after the date of the financial report, a high credit rating (group A or above), an analysis of stability in stress scenarios carried out by an independent external party or by the Bank, backing and included in this direct government investment in shareholders' equity for purposes of ensuring the strength of the issuer.

These principles are in accordance with the guideline issued by the Supervisor of Banks, except for the definitions of "significant rating" and "significant impairment" which were determined by the Bank.

Note 1 - Significant Accounting Policies (cont'd)

When impairment in value occurs not of a temporary nature, the cost of the security is reduced to the fair value and serves as a new cost basis. Losses from securities which are not of a temporary nature are charged to the statement of profit and loss.

Increases in value over the new cost basis in subsequent reporting periods, are included in a separate item in shareholders' equity under total other accumulated profit and is not charged to profit and loss.

Interest income in respect of asset-backed financial instruments such as MBS, CLO, CDO, and CMO (except for instruments of high credit quality) are recognized in accordance with the prospective interest method, after adjusting the interest rate used to recognize income to changes in the estimate of future cash flows.

H. Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

The Bank applies the Directives on Reporting to the Public regarding "Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". Directives in this circular adopt the 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 or purchased under conditions of resale, securities borrowed or lent, and other financial instruments transferred or received by the Bank, in which the Bank did not lose control over the transferred asset or did not acquire control in the asset received are treated as secured debt. Financial instruments transferred in transactions such as the above, are measured in accordance with the same principles applied before their transfer.
Securities sold are not deducted from the balance sheet and are shown under "Securities", and 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".
Securities purchased are recorded according to their value on the day the transaction was made under "Securities borrowed or purchased under agreements to resell".
The Bank monitors the fair value of securities borrowed and lent as well as securities transferred under purchase and sale agreements on a daily basis, and a demand for collateral is made in appropriate cases. Interest received or paid in respect of the said securities is reported as finance income or expense respectively.

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)

The Bank deducts a liability if and only if the liability is repaid, namely one of the following conditions exist: (a) the Bank paid the lender and was released from its obligation under the liability, or (b) the Bank was legally released, by legal proceedings or by agreement of the lender, from being the principal debtor under the liability.

I. Buildings and equipment

(1) Recognition and measurement

Buildings and equipment are shown at cost less accumulated depreciation and losses from impairment in value. Cost includes expenses which can be directly attributed to acquisition of the asset.

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 profit after taxes from extraordinary activities

(2) Subsequent costs

The cost of replacement of part of an item of fixed assets is recognized as part of the book value of that item if it is expected that the future economic advantages inherent in the part replaced will come to the Bank, and if its cost can be measured accurately. The book value of the part replaced is deducted. Ongoing maintenance costs of fixed asset items are charged to the profit and loss statement when incurred.

(3) Costs of software

Software purchased is measured by costs less accumulated depreciation and losses from impairment in value.
Costs in connection with the development of computer software intended for internal use are capitalized 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 and the Bank has both an intention and sources of funds to complete the development and use the software. Capitalized costs include direct costs and overhead expenses which can be attributed directly to the preparation of the software for its intended use. These costs are measured by cost less accumulated depreciation and losses from impairment in value. Other costs are charged to profit and loss when incurred.

Subsequent costs of software are recognized as an asset only if they increase the future economic advantages inherent in the asset for which they were expended. Other costs are charged to profit and loss when incurred.

(4) Depreciation

Depreciation is calculated on the cost, in accordance with estimated useful, on a straight line basis. Estimates of useful life and residual value are re-examined periodically.

Note 1 - Significant Accounting Policies (cont'd)

J. Issue expenses

Expenses of issue of debentures, bonds and subordinated notes are amortized in proportion to the balances outstanding each year according to the effective interest method.

K. 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 are charged to the profit and loss statement on an actual collection basis.

(4) Income from commissions on early repayment of loans, after deducting a relative portion relating to the financial equity, are included in the profit and loss statement in equal annual amounts during the period of the remainder of the period until repayment of the loan or for three years from the date of early repayment, whichever period is shorter.

(5) Operating commissions for granting services are charged to profit and loss when the service is granted.

(6) In capital instruments including an incentive for redemption such as increased interest (step up) the rates of interest are based on Management's assessment of the date of redemption.

L. Derivative financial instruments and hedge accounting

(1) The Bank holds derivative financial instruments for purposes of hedging foreign currency risks and interest rate risks, and also carries out activity in derivatives. Embedded derivative instruments are separated from host contract and dealt with separately if: (a) there is no clear and close relationship between the economic characteristics and risks of the host contract and of the embedded derivative instrument; (b) a separate instrument with the same conditions as the embedded derivative instrument would fulfill the definition of a derivative; and (c) the hybrid instrument is not measured according to fair value through profit and loss.

(2) If an instrument is earmarked for hedging, the Bank, at the date the hedge is made, formally documents the hedging relationships between the hedging instrument and the hedged item, including and the purpose of risk management and the Bank's strategy in creating the hedging transaction, and the manner in which the Bank will evaluate the effectiveness of hedging relationships. The Bank evaluates the effectiveness of hedging relationships both at the beginning of the hedge and also on an ongoing basis in accordance with its risk management policy.

(3) **Fair value hedging**
Changes in the fair value of derivative financial instruments designated to hedge fair value are charged to the profit and loss statement. The hedged item is also shown at fair value with

reference to the risks hedged, and changes in fair value are charged to the profit and loss statement.

If the hedging instrument no longer fulfills the criteria of an accounting hedge, or expires, is sold, cancelled or realized, or the Bank cancels the designation of a fair value cash hedge, the Bank ceases utilization of hedge accounting. When a hedged firm commitment no longer fulfills the definition of a firm commitment, any asset or liability recorded in accordance with recognition of the firm commitment will be cancelled recognized as profit or loss in the statement of profit and loss for the current period.

(4) Economic hedging

Hedge accounting is not applied with regard to derivative instruments serving as part of Bank's asset and liability management system (ALM). Changes in the fair value of these derivatives are recognized in the statement of profit and loss when incurred.

(5) Derivatives not used for hedging

Changes in the fair value of derivatives not used for hedging are charged immediately to profit and loss.

(6) Embedded derivatives

An embedded derivative that was separated is included in the balance sheet together with the host contract, and changes in fair value of separated embedded derivatives are charged on a current basis to profit and loss.

In certain cases (such as in cases when the Bank is not able to separate the embedded derivative from the host contract), in accordance with American Accounting Standard 155 (FAS 155), Accounting Treatment of Certain Hybrid Financial Instruments, the Bank elects not to separate the embedded derivative and to measure the hybrid instrument as a whole for fair value while reporting on changes in the fair value in the statement of profit and loss when they occur. The above election is made at the date of purchase of the hybrid instrument or on the occurrence of certain events when the instrument is subject to remeasurement (remeasurement event), such as a result of business combinations or material changes in the debt instrument. Such fair value election is irrevocable.

(7) Fair value

Derivative financial instruments with an active market are evaluated according to market value; in the event that an instrument is traded on several markets, the evaluation is based on the most active market. Derivative financial instruments that are not traded on an active market are evaluated according to models used by the Bank in its current activity, taking into account the risks inherent in the derivative financial instrument (market risk, credit risk, etc).

Note 1 - Significant Accounting Policies (cont'd)

M. Provision for doubtful debts

Provisions for doubtful debts are determined specifically 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 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.

In addition, a "supplementary provision" and a "general provision" for doubtful debts are made by banking corporations in Israel.
The supplementary provision is based on the quality of the customer credit portfolio, according to various risk characteristics, and calculated according to different percentages for the various characteristics, as stipulated in the Directives of the Supervisor of Banks. The general provision is at the amount that was required as at 31 December 1991, after adjustment for inflation to 31 December 2004.

The accumulated percentage of the supplementary and general provision for doubtful debts in the consolidated balance sheet from the amount of risk of total credit to the public at balance sheet date was 0.29% (31 December 2008 – 0.30%, 31 December 2007 - 0.29%).
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.

N. Assets transferred to Group ownership following the settlement of problematic debts

Assets that were transferred to Group ownership 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.

O. Offsetting off financial instruments

Financial assets and liabilities are offset when there exists a legally enforceable right and the intent to offset 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 offset 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)

P. 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.

Claims made against the Bank are classified in three categories, according to the probability of realization of the risk exposure as follows:

1. Probable risk – probability of realization of the risk exposure exceeding 70%. For claims included in this risk group, provisions are included in the financial statements.

2. Reasonably possible risk – probability of realization of the risk exposure between 20% and 70%. For claims included in this risk group, provisions are not included in the financial statements but disclosure only is made.

3. Remote risk – probability realization of the risk exposure less than or equal to 20%. For claims included in this risk group, provisions are not included in the financial statements and no disclosure is made.

In rare cases the Bank determined that, in the view of Bank Management, with reliance on its legal advisors, it is not possible to evaluate the probability of realization of the risk exposure with regard to a normal claim and a claim approved as a class action, and so no provision was made.

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.

Q. Employee 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.

(2) Liabilities for severance pay and pensions are covered mainly by amounts funded which are deposited in provident funds for pension and severance pay. For amounts of liabilities not covered as stated, a provision is made in the financial statements.

(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.

Note 1 - Significant Accounting Policies (cont'd)

R. 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.

The provision for taxes on the income of the Bank and its consolidated companies that are financial institutions for Value Added Tax purposes, include profits tax levied on the income according to the Value Added Tax Law. Value Added Tax Law levied on salaries in financial institutions is included in the statement of profit and loss under “Salaries and allied expenses”.

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 and the supplementary 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.

The Bank sets off deferred tax assets and liabilities, if there is a legal and enforceable right to set off current tax assets and liabilities.

The Bank may incur additional tax in the event of allocation of a dividend in respect of investee companies. This additional tax is not included in the financial statements in view of the policy of the investee companies not to bring about an allocation of a dividend which involves additional tax for the Bank in the foreseeable future. In cases where an investee company is expected to allocate a dividend from earnings involving additional tax for the bank, the Bank creates a tax reserve for the additional tax which it may incur.

Note 1 - Significant Accounting Policies (cont'd)

S. Earnings per share

The Bank reports basic and diluted earnings per share with regard to its ordinary share capital. Basic earnings per share is calculated by dividing the profit or loss attributed to the ordinary shareholders of the Bank by the weighted average number of ordinary shares that were in circulation during the period. Diluted earnings per share is determined by adjusting the profit or loss relating to the ordinary shareholders, and adjusting the weighted average of ordinary shares in circulation, for the effect of all the potential diluting ordinary shares, including, among others, options for shares granted to employees.

T. Statement of cash flows

The statement of cash flows is presented classified under cash flows from operating activities, from activities in assets, and from activities in liabilities and capital. The above statement shows 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.

U. Impairment in value of non-monetary assets

The Bank examines the necessity, for every reporting period, 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 of an asset or a cash-generating unit 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. For the purpose of examining impairment, assets which cannot be examined individually are grouped together into the smallest group generating cash flows from continued use, which are largely independent of assets in other groups ("cash-generating unit"). For the purpose of examining impairment of goodwill, cash-generating units to which goodwill has been allocated are grouped so that the level at which impairment is examined represents the lowest level at which goodwill can be monitored for purposes of internal reporting, but will not be larger than an operational segment.

Headquarter assets of the Bank do not produce separate cash flows. If there are indications that impairment has occurred in an asset belonging to the Bank's headquarters, a recoverable value is determined for the group of cash producing units served by the headquarters.

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.
Goodwill representing part of the account of investment in a company included on equity basis is not recognized separately, and so is not examined separately in the examination for impairment. Instead of this, impairment is examined with relation to the investment as a whole, when there is objective evidence indicating impairment.

Note 1 - Significant Accounting Policies (cont'd)

V. Comparative figures

Reclassified comparative figures have been indicated in the financial statements.

W. Use of estimates

The preparation of financial statements, in accordance with generally accepted accounting principles in Israel and directives and guidelines of the Supervisor of Banks, requires management to make use of estimates, evaluations and considerations that affect the reported amounts of assets and liabilities, the disclosure relating to contingent assets and liabilities and amounts of income and expenses during the reporting period. It should be made clear that actual results may differ from such estimates.
When formulating accounting estimates used in preparing the Bank's financial statements, Bank management has to make assumptions concerning circumstances and events which involve significant uncertainty. In its consideration of the estimates, Bank management bases itself on past experience, various facts, external factors, and on reasonable assumptions in accordance with circumstances appropriate to each estimate.

The estimates and the assumptions on which they are based are reviewed on a routine basis. Changes in accounting estimates are recognized in the period in which the estimates were amended and for each period affected in the future.

X. Initial Implementation of Accounting Standards

In January 2009, the Israel Accounting Standards Board published Accounting Standard No. 15 (Amended), "Impairment of Assets", Clarification No. 10, "The Accounting Treatment of Impairment in Investment in an Investee Company which is not a Subsidiary", and a revised text of Clarifications No. 1 and No. 6, "The Accounting Treatment of Impairment in Investment in an Investee Company which is not a Subsidiary" and "The Treatment of Impairment in Assets of an Investee Company which is not a Subsidiary", respectively.

Accounting Standard No. 15 (Amended) changes mainly the accounting treatment of the manner of allocating goodwill to cash-generating units in a consolidated balance sheet. Clarification No. 10 determines how a loss from impairment of an investee company which is not a subsidiary is to be allocated, including the treatment of the cancellation of a loss from impairment recognized in previous periods.

According to the Standard, for purposes of examining impairment, goodwill acquired during a business combination is to be allocated from the date of acquisition to each of the cash-generating units or groups of cash-generating units of the acquired entity and to each of the cash-generating units or groups of cash-generating units of the acquiring entity, which are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquired entity are assigned to those units or groups of units. The basis of the allocation will be according to fair value ratios of the units as at the day of acquisition. Thus impairment of goodwill will be examined at the level reflecting the manner in which the entity manages its activities and to which the goodwill is attributed. The Standard also stipulates that each unit or group of units to which goodwill is attributed will show the lowest level at which the goodwill is monitored for internal management purposes; and is not to be larger than an operational segment as defines in accordance with Accounting Standard No. 11, "Sector Reporting". The Standard thus cancelled the accounting treatment in the previous Standard with regard to the implementation of a two-stage examination of recognition of impairment ('top-down' and 'bottom-up' examinations).

Clarification No. 10 stipulates that an entity has to determine for each balance sheet date if there are signs indicating impairment in an investment in a company included on equity basis. If such signs exist, the entity is to estimate the recoverable amount of the investment in accordance with the provisions of the Standard. If a loss from impairment is recognized, in accordance with the Standard, this loss is to be allocated to the investment as a whole. Cancellation of a loss from impairment in an investment will be made also after examining the investment as a whole. In this manner Clarification No. 10 cancels the rules set out on Standard No. 15 before it was amended, according to which the allocation of loss from impairment in an investment in a company included on equity basis was first allocated to goodwill in the account of the investment, and the balance of the loss was recorded against the investment as a whole.

The revised text of Clarification No. 1 was adapted to the accounting treatment of impairment of investee companies as stipulated in Standard 15 (Amended) and in Clarification No. 10.

The provisions of the Standard and the Clarifications will be implemented immediately from now on. The implementation of the Standard had no material effect of the operating results of the Bank.

Y. 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 Financial 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 yet apply to banking corporations, the financial statements of which are prepared in accordance with the directives and guidelines of the Supervisor of Banks.

In June 2009, the Supervisor of Banks published a circular on the subject of "Reporting of Banking Corporations and Credit Card Companies in Israel in accordance with International Financial Reporting Standards (IFRS)", which determines the expected manner of adoption of IFRS by banking corporations and credit card companies.

Pursuant to the circular, the target date for reporting of banking corporations and credit card companies according to IFRS standards is:

1. Subjects that are not a core part of the banking business – beginning 1 January 2011. From this date onwards, banking corporations and credit card companies will be required to update the accounting treatment of these subjects on an ongoing basis, pursuant to the transitional provisions contained in the new International Standards published in this regard, and in accordance with clarifications to be provided by the Supervisor of Banks.
2. Subjects that are a core part of the banking business – beginning 1 January 2013, while the Banking Supervision Department intends to make a final decision in this regard during 2011. The final decision will be made while taking into account the timetable laid down in the U.S., and progress made in the convergence process between the International and American Standard Boards.

Note 1 - Significant Accounting Policies (cont'd)

The circular clarifies that following completion of the process of adaptation of the directives to IFRS, the Banking Supervision Department will continue to have the authority to lay down binding clarifications regarding the manner of implementation of the requirements of the international standards, and to determine additional directives where such is required in light of the requirements of regulatory authorities in developed countries worldwide, or on subjects not dealt with in the international standards. In addition, the Banking Supervision Department retains
its authority to determine disclosure and reporting requirements.

Thus, until the target dates for the adoption of IFRS, as noted above, the financial statements of a banking corporation will continue to be prepared in accordance with the directives and guidelines of the Supervisor of Banks.

On 31 December 31, the Supervisor of Banks issued a circular concerning the adoption of certain IFRS standards. Pursuant to the circular, certain IFRS standards were adopted with the necessary interpretations published by the IASB which address matters that are not a core part of the banking business. Specifically, the IFRS standards were adopted in the circular in the areas listed below:

Accounting policies, changes in accounting, changes in foreign exchange rates, earnings per share, share-based payment, hyperinflationary economies and interim financial reporting, business combinations, consolidated statements and investments in companies included on equity basis, impairment of assets, leases, fixed assets and investment property.

The IFRS standards to be adopted according to the following principles (unless determined otherwise by the Supervisor of Banks):

- In cases in which material matters are not specifically addressed by the standards or interpretations, or there are a number of alternatives for the treatment of a material matter, banking corporations shall act according to specific implementation instructions established by the Supervisor;

- In cases in which a material issue arises which is not resolved in the IFRS or in the implementation instructions of the Supervisor, banking corporations shall treat the issue according to GAAP at US banks specifically applicable to these matters;

- Where an IFRS contains a reference to another IFRS adopted in the Public Reporting Directives, the banking corporation shall act in accordance with the IFRS;

- Where an IFRS contains a reference to another IFRS not adopted in the Public Reporting Directives, the banking corporation shall act in accordance with the Reporting Directives and with Israeli GAAP;

- Where an IFRS contains a reference to a definition of a term defined in the Public Reporting Directives, the reference to the definition in the Directives shall replace the original reference.

- Banking corporations shall implement the IFRS standards from 1 January 2011 forward.

The first-time implementation of the IFRS standard adopted in this circular shall be performed in accordance with transitional directives established in the IFRS, including the retroactive adjustment of comparison figures if required by the specific standard.

The Bank is examining the implications of the adoption of IFRS standards on its financial statements; at this stage, it cannot estimate the expected effect of the first-time implementation thereof.

(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 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 May 2008 a letter was circulated by the Supervisor of Banks in which he indicated a re-examination was being made of the rules to be applied to banking corporations and credit card companies with respect to the treatment of transactions between an entity and its controlling shareholder. According to the letter, the Banking Supervision Department intends to determine that the following rules will apply to transactions between a banking corporation and credit card companies and their controlling owner, and on transactions between a banking corporation and a company under its control:

- International financial reporting standards;

- In the absence of specific reference in international financial reporting standards, the accepted accounting rules in the U.S. applying to banking corporations in the U.S. will be implemented, provided that they do not contradict international financial reporting standards;

- In the absence of specific reference in the accepted accounting rules in the U.S., parts of Standard No. 23 are to be implemented, provided that they do not contradict international financial reporting standards as well as accepted accounting rules in the U.S. as stated above.

As at the date of publication of the Report, the Supervisor of Banks has not yet 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,
- Furthermore, 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)

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 July 2011. 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 July 2010 will be included directly in the retained earnings item in shareholders' equity. At the time of initial implementation, the following, *inter alia,* will be required:

- 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.

h. Adjustments required by the directive to the balance of the provision for credit losses to the public and in respect of off-balance sheet credit instruments, as of the date of the initial application of the directive, are to be included directly under retained earnings in shareholders' equity.

   Also, additional draft directives have been published by the Supervisor of Banks regarding the manner of implementation of the requirements for the determination of a group provision for credit losses, the adaptation of the classification requirements for debts in excess in current accounts to the acceptable treatment in the USA, and the adaptation of certain Proper Banking Management Directives to the new directives, as well as the commencement date for the new directive and the related transitional provisions.

The following changes, among others, have been proposed in the new draft directives:

- Cancelling paragraph 5 of Proper Conduct of Banking Business Directive 325, on the subject of "Management of Credit Facilities in Current Accounts", relating to accounting aspects of classifying certain accounts as problematic, and recognizing interest income. These matters will be dealt with in the framework of the general directive on measurement of provisions for credit losses and disclosure with regard to problematic debts.

- With the aim of simplifying the rules for the measurement of provisions for credit losses on a group basis, which requires the use of complex statistical models and data history of accounting write-offs, which do not exist in the banking system, a temporary order has been included in the draft directive to be implemented in the years 2011-2012 (hereinafter: "the transitional period"), including a simpler model for calculating credit loss provisions on a group basis.

- With the aim of adapting the definitions and terms included in Proper Conduct of Banking Business Directive No. 315, on the subject of "Supplementary provision for doubtful debts", to the terms included in the new draft directives, as of 1 January 2011 the term "problematic debts" will be changed to "Credit risk under negative classification and credit risk under special supervision", and it will include three types of the said debts: "Impaired debts", "Inferior debts" and "Debts under special supervision".

  The rates of supplementary provision applying to the various types of problematic debts will be as follows:

  - Credit risk "under special supervision" – 1%
  - "Inferior" credit risk – 2%
  - "Impaired" credit risk – 4%

- Reporting to the Supervisor of Banks on changes expected in shareholders' equity, credit to the public and credit risk as at 31 December 2009, as if the new directives would be implemented at that date.

Implementing the provisions of the directive requires the upgrading and/or building of a computer infrastructure system in order to ensure the process for evaluating and making provisions for credit losses, including internal control systems to check on proper implementation of the directive, and validation of the effectiveness of the method for calculating the provision. Bank management has made preparations for the implementation of the directive.

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.

Preparations have begun for the modification of the computer systems, in which material changes to the information systems are required in order to carry out the necessary work processes.

As of the date of the publication of this Report, the main component of the computerization process for managing and documenting credit losses has been completed. Preparations have begun for writing work procedures for classification of impaired debts in accordance with the new rules. In the fourth quarter of 2009 and the first quarter of 2010, training was carried out for employees in the business divisions on the subject and it was integrated in courses on lending.

It is not possible at this stage to estimate the implications of the implementation of the directive and the draft, when they are adopted, on the Bank's future financial results.

(4) Pursuant to the Supervisor of Banks' Circular dated 6 September 2009, banking corporations and credit card companies (hereinafter - "banking corporations") are required to implement the rules laid down in FAS 166 – "Accounting for Transfers of Financial Assets" which establishes stricter terms for accounting treatment as a sale with regard to the transfer of part of financial assets including clarifications of the terms for subtraction of financial assets, and FAS 167 – "Consolidation of Variable Interest Entities", which updates the criteria for the identification of Variable Interest Entities (VIEs). In addition the rules establish disclosure requirements established from 1 January 2011 and onwards, in accordance with the transitional provisions established in those Standards.

As a general rule, these transitional provisions require the following:

- The implementation of the Standard's recognition and measurement requirements regarding transfers of financial assets that are carried out from 1 January 2010 and onwards.

- To examine, as of 1 January 2010 and onwards, whether, in accordance with FAS 167, it is necessary to consolidate entities that were defined pursuant to the old rules as qualified special purpose entities.

In addition, a banking corporation is permitted not to make disclosure of comparative figures for 2009 with regard to the disclosure requirements that were added for the first time because of the Banking Supervision Department's circular.

The impact of the initial implementation for the said standards is not expected to be material.

(5) Fair Value Measurements and Fair Value Alternative

On 31 December 2009, the Supervisor of Banks issued a circular regarding fair value measurements and fair value alternative. The circular adopts:

a. Fair Value Measurements - US Financial Accounting Standard FAS 157

FAS 157 defines fair value and establishes a consistent working framework for the measurement of fair value by defining fair value assessment techniques with regard to assets and liabilities, and by establishing a fair value hierarchy with a division into three levels, and details implementation instructions. In addition, FAS 157 expands the disclosure requirements for measurements of fair value. The implementation of the rules set forth in FAS 157 will require the cessation of the use of the blockage factor in the calculation of fair value, and will replace the directives which prohibit the recognition of day one profits and require that the fair value of derivative instruments not
traded on an active market be determined according to the transaction price. In addition, FAS 157 requires the banking corporation to reflect credit risk and other risks of the bank in the measurement of the fair value of debt, including derivatives, issued by the banking corporation and measured at fair value.

FAS 157 will apply from 1 January 2011 forward, with the exception of several financial instruments to be adopted for the first time in a limited format of retroactive implementation.
The difference between the balance-sheet balances of the financial instruments and the fair values of those instruments shall be recognized as a cumulative effect in the opening balance of surpluses as of 1 January 2011, which will be presented separately.

The banking corporation shall be required to reexamine its implemented assessment methods for the measurement of fair value, taking into consideration the relevant circumstances for the various transactions, including prices of recent transactions in the market, indicative prices of assessment services, and the results of back-testing of similar types of transactions.

In light of the foregoing, the Bank is examining the effects of the adoption of the standard on the financial statements; at this stage, the Bank cannot estimate the expected effect of the first-time implementation of FAS 157.

b. The Fair Value Alternative for Financial Assets and Financial Liabilities - US Financial Accounting Standard FAS 159

The purpose of FAS 159 is to allow reduced fluctuations in reported profits arising from the measurement of hedged assets and hedged liabilities and hedging derivative instruments using different measurement bases.

FAS 159 allows a choice, at defined dates, to measure financial instruments and certain other items (the eligible items) at fair value, which under Public Reporting Directives are not required to be measured at fair value. Unrealized profits and losses in respect of changes in the fair value of the items for which the fair value alternative is selected shall be reported in the statement of profit and loss for each consecutive reporting period. In addition, prepaid costs and fees related to the items for which the fair value alternative is selected shall be recognized in profit and loss on the date of creation, rather than deferred. The choice to apply the fair value alternative, as noted above, shall be made instrument by instrument, and cannot be cancelled. In addition, FAS 159 establishes presentation and disclosure requirements aimed at facilitating comparisons between banking corporations that choose different measurement bases for similar types of assets and liabilities.

Despite the aforesaid, the circular clarifies that a banking corporation shall not choose the fair value alternative unless the banking corporation has developed knowledge, systems, procedures, and controls at a high level, in advance, which will enable it to measure the item at a high degree of reliability. Thus, a banking corporation shall not choose the fair value alternative with regard to any asset classified in level 2 or level 3 of the fair value hierarchy, or with regard to any liability, unless it receives advance approval to do so from the Supervisor of Banks.

FAS 159 will apply from 1 January 2011 forward. Implementation through retroactive adoption or implementation through early adoption is prohibited.

The transitional directives of the Supervisor of Banks refer to the implementation with regard to eligible assets existing at the inception date, and to securities available for sale and securities held to maturity, as follows:

- Implementation for eligible items existing at the inception date: A banking corporation is permitted to choose the fair value alternative for eligible items existing at the inception date. In these cases, the balance-sheet balances of these eligible items shall be adjusted to fair value, and the effect of the initial re-measurement at fair value shall be allocated as an adjustment in respect of the cumulative effect to the opening balance of surpluses. In addition, a banking corporation choosing the fair value alternative for items existing at the inception date shall include extensive disclosures, as required in the Circular, in its annual financial statements and in its first interim financial statements for 2011.

- Securities available for sale and securities held to maturity: Securities available for sale and securities held to maturity held at the inception date are eligible for the fair value alternative at that date. If the fair value alternative is chosen for any of these securities at the inception date, accrued profits and losses not yet realized at that date shall be included in the adjustment in respect of the cumulative effect, and the security in question shall be reported as of that date as a security held for trading. In addition, separate disclosure shall be given to the amount of unrealized profits and losses reclassified from cumulative other comprehensive profit, and to the amount of unrealized profits and losses not previously recognized. The choice of the fair value alternative for an existing security held to maturity at the initial adoption shall not cast doubt on the banking corporation's intention to hold other bonds to maturity in the future.

The Bank is examining the implications of the adoption of the standard on the financial statements; at this stage, the Bank cannot estimate the expected effect of the first-time implementation of FAS 159.

Note 2 - Cash and Deposits with Banks

Reported Amounts

	31 December 2009	31 December 2008
	NIS millions	
Cash and deposits with central banks	**28,838**	19,253
Deposits with commercial banks (a)	**13,687**	13,436
Deposits with specialized banking entities	**408**	441
Total	**42,933**	33,130
Including: Cash and deposits with central and commercial banks for original periods not exceeding three months	**40,255**	31,005

(a) The provision for doubtful debts has been deducted.

Note: For liens – See Note 14.

Note 3 - Securities

Reported Amounts

	31 December 2009					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 (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									
1. Debentures held to maturity:										
- bonds and loans										
Government of Israel	**271**	**271**	**7**	**-**	**278**	880	880	18	-	898
Foreign governments	**522**	**522**	**16**	**-**	**538**	558	558	12	(1)	569
Other companies	**59**	**59**	**-**	**-**	**59**	71 (e)	71 (e)	-	-	(e) 71
Total debentures held to maturity	**852**	**852**	**23**	**-**	**875**	1,509	1,509	30	(1)	1,538

	Amount in Balance Sheet	Amortized cost in shares -cost)	Accumulated other comprehensive income Profits	Losses	Fair Value (a)	Amount in Balance Sheet	Amortized cost in shares -cost)	Accumulated other comprehensive income Profits	Losses	Fair Value (a)
	NIS millions									
2. Securities available for sale:										
- bonds and loans										
Government of Israel	**23,368**	**23,267**	**132**	**(31)**	**23,368**	10,063	9,629	457	(23)	10,063
Foreign governments (b)	**1,161**	**1,158**	**5**	**(2)**	**1,161**	336	327	9	-	336
Other companies	**19,752**	**20,017**	**317**	**(582)**	**19,752**	18,928 (e)	20,792 (e)	36	(1,900)	(e) 18,928

See notes on next page.

Note 3 - Securities (cont'd)

Reported Amounts

	31 December 2009					31 December 2008				
	Amount in Balance Sheet	Amortized cost (for 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 (for shares - cost)	Unrealized profits from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair Value (a)
	NIS millions									
3. Securities held for trading:										
- bonds and loans										
Government of Israel	5,074	5,028	69	(23)	5,074	5,554	5,465	117	(28)	5,554
Foreign governments	2,354	2,340	14	-	2,354	3,707	3,674	44	(11)	3,707
Other companies	2,357	2,340	45	(28)	2,357	1,489	1,639	7	(157)	1,489
	9,785	9,708	128	(51)	9,785	10,750	10,778	168	(196)	10,750
Shares of other companies and mutual funds	97	446	-	(349)	97	105	457	-	(352)	105
Total securities held for trading	9,882	10,154	128 (d)	(400) (d)	9,882	10,855	11,235	168 (d)	(548) (d)	10,855
Total securities	57,505	57,297	1,253	(1,022)	57,528	44,910	46,282	1,130	(2,473)	44,939

Notes:

(a) With regard to fair value data, see Note 1(G)(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 947 million with regard to shares which have no readily available fair value, which are shown at cost (31 December 2008 - NIS 1,263 million). As of 31 December 2008, 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 credit 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.

(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 for securities intended as hedging instruments for hedging fair value.

(d) Reported in the profit and loss statement but not yet realized.

(e) Reclassified from securities available for sale to bonds held to maturity of data of a foreign subsidiary. The reclassification amends a classification made previously by the subsidiary. The impact on capital reserves is not material.

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 2009					
	Amount in balance sheet	Amortized cost	Other total accumulated gain (loss)*		
			Profits	Losses	Fair value
	NIS millions				
4. Bonds available for sale					
Pass-through securities:					
Securities guaranteed by GNMA	2,123	2,125	14	(16)	2,123
Securities issued by FNMA and FHLMC	460	448	12	-	460
Total	2,583	2,573	26	(16)	2,583
Other Mortgage-backed securities (including CMO and STRIPPED MBS)					
Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	2,274	2,273	12	(11)	2,274
Other mortgage-backed securities	33	61	-	(28)	33
Total	2,307	2,334	12	(39)	2,307
Asset-backed securities (ABS)					
Lines of credit for any purpose secured by dwelling	3	5	-	(2)	3
Credit for purchase of vehicle	12	12	-	-	12
Other credit to private persons	7	7	-	-	7
CLO debentures	911	763	184	(36)	911
CDO debentures	25	25	-	-	25
SCDO debentures	66	56	10	-	66
Others	24	25	-	(1)	24
Total	1,048	893	194	(39)	1,048
Total Asset-backed bonds available for sale	5,938	5,800	232	(94)	5,938

* Amounts charged to capital reserve as part of adjustments of securities available-for sale to fair value

Note 3 - Securities (cont'd)

Reported Amounts

31 December 2008					
	Amount in balance sheet	Amortized cost	Other total accumulated gain (loss)*		Fair value
			Profits	Losses	
	NIS millions				
4. Bonds available for sale					
Pass-through securities:					
Securities guaranteed by GNMA	84	87	-	(3)	84
Securities issued by FNMA and FHLMC	1,211	1,226	10	(25)	1,211
Securities issued by others	10	10	-	-	10
Total	1,305	1,323	10	(28)	1,305
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
Securities secured by mortgage-backed					
Other mortgage-backed securities	64	67	-	(3)	64
Total	2,003	2,054	5	(56)	2,003
Asset-backed securities (ABS)					
Lines of credit for any purpose secured by dwelling	6	8	-	(2)	6
Credit for purchase of vehicle	24	27	-	(3)	24
Other credit to private persons	10	10	-	-	10
CLO debentures	690	790	-	(100)	690
CDO debentures	26	27	-	(1)	26
SCDO debentures	112	122	-	(10)	112
Others	35	36	-	(1)	35
Total	903	1,020	-	(117)	903
Total Asset-backed bonds available for sale	4,211	4,397	15	(201)	4,211

* Amounts charged to capital reserve as part of adjustments of securities available-for sale to fair value

Note 3 - Securities (cont'd)

Reported Amounts

	31 December 2009				
	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	1	1	-	-	1
Total	1	1	-	-	1
Other Mortgage-backed securities (including CMO and STRIPPED MBS)					
Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	39	38	1	-	39
Other mortgage-backed securities	50	59	-	(9)	50
Total	89	97	1	(9)	89
Asset-backed securities (ABS)					
Lines of credit for any purpose secured by dwelling	5	7	-	(2)	5
Credit not to private persons	2	5	-	(3)	2
CDO debentures	2	7	-	(5)	2
Others	2	2	-	-	2
Total	11	21	-	(10)	11
Total Asset-backed securities for trading	101	119	1	(19)	101

* Profits (losses) charged to profit and loss account.

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 guaranteed by GNMA					
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
CDO debentures	3	7	-	(4)	3
Others	3	3	-	-	3
Total	38	50	-	(12)	38
Total Asset-backed securities for trading	207	257	1	(51)	207

* Profits (losses) attributed to profit and loss account.

6. The redemption portfolio includes a security issued by the FHLMC in the amount of some NIS 8 million, similar to 31 December 2008.

Note 3 - Securities (cont'd)

Reported Amounts

(7) Additional details regarding securities available for sale secured by assets in which unrealized losses are included.

	31 December 2009					
	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 profits from adjustments to fair value
	NIS millions					
Additional details of asset-backed securities available for sale for which are included unrealized losses from adjustments to fair value						
Mortgage-backed securities (MBS)	**980**	**(16)**	**6**	**-**	**986**	**(16)**
Other Mortgage-Backed Securities (including REMIC, CMO and STRIPPED MBS)	**373**	**(4)**	**711**	**(35)**	**1,084**	**(39)**
Asset-backed securities (ABS)	**25**	**-**	**461**	**(39)**	**486**	**(39)**
Total	**1,378**	**(20)**	**1,178**	**(74)**	**2,556**	**(94)**

	31 December 2008					
	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 profits from adjustments to fair value
	NIS millions					
Additional details of asset-backed securities available for sale for which are included unrealized losses from adjustments to fair value						
Mortgage-backed secusities (MBS)	321	(8)	425	(20)	746	(28)
Other Mortgage-Backed Securities (including REMIC, CMO and STRIPPED MBS)	246	(4)	1,171	(52)	1,417	(56)
Asset-backed securities (ABS)	119	(14)	398	(103)	517	(117)
Total	686	(26)	1,994	(175)	2,680	(201)

Note 3 - Securities (cont'd)

Reported Amounts

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 2009	31 December 2008
	NIS millions	
Credit	**204,782**	213,490
Customers' liabilities for acceptances	**662**	554
Total credit (a)	**205,444**	214,044
General and supplementary provisions for doubtful debts (b)	**(775)**	(829)
Total	**204,669**	213,215

(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 2009 was NIS 377 million (31 December 2008 – NIS 374 million), are shown after deduction from shareholders’ equity in accordance with the Directive of the Supervisor of Banks.

Note 4 - Credit to the Public (cont'd)

Reported Amounts

B. Credit to the public includes:

	31 December 2009	31 December 2008
	NIS millions	
Credit to problematic borrowers that are not local authorities or housing loans (b):		
a) Non-accrual loans to problematic borrowers		
In unlinked Israeli currency	**1,095**	1,167
In CPI linked Israeli currency	**221**	170
In foreign currency (a)	**530**	675
b) Restructured credit:		
(1) Loans restructured in prior years with waiver of income		
In unlinked Israeli currency	**80**	-
In CPI linked Israeli currency	**51**	56
In foreign currency (a)	**1**	2
(2) Loans restructured during current year without waiver of income		
In unlinked Israeli currency	**260**	109
In CPI linked Israeli currency	**120**	172
In foreign currency (a)	**167**	66
c) Credit to borrowers for which a decision for restructuring has been made		
by Bank Management which has not yet been executed		
Balance as at balance sheet date	**410**	558
d) Credit in temporary arrears		
Balance as at balance sheet date	**245**	155
Interest related to the above credit charged to the statement of profit and l	**2**	2
e) Credit under special supervision		
Balance as at balance sheet date	**11,960**	14,040
f) Credit repaid during the current year by foreclosure on assets	**65**	73

(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.

Note 4 - Credit to the Public (cont'd)

Reported Amounts

C. Provision for doubtful debts

2009	Specific provision (a)	Specific provision according to length of arrears (a)	Supplrmentary provision (b)	Total
	NIS millions			
Balance at beginning of year	**8,246**	**675**	**948**	**9,869**
Provisions during the year	**2,353**	**218**	**68**	**2,639**
Decrease in provisions	**(757)**	**(232)**	**(116)**	**(1,105)**
Collection of previous years' write-offs	**(17)**	**-**	**-**	**(17)**
Net amount charged to statement of profit and loss	**1,579**	**(14)**	**(48)**	**1,517**
Write-offs	**(636)**	**(83)**	**-**	**(719)**
Balance at end of year	**9,189**	**578**	**900**	**10,667**
Including balance of provision not deducted from credit to the public	**144**	**-**	**125**	**269**

2008	Specific provision (a)	Specific provision according to length of arrears (a)	Supplrmentary provision (b)	Total
	NIS millions			
Balance at beginning of year	7,250	688	875	8,813
Provisions during the year	2,463	317	121	2,901
Decrease in provisions	(459)	(220)	(48)	(727)
Collection of previous years' write-offs	(29)	-	-	(29)
and loss	1,975	97	73	2,145
Write-offs	(979)	(110)	-	(1,089)
Balance at end of year	8,246	675	948	9,869
Including balance of provision not deducted from credit to the public	233	-	119	352

See notes on next page.

Note 4 - Credit to the Public (cont'd)

Reported Amounts

C. Provision for doubtful debts (cont'd)

	2007			
	Specific provision (a)	Specific provision according to length of arrears (a)	Supplrmentary provision (b)	Total
	NIS millions			
Balance at beginning of year	7,580	675	1,024	9,279
Provisions during the year	1,218	218	-	1,436
Decrease in provisions	(679)	(168)	(149)	(996)
Collection of previous years' write-offs	(33)	-	-	(33)
and loss	506	50	(149)	407
Write-offs	(836)	(37)	-	(873)
Balance at end of year	7,250	688	875	8,813
Including balance of provision not deducted from credit to the public	247	-	117	364

(a) Not including provision for interest in respect of the period after the debts were determined to be doubtful. With respect to loans for which a provision was made according to the extent of the arrears, no accrual for interest is included for loans in arrears.

(b) Including a general and special provision for doubtful debts in the amount of NIS 656 million (31 December 2008 – NIS 699 million; 31 December 2007 – NIS 694 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 related provisions for doubtful debts according to period of arrears

	From three to six months	From six to fifteen months	From fifteen to thirty three months	More than thirty three months	Balances of rescheduled loans	Total
	NIS millions					
31 December 2009						
Overdue amount	**12**	**19**	**24**	**263**	**18**	**336**
Of which: interest on overdue amount	**-**	**1**	**2**	**126**	**1**	**130**
Balance of provision for doubtful debts according to period of arrears (a)	**-**	**30**	**49**	**341**	**158**	**578**
Balance of loans less provision	**339**	**187**	**57**	**95**	**50**	**728**
31 December 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

(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 2009

		Problematic debts				
				Specific provision		
	Credit	Balance sheet debt balance	Of which: in arrears (c)	Per length of arrears (d)	Other	Total
	NIS millions					
Housing loans that require calculating the provision	**28,756**	**523**	**177**	**423**	**-**	**423**
"Large Loans" (a)	**9,625**	**116**	**136**	**121**	**-**	**121**
Other Loans (b)	**7,637**	**171**	**23**	**34**	**7**	**41**
Total	**46,018**	**810**	**336**	**578**	**7**	**585**

December 31, 2008

		Problematic debts				
				Specific provision		
	Credit	Balance sheet debt balance	Of which: in arrears (c)	Per length of arrears (d)	Other	Total
	NIS millions					
Housing loans that require calculating the provision	28,338	659	282	470	-	470
"Large Loans" (a)	6,796	140	184	156	-	156
Other Loans (b)	6,925	210	43	49	8	57
Total	42,059	1,009	509	675	8	683

(a) Housing loans of which each balance exceeds NIS 873 thousand (31 December 2008 – NIS 841 thousand), including loans for home purchase and secured by a residential mortgage.

(b) Loans for any purpose secured by a residential mortgage, of which each balance is less than NIS 873 thousand (31 December 2008 – NIS 841 thousand).

(c) Including interest on the amount in arrears.

(d) Including balance of specific provision in excess of amount required according to depth of arrears in the amount of NIS 111 million (31 December 2008 – NIS 132 million).

Note 4 - Credit to the Public (cont'd)

Reported Amounts

F. Classification of credit to the public (a) **and of off-balance sheet credit risk** (b) **according to size of debt per borrower**

		31 December 2009		
Credit limit		Number of borrowers (c)	Credit(a)	Off-balance sheet credit risk (b)
NIS thousands			NIS millions	
From	To			
0	10	**859,561**	**853**	**1,710**
10	20	**292,706**	**1,547**	**2,841**
20	40	**300,439**	**3,627**	**5,109**
40	80	**258,408**	**7,038**	**7,774**
80	150	**135,339**	**8,505**	**6,201**
150	300	**78,921**	**13,300**	**3,599**
300	600	**50,955**	**19,129**	**2,498**
600	1,200	**22,696**	**16,024**	**3,031**
1,200	2,000	**5,988**	**7,602**	**1,648**
2,000	4,000	**3,899**	**8,654**	**2,345**
4,000	8,000	**2,339**	**10,265**	**3,134**
8,000	20,000	**1,749**	**16,623**	**5,598**
20,000	40,000	**809**	**16,486**	**6,007**
40,000	200,000	**676**	**35,830**	**18,281**
200,000	400,000	**81**	**14,526**	**7,460**
400,000	800,000	**37**	**13,601**	**8,040**
800,000	1,200,000	**13**	**9,635**	**2,551**
1,200,000	1,600,000	**4**	**2,517**	**3,251**
1,600,000	2,000,000	**1**	**1,349**	**520**
2,000,000	2,382,000	**2**	**1,293**	**3,337**
Total		**2,014,623**	**208,404**	**94,935**

Commencing with the NIS 8,000 thousand credit level, the classification is set out in accordance with the specific consolidation method; with respect to the other borrowers, credit has been classified according to the category consolidation loans method.

(a) Net of specific provisions for doubtful debts and with the addition of the fair value of derivative instruments in the amount of NIS 2,960 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 single borrower 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 limit		31 December 2008 Number of borrowers (c)	Credit(a)	Off-balance sheet credit risk (b)
NIS thousands		NIS millions		
מ	עד			
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	0
Total		1,796,178	218,640	93,650

Commencing with the NIS 8,000 thousand credit level, the classification is set out in accordance with the specific consolidation method; with respect to the other 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 single borrower limitations.
(c) Number of borrowers according to total credit and credit risk.

Note 5 - Credit to Governments

Reported Amounts

	31 December 2009	31 December 2008
	NIS millions	
Credit to the government	**259**	256
Credit to foreign governments	**148**	264
Total credit to governments	**407**	520

Note 6 - Investments in Companies Included on Equity Basis

Reported amounts

A. Composition:	**31 December 2009**	31 December 2008
	Companies included on equity basis	Companies included on equity basis
	NIS millions	
Total investments in shares stated on equity basis (including other assets)	**2,170**	1,834
Loans from shareholders	**8**	8
Total investments	**2,178**	1,842
Including - post-acquisition profits	**975**	897
Post-acquisition changes in shareholders' equity:		
Financial statement translation differences	**(93)**	(121)
Details regarding goodwill and other assets:		
Amortization period	**10 -20 years**	10 -20 years
Original amount, net (a)	**280**	310
Unamortized balance (a)	**173**	225

Details on book value and market value of quoted investments:

	31 December 2009		31 December 2008	
	Book value	Market value	Book value	Market value
	NIS millions			
The Israel Corporation Ltd. (a)	**1,371**	**3,810**	1,186	1,184
Paz Oil Company Ltd	**565**	**880**	485	571
Total	**1,936**	**4,690**	1,671	1,755

(a) Includes negative goodwill in an original amount of NIS 29 million. Balance for amortization in amount of NIS 28 million.

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

	2009	2008	2007
	NIS millions		
Group's equity in operating profit of companies included on equity basis	**74**	260	205
Provision for deferred taxes	**7**	(11)	(21)
Group's equity in after-tax operating profits of companies included on equity basis	**81**	249	184

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

Reported Amounts

C. Details regarding sale of investee companies

1. Sale of real holding corporations (companies included on equity basis)

a. Holdings in Real Holding Corporations (Conglomerates)

The Bank's holdings in real 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 means of control in one conglomerate ("real holding corporation") only (a corporation whose capital exceeds some NIS 1,976 million and that operates in more than three branches of the economy). The Bank holds one conglomerate - The Israel Corporation Ltd.
According to the financial statements of Paz for the first quarter of 2007, in which new accounting standards were implemented, it is indicated that Paz's shareholders' equity exceeds the minimal amount of capital for the definition of a conglomerate (real 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.
At the request of the Bank, the Bank of Israel permitted it to sell its holdings in Paz by 30 December 2010, subject to the Bank’s holdings being transferred to a trustee. To this end, the Bank transferred its holdings in Paz to a trustee at the end of June 2009.

b. Migdal Insurance and Financial Holdings Ltd.

The Bank holds 9.85% of the issued and paid-up share capital of Migdal Insurance and Financial Holdings Ltd. (“Migdal Holdings”), (9.74% fully diluted), which controls 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 conglomerate.

It is to 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 3 March 2010, the Banking (Licensing) (Amendment No. 15) Law, 2010 was published in the Official Gazette, which determines *inter alia* that a corporation which is an insurer operates in the insurance sector only and therefore is not deemed a conglomerate.

At the request of the Bank, the Bank of Israel extended its permit given to the Bank to hold Migdal shares, provided that the shares would be transferred to a trustee. The shares were transferred to a trustee on 4 January 2009, in accordance with directives of the Bank of Israel that if the shares held by the trustee were not sold by 31 August 2010, the trustee would sell the shares to a third party not later than 31 December 2010. The trustee was vested with all the rights that the shares confer (excluding the right to receive a dividend and

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

Reported Amounts

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 until 31 August 2010).

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 of equity granting a right to profits		Percentage of voting rights		Investment in shares - net asset value	
		31 December		31 December		31 December	
		2009	2008	**2009**	2008	**2009**	2008
		(%)	(%)	**(%)**	(%)	NIS millions	
In Israel							
Arab-Israel Bank Ltd.	General banking services	**99.7**	99.7	**99.7**	99.7	**321**	334
Leumi Mortgage Bank Ltd.	Provision of housing loans	**100.0**	100.0	**100.0**	100.0	**2,473**	2,142
Leumi Agricultural Development Ltd.		**100.0**	100.0	**100.0**	100.0	**58**	59
Leumi Industrial Development Ltd.		**99.6**	99.6	**99.8**	99.8	**104**	104
Leumi Partners Ltd. (c)	Business and financial services	**100.0**	100.0	**100.0**	100.0	**373**	264
Leumi Leasing and Investments Ltd. (d)	Equipment leasing and granting loans	**99.5**	99.5	**99.8**	99.7	**885**	823
Leumi Finance Company Ltd.	Raising capital by bond issues	**100.0**	100.0	**100.0**	100.0	**153**	156
Leumi Card Ltd.	Provision of credit card services	**80.0**	80.0	**80.0**	80.0	**667**	557
Leumi Securities and Investments Ltd.		**100.0**	100.0	**100.0**	100.0	**75**	45
Leumi Capital Market Services Ltd.	Operating services to provident funds	**100.0**	100.0	**100.0**	100.0	**58**	23
Leumi Financial Holdings Ltd.	Financial holdings	**100.0**	100.0	**100.0**	100.0	**457**	421
Abroad							
Bank Leumi le-Israel Corporation	Holding company - registered in the U.S.	**100.0**	100.0	**100.0**	100.0	**552**	561
Bank Leumi USA (f)	General banking services - registered in the U.S.	**99.9**	99.9	**99.9**	99.9	**1,834**	1,776
Bank Leumi (UK) plc (g)	General banking services - registered in the U.K.	**99.8**	99.8	**99.8**	99.7	**618**	545
Bank Leumi le-Israel (Switzerland) (h)	General banking services - registered in Switzerland	**84.1**	84.1	**93.9**	93.9	(g) **586**	544
Leumi Re Ltd.	Insurance	**100.0**	100.0	**100.0**	100.0	**95**	75
Bank Leumi (Luxembourg) SA	General banking services - registered in Luxembourg	**100.0**	100.0	**100.0**	100.0	**103**	(2)
Bank Leumi Romania	General banking services - registered in Romania	**99.9**	99.9	**99.9**	99.9	(i) **431**	438
Leumi Finance Corporation		**99.9**	99.9	**99.9**	99.9	**5,155**	5,170
Leumi USA Investment Corporation		**99.9**	99.9	**99.9**	99.9	**3,438**	3,336

(a) Data regarding consolidated companies 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 the results of other companies in the Bank Group in respect of the above said investments.

(b) Including adjustments from presentation of securities available for sale of consolidated companies according to fair value.

(c) The Bank’s investment increased to 87,266 shares for proceeds of NIS 200,000 thousand following a rights issue.

(d) The Bank's share in capital reserve in respect of the benefit inherent in controlling shareholders' loans is NIS 40 million.

(e) The Bank's share in capital reserve in respect of the benefit inherent in controlling shareholders' loans is NIS 82 million.

(f) The investment in the company was made by Bank Leumi le-Israel Corporation.

Other equity investments		Contribution to net operating profits		Contribution to profit from extraordinary transactions		Dividend received		Other items in accumulated shareholders' equity (b)		Guarantees on of the company to parties outside the Group	
31 December		31 December		31 December		31 December		31 December		31 December	
2009	2008	**2009**	2008	**2009**	2008	**2009**	2008	**2009**	2008	**2009**	2008
153	100	**79**	73	**-**	-	**80**	80	**(12)**	17	**-**	-
40	55	**131**	126	**-**	-	**-**	-	**-**	1	**-**	-
-	-	**-**	1	**-**	-	**1**	2	**-**	-	**-**	-
-	-	**2**	2	**-**	-	**2**	3	**-**	-	**-**	-
1,122	722	**37**	(46)	**-**	-	**-**	-	**72**	(121)	**-**	22
-	-	**73**	48	**-**	-	**-**	-	**(10)**	(36)	**14**	-
-	-	**9**	11	**-**	-	**9**	10	**(3)**	1	**25**	-
-	-	**110**	116	**-**	17	**-**	-	**-**	-	**4**	4
-	-	**30**	3	**-**	-	**-**	-	**-**	-	**-**	-
-	-	**35**	(3)	**-**	-	**-**	-	**-**	-	**-**	-
-	-	**35**	10	**-**	-	**-**	-	**-**	-	**-**	-
-	-	**(1)**	3	**-**	-	**-**	-	**(7)**	(1)	**-**	-
-	-	**18**	29	**-**	-	**-**	-	**40**	(19)	**91**	60
444	404	**50**	(243)	**-**	-	**-**	-	**23**	(23)	**29**	29
184	179	**37**	25	**-**	-	**-**	-	**5**	(4)	**-**	-
-	-	**20**	3	**-**	-	**-**	34	**-**	-	**-**	-
58	(j) 58	**17**	(64)	**-**	-	**-**	-	**55**	(50)	**7**	-
-	-	**(6)**	(53)	**-**	(1)	**-**	-	**-**	(2)	**54**	-
-	-	**(15)**	82	**-**	-	**-**	-	**-**	-	**-**	-
-	-	**75**	91	**-**	-	**-**	-	**-**	-	**-**	-

(g) In 2009, the Bank acquired approximately 0.45% of the share capital of Bank Leumi le-Israel (Switzerland) (2008 – 1.06%). The investment includes a balance of goodwill, in the amount of NIS 30.3 million in 2009 (2008 – NIS 35.2 million).

(h) The Bank's investment to NIS 33,941 thousand due to a share issue.

(i) The investment includes a balance of goodwill, in the amount of NIS 74.6 million (31 December 2008 – NIS 86.1 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 consolidated capital were created, which are offset from Bank Leumi U.S.A.

(k) Reclassified.

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

Reported Amounts

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D. Details concerning principal investee companies (cont'd)

(2) Companies included on equity basis (a)

Name of company	Principal area of activity	Percentage of equity granting a right to profits		Percentage of voting rights	
		31 December		31 December	
		2009	2008	**2009**	2008
		(%)	(%)	**(%)**	(%)
The Israel Corporation Ltd. (b)	Holding company	**18.1**	18.2	**18.1**	18.2
Paz Oil Company Ltd (c)	Supply of energy products and management of refueling and commerce areas	**15.7**	15.7	**15.7**	15.7

(a) The data regarding companies included on equity basis is on a consolidated basis.
(b) Includes balance of other assets in the amount of NIS 51 million (31 December 2008 - NIS 56 million).
(c) The investment includes balance of goodwill and other assets in the amount of NIS 149 million (31 December 2008 - NIS 167 million).
(d) Includes other reserves in retained earnings.

Investment in shares - net asset value		Investment in shares - market value		Contribution to net operating profits		Dividend received		Other items in accumulated equity (d)		Guarantees on of the company the Group	
31 December		31 December		31 December		31 December		31 December		31 December	
2009	2008	**2009**	2008	**2009**	2008	**2009**	2008	**2009**	2008	**2009**	2008
NIS millions											
1,371	1,186	**3,810**	1,184	**1**	157	**0**	32	**192**	(98)	**71**	205
565	485	**880**	571	**72**	82	**0**	80	**8**	(69)	**283**	191

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 2008	3,163	5,680	8,843
Additions	**109**	**625**	**734**
Disposals	**(45)**	**(108)**	**(153)**
As at 31 December 2009	**3,227**	**6,197**	**9,424**
Accumulated Depreciation			
As at 31 December 2008	1,566	3,832	5,398
Current year provision	**73**	**539**	**612**
Disposals	**(33)**	**(106)**	**(139)**
As at 31 December 2009	**1,606**	**4,265**	**5,871**
Balance after depreciation as at 31 December 2009	**1,621**	**1,932**	**3,553**
Balance after depreciation as at 31 December 2008	1,597	1,848	3,445

(a) Including leasehold installations and improvements.

B. Average depreciation rate:

	31 December 2009	31 December 2008
Buildings and real estate	**3.08%**	3.02%
Equipment, furniture and motor vehicles	**18.29%**	16.13%

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 133 million (31 December 2008 – NIS 135 million).

D. Investment property - buildings and real estate not used by the Group, mainly rental buildings, amount to NIS 27 million in the balance sheet (31 December 2008 – NIS 29 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 189 million (31 December 2008 – NIS 195 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 17 million (31 December 2008 – NIS 21 million) are shown net of a provision for anticipated losses. The fair value of the assets earmarked for sale at 31 December 2009 was NIS 22 million (31 December 2008 - NIS 66 million) .

G. The balance of equipment includes capitalized costs relating to the development of computer software in the amount of NIS 95 million (31 December 2008 – NIS 93 million).

Note 8 – Other Assets

Reported Amounts

	31 December 2009	31 December 2008
	NIS millions	
Deferred tax asset, net - see Note 26 (I)	**1,107**	1,745
Excess of funds allocated for severance pay over provision – see Note 15D	**241**	2
Assets transferred to ownership of the Group as a result of settlement of problematic credits	**37**	13
Investment in life insurance policies in foreign branch	**380**	376
Goodwill	**125**	(a) 142
Excess of advance tax payments over current provisions	**663**	766
Expenses to be amortized on issuance of debentures, bonds and subordinated notes	**51**	48
Debit balances in respect of derivative instruments (except embedded derivatives	**6,440**	10,047
Accrued income	**255**	120
Prepaid expenses	**266**	159
Other receivables and prepayments	**221**	(a) 111
Total other assets	**9,786**	13,529

(a) Reclassified

Note 9 - Deposits of the Public

Reported Amounts

	31 December 2009	31 December 2008
	NIS millions	
Demand deposits	**65,979**	42,593
Time and other deposits	**179,941**	196,295
Deposits in savings plans (before the reform)	**4,498**	5,895
Total deposits of the public	**250,418**	244,783

Note 10 - Deposits from Banks

Reported Amounts

	31 December 2009	31 December 2008
	NIS millions	
Commercial banks:		
Demand deposits	**2,194**	1,544
Time deposits	**791**	1,317
Acceptances	**662**	554
Specialized banking entities:		
Demand deposits	**90**	298
Time deposits	**48**	29
Total deposits from banks	**3,785**	3,742

Note 11 – Debentures, Bonds and Subordinated Notes

Reported Amounts

	Average maturity (a)		Internal rate of return (a)	31 December	
	Years		%	2009	2008
				NIS millions	
Debentures and Bonds (b):					
In Israeli currency linked to the CPI	4.45		5.00	1,195	1,196
In unlinked Israeli currency	-		-	-	32
Subordinated notes (b)					
Unlinked Israeli currency	5.00		5.02	3,214	1,862
In Israeli currency linked to the CPI (d)	4.26		4.95	19,134	15,488
In Israeli currency linked to the U.S. dollar	0.25	(c)	2.32	335	344
In U.S. dollars	1.94	(c)	2.80	1,383	1,714
Total debentures, bonds and subordinated notes				25,261	20,636

Debentures issued by Israeli consolidated companies are secured by liens registered on their assets - see Note 14.

(a) The average duration is the average of the payment periods, weighted according to the payment flow discounted at the internal rate of return. The internal rate of return 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 duration as of the date of change in interest in subordinated notes linked to the U.S. dollar is 0.26 years and subordinated notes in U.S. dollars is 0.39 years.

(d) Of which, subordinated notes (non-marketable) deemed Upper Tier II capital in the amount of NIS 3,522 million (31 December 2008 - NIS 446 million) that, in certain circumstances, may be converted to shares.

(e) In August 2009, in accordance with a permit received from the Israel Securities Authority, the Bank published a shelf prospectus allowing it to issue up to 6 series of debentures (series 400 to 405), up to 11 series of subordinated notes (series 250 to 256 and series 300 to 303) and up to 6 series of subordinated capital notes (series 200 to 205). The maximum amount of debentures and subordinated noted and subordinated capital notes which the Bank may issue under this shelf prospectus is NIS 4 billion nominal value of each of the above series. The prospectus will remain valid for two years from the date of its publication. In February 2010, the Bank issued subordinated capital notes (series 200 and 201) for a total amount of some NIS 2.3 billion, under the above shelf prospectus. The capital notes are for repayable at the end of 50 years (February 2060), with series 200 in the amount of NIS 1,250 million linked to the CPI and bearing interest at the rate of 4.0%. Capital notes series 201 in the amount of NIS 950 million are not linked and bear variable interest at the rate of the yield on 1 year *Makam* plus a margin of 1.4%.

Note 12 - Other Liabilities

Reported Amounts

	31 December 2009	31 December 2008
	NIS millions	
Deferred tax liability, net – see Note 26I	74	67
Excess of current provisions for taxes over advance payments	42	117
Excess of provisions for severance pay and pensions over amounts allocated - see Note 15(d)	3,015	3,085
Provisions for unutilized vacations and long service bonus	794	782
Deferred income	475	384
Credit balances in respect of derivative instruments (except embeddec	7,559	10,513
Provision for doubtful debts in respect of off-balance sheet items	221	272
Accrued expenses in respect of salaries and related expenses	440	117
Payables in respect of credit cards	5,159	4,910
Accrued expenses	394	403
Market value of securities sold short	523	63
Other payables and credit balances	486	621
Total other liabilities	19,182	21,334

Note 13 - Shareholders' Equity and Capital Adequacy (cont'd)

A. Share capital

	31 December 2009		31 December 2008	
	Authorized	Issued and paid	Authorized	Issued and paid
	NIS	NIS	NIS	NIS
Ordinary shares of NIS 1.0 each	2,215,000,000	1,473,551,221	2,215,000,000	1,473,551,221

All shares issued 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 138,064,557 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, in 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 15C below.

B. Dividend policy

Dividend policy for the years 2009-2010

The Supervisor of Banks has announced that he expects that the banking system will not distribute dividends for the year 2009 in light of current risks, with the purpose of building strong levels of capital in anticipation of the implementation of Basel II. Any bank wishing to distribute dividends will be required to apply to the Supervisor of Banks, to give explanations and receive approval for such distribution.

The Board of Directors in its meeting of 24 March 2010 decided to recommend the distribution of a dividend in cash for 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 24 March 2010 not to decide at this stage the dividend policy for the year 2010.

Note 13 - Shareholders' Equity and Capital Adequacy (cont'd)

C. Capital adequacy

Capital adequacy according to Basel II is calculated pursuant to Provisional Directives on the subject of "Working Framework for the Measurement and Adequacy of Capital" from 31 December 2008 in accordance with the standardized approach.

Capital adequacy according to Basel I is 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".

1. In balance sheet terms			
	31 December 2009		31 December 2008
	NIS millions		
	Basel II	Basel I (a)	Basel I (a)
Capital for purposes of calculating capital ratio			
Tier 1 capital, after deduction	**21,478**	**21,578**	19,290
Tier 2 capital, after deduction	**14,863**	**14,640** (b)	10,449 (b)
Tier 3 capital	**-**	**-**	-
Total capital	**36,341**	**36,218**	29,739 (d)
Weighted balance of risk assets			
Credit risk	**229,551**	**243,766**	251,473
Market risk	**7,418**	**9,415**	5,476
Operational risk	**20,928**	**-**	-
Total weighted balance of risk assets	**257,897**	**253,181**	256,949
Ratio of capital to risk assets			
Ratio of Tier 1 capital to risk assets	**8.33%**	**8.52%**	7.51%
Ratio of total capital to risk assets	**14.09%**	**14.31%**	11.58% (d)
Ratio of total minimum capital required by the Supervisor of Banks	**9.00%**	**9.00%**	9.00%
2. Principal subsidiary companies			
Leumi Mortgage Bank			
Ratio of Tier 1 capital to risk assets	**10.87%**	**6.43%**	6.15%
Ratio of total capital to risk assets	**16.32%**	**9.66%**	9.24%
Ratio of total minimum capital required by the Supervisor of Banks	**9.00%**	**9.00%**	9.00%
Arab Israel Bank			
Ratio of Tier 1 capital to risk assets	**10.70%**	**12.94%**	13.41%
Ratio of total capital to risk assets	**15.91%**	**19.18%**	17.84%
Ratio of total minimum capital required by the Supervisor of Banks	**9.00%**	**9.00%**	9.00%
Leumi Card Ltd.			
Ratio of Tier 1 capital to risk assets	**14.80%**	**20.70%**	19.10%
Ratio of total capital to risk assets	**14.80%**	**20.70%**	19.10%
Ratio of total minimum capital required by the Supervisor of Banks	**9.00%**	**9.00%**	9.00%
Bank Leumi USA			
Ratio of Tier 1 capital to risk assets	**(e)**	**10.97%**	9.31%
Ratio of total capital to risk assets	**(e)**	**14.44%**	12.40%
Ratio of total minimum capital required by the local authorities	**(e)**	**10.00%**	10.00%

See notes on the next page.

Note 13 - Shareholders' Equity and Capital Adequacy (cont'd)

C. Capital adequacy (cont'd)

3. Capital components for purposes of calculating the capital ratio (in balance sheet terms)

	31 December 2009		31 December 2008
	NIS millions		
	Basel II	Basel I (a)	Basel I (a)
Tier 1 capital			
Shareholders' equity	**21,553**	**21,862**	18,672
Minority interest of external shareholders in equity of consolidated subsidiaries	**282**	**282**	245
Hybrid capital instruments	**-**	**-**	-
Other Tier 1 capital components	**-**	**-**	-
Less goodwill	**239**	**239**	272 (d)
Less intangible assets	**51**	**-**	-
Less profits (losses) from adjustment to fair value of securities avaliable for sale	**-**	**327**	(645)
Less investments in regulatory capital components of banking corporations and their subsidiaries in Israel, and cross-investments abroad	**-**	**-**	-
Less investments in companies other than non-banking which have a significant effect	**-**	**-**	-
Less other deductions from Tier 1 capital	**67**	**-**	**-**
Total Tier 1 capital	**21,478**	**21,578**	19,290
Tier 2 capital			
a. Upper Tier 2 capital			
45% of net profits, before related tax effect, in respect of adjustments to fair value of securities available for sale	**208**	**-**	-
General provision for doubtful debts	**428**	**428**	428
Hybrid capital instruments	**3,523**	**3,523**	446
Other Upper Tier 2 capital components	**-**	**-**	-
b. Lower Tier 2 capital			
Subordinated notes	**10,772**	**10,788**	9,645
Other Lower Tier 2 capital components	**-**	**-**	-
c. Deductions from Tier 2 capital			
Less investments in regulatory capital components of banking corporations and their subsidiaries in Israel, and cross-investments abroad	**-**	**-**	-
Less investments in companies other than non-banking which have a significant effect	**44**	**89**	70
Other deductions from Tier 2 caital	**24**	**10**	0
Total Tier 2 capital	**14,863**	**14,640**	10,449

(a) The headings of certain terms and sub-totals that were reported in this Note in previously published statements, have been adapted in accordance with the format for disclosure in the current year. Data for 31 December 209according to Basel I are reported to clarify the effect of the change in the method of measurement of the capital ratio to risk assets and to allow for comparison with previous periods.

(b) For purposes of Basel I the balances of investments in shares and subordinated notes of financial companies are deducted from the capital.

(c) For purposes of Basel I not including adjustment reserve of securities available for sale except for unrealized losses from adjustments to fair value of securities available for sale.

(d) Reclassified mainly pursuant to a change in allocation of Tier 1 and Tier 2 capital for exposure to market risk, similar to the allocation of capital for credit risk from a total of 11.49% to 11.58%, pursuant to clarification from the Bank of Israel.

(e) The US branch is not obliged to calculate the capital adequacy ratio according to Basel II.

Note 14 - Liens and Restrictive Conditions

Debentures and bonds issued by Israeli subsidiaries amounting to NIS 12 million (31 December 2008 - NIS 28 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 (FHLB) and certain obligations pursuant to requirements of the authorities of the countries in which they operate. Pledged assets amount to NIS 914 million (31 December 2008 - NIS 1,384 million). The total liabilities in respect of which the assets were pledged amount to NIS 824 million (31 December 2008 - NIS 1,111 million).

The Bank deposited 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 drawdowns 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 2009 amounted to approximately US$ 198 million (31 December 2008 – US$ 189 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 is not 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 2009 was NIS 152 million (December 2008 – NIS 151 million).

The Bank is a member of the Maof Clearing System Risk Fund. The Bank has undertaken 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 shown in Note 18 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 158 million (about 22% of the Fund).

Note 14 - Liens and Restrictive Conditions (cont'd)

Reported Amounts

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 2009 was NIS 1,226 million (31 December 2008 – US$ 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 2009 the Group made deposits in favor of foreign banks totaling NIS 985 million (31 December 2008 – US$ 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 2009 the Group had deposited an amount of US$ 170 million in the above banks (31 December 2008 – US 65 million).

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 for the receipt of loans from the Bank of Israel, based on the needs of the Bank. As of 31 December 2009, Leumi had not deposited debentures in favor 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.

During 2009 and as of 31 December 2008, 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.

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 Continuous Linked Settlement Bank (CLS) Bank, with the addition of interest, costs and expenses involved in realizing 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. Leumi did not avail itself of any such credit during 2008-2009.

Note 14 - Liens and Restrictive Conditions (cont'd)

Reported Amounts

	31 December 2009 (NIS millions)	31 December 2008
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	**744**	201
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	**273**	549

Apart from these securities, as at the date of the balance sheet, additional securities were given as collateral, shown under Securities above, which the lenders are not permitted to sell or pledge.

Note 15 – Employee 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 issue of shares to the employees, see paragraph C 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 (hereinafter: (2nd generation employees") 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 above and in (3) 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 allocated for liabilities for severance pay are deposited in provident funds.

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, 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 new pension distribution is that about 76% choose a pension compared to 64% that chose a pension up to the year 2008 while the remainder chose severance pay and provident funds), and past experience regarding disability, etc.

Note 15 – Employee Rights (cont'd)

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.

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 7.0%.

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 (3) 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) 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.

The accumulated amount at 31 December 2009 for expected costs in respect of the above entitlements in the period following the employment period according to actuarial calculation amounts to some NIS 98 million (31 December 2008 – NIS 96 million).

(3) 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..

(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

Note 15 – Employee Rights (cont'd)

Management) will be counted as additional years of seniority for purposes of the age of 75 as stated. The pension for members of Management 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 as mentioned) 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).

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.

In 2009 the Bank approved personal employment contracts for a group of senior managers from among the 2nd generation in the Bank, who are entitled to a pension plan as stated in the first paragraph of Note 15.B (1) above. These managers are not entitled to a pension from the Bank. It was therefore stipulated in these personal contracts that the Bank undertook, in the event of dismissal, to pay compensation at the rate of 250% of the last monthly salary for each year of work in the Bank, together with provident fund allocations, subject to the transfer to the Bank of the provisions for severance pay. If a manager is dismissed whose age is 55 or more, and whose period of service in the Bank is 25 years or more, the manager will be entitled to chose, on dismissal, between compensation at the rate of 200% of the last monthly salary for each year of work in the Bank, together with provident fund allocations (subject to the transfer to the Bank of the provisions for severance pay), and receiving all the funds and rights in the compensation and provident fund, when until the date he will be entitled to receive them, under the terms of the rules of the fund and the provisions of the law, he will be entitled to receive a pension from the Bank.

Note 15 – Employee Rights (cont'd)

The maximum additional expense that the Bank can incur in the event of the employees mentioned above being immediately dismissed to NIS 341 million (including salary tax payable on the pension) (2008 – NIS 383 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 91 million (including salary tax) (2008 – NIS 103 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 2009 was NIS 9 million (31 December 2008 was NIS 10 million).

(4) The Chairman of the Board of Directors of the Bank is entitled, in the case of involuntary retirement, to severance benefits at the rate of an additional 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.

On 24 January 2010 the Chairman of the Board of Directors gave notice that he does not intend submitting his candidacy for re-election as director in the General Meeting of the Bank. On 31 January 2010, the Audit Committee and subsequently the Board of Directors approved retirement terms for the Chairman of the Board of Directors, subject to approval of the General Meeting of the Bank, as follows:

(1) Severance pay on retirement, whether voluntary or involuntary, at the rate of 100% of the last salary of the Chairman of the Board of Directors for each year of service, i.e. one salary for each year of service. Severance pay is for a total of 15 salaries (instead of severance pay of 9 salaries stipulated in the current labor agreement). This severance pay is in addition to the entitlement of the Chairman of the Board of Directors to receive the provident and compensation fund held in his name (severance pay is about 100% in addition to the compensation fund).

(2) An additional and special retirement bonus at the rate of 7.5 salaries.

(3) Nothing stated in the terms of retirement will derogate from the right of the Chairman of the Board of Directors to receive an annual bonus for the period of his service as Chairman of the Board of Directors of the Bank, as per the decisions of the Audit Committee, the Board of Directors, and the General Meeting of the Bank, insofar as such a decision will be made.

(4) The distinction between dismissal and retirement will be cancelled in the matter of rights regarding the termination of a working relationship, and the terms of his retirement will apply in any event to the Chairman of the Board of Directors.

(5) Extension of the cooling-off period to 9 months (with payment of salary and related expenses), instead of 6 months. The cooling-off undertaking will be expanded so that the Chairman of the Board of Directors will not be employed nor ptovide services to insurance companies.

Note 15 – Employee Rights (cont'd)

C. 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).

Below are the changes in options during the years 2006-2009:

	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
Expired on 12 February 2009	(24,062,240)
Balance as at 31 December 2009	-

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 – Employee Rights (cont'd)

D. 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 2009	31 December 2008
	NIS millions	
Provision for severance pay	2,639	2,371
Amounts funded for severance pay (1)	(2,806)	(2,278)
Provision for pensions	3,080	3,099
Amounts funded for pensions	(139)	(109)
Excess of provisions over amounts funded, net	2,774	3,083
Excess of provisions over amounts funded, net, included in "other liabilities"	3,015	3,085
Excess of amounts funded included in "other assets"	241	2
Excess of provisions over amounts funded, net (2)	2,774	3,083

(1) The Bank and the consolidated companies 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 uses of funds.

(3) Total liabilities for pensions to employees who commenced work in the Bank before 1 January 1999, totaled at 31 December 2009 NIS 5,833 million. To cover this liability are severance monies deposited in Central Severance Pay Funds in the amount of NIS 2,218 million as well as provident monies deposited in provident funds in the amount of NIS 3,470 million which are managed by the management company owned by the members of these funds, as stated in section G 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.

E. 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 monetary 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 (same as in 2008).

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 (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 provision for special service vacations is made on an actuarial basis taking into account past experience with respect to utilization of such vacations.

Note 15 – Employee Rights (cont'd)

F. Provision for vacations

There is a provision of NIS 191 million under "Other Liabilities" for unutilized vacation pay (31 December 2008 - NIS 179 million). The provision is calculated on the basis of the latest salary plus related benefits.

G. 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 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 depositing 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.

H. Bonus Program for Senior Managers

In March 2010, the Bank's Board of Directors approved a long-term bonus program for the Bank's senior managers: the Chairman of the Board of Directors (subject to the approval of the General Meeting), the President and Chief Executive Officer and all the other members of the Bank's Management (the "Senior Managers"), for the year 2009 and onwards (the "Bonus Program") .

1. The Bonus Program determines the manner in which the annual bonus for the Senior Managers will be determined in respect of 2009 and onward. The Bonus Program is based on, *inter alia*, the annual net profit of the Leumi Group (the Bank and/or Leumi Group, whichever is relevant, is referred to hereinafter as the "Bank") in respect of ordinary operations only, the annual return on capital from ordinary operations after tax (the "Return on Capital"), the Bank's annual performance in relation to targets set by the Bank's Board of Directors and in relation to the other banking groups (the "Other Banks"), and it is also affected by the development, over time, of the Bank's business results. The program and its components will be re-examined by the Board of Directors after the first year of its operation and its implementation will be monitored on an ongoing basis.

2. The bonus of the Senior Managers will be determined in accordance with the following description:

   2.1 Determination of the Scope of the Overall Annual Bonus to the Senior Managers – the scope of the overall bonus (the "Overall Bonus") will be determined by the Board of Directors on the basis of the adjusted rate of return, which is obtained by multiplying the actual return on capital by the Bank's weighted grade (divided by 100), as described in section 2.3 below (the "Adjusted Rate of Return").

   Only an Adjusted Rate of Return which is equal to or higher than 8% will create an entitlement to a (positive) bonus. If the Adjusted Rate of Return is 8%, the scope of the Overall Bonus will be 0.5% of the adjusted net profit[1]. If the Adjusted Rate of Return is 9%, the scope of the Overall Bonus will be 0.68% of the adjusted net profit. If the

[1] The adjusted net profit will be calculated as the product of the Bank's Adjusted Rate of Return multiplied by the Bank's weighted capital (which is used for the calculation of the return on capital in the Consolidated Financial Statement in accordance with the public reporting directives) during the assessed year.

Note 15 – Employee Rights (cont'd)

Adjusted Rate of Return is 10%, the scope of the Overall Bonus will be 0.85% of the adjusted net profit, and if the Adjusted Rate of Return is 12% or more, the scope of the Overall Bonus will be 1.00% of the adjusted net profit. In any case, on calculation of the bonus, the Adjusted Rate of Return will not exceed 15%.

To the extent the Adjusted Rate of Return is within a range which is between the values described above, the size of the bonus will be determined in a linear manner between the two values. In any event, the scope of the Overall Bonus will not exceed NIS 30 million.

2.2 The Overall Bonus will be divided among the Senior Managers as described below in section 2.4. Thereafter, 10% of the total share of the Senior Managers (other than the Chairman of the Board and the CEO) of the Overall Bonus will be set aside and held as a reserve. This reserve will first be used for the payment of the positive differentials (to the extent that such exist) between the total bonuses to the Internal Auditor, the Chief Accountant and the CRO (the individual responsible for risk management within the company, when a CRO is appointed for the Bank), decided upon by the Audit Committee as stated in section 2.4.3 below, and the total bonuses to which the above-mentioned officers would have been entitled if this Bonus Program were implemented with respect to them. The balance of the reserve following payment of the said bonus differentials will serve as a "CEO reserve" and will be divided among the Senior Managers (other than the Chairman of the Board and the CEO), in accordance with the CEO's recommendation - which shall be submitted for the Board of Directors' approval – in respect of outstanding performances of any of the said Senior Managers during the course of the assessed year.

2.3 Determination of the Bank's Weighted Grade for the Purpose of Calculating the Adjusted Rate of Return - the Bank's performance will be measured on the basis of five parameters, for which grades shall be given in a range of 70-120 for each parameter. The following are the parameters and the weights attributed to them: (a) 30% - a comparison of the actual return on capital for the assessed year, compared with a multi-year return of 10%; (b) 30% - a comparison of the actual return on capital for the assessed year compared with the adjusted return on capital (according to the weighted shareholders' equity for the year) at the other four large banks in Israel for the same assessed year; (c) 10% - a comparison of the Bank's capital adequacy (ratio of capital to risk assets) compared with the Bank's targets as established from time to time. The Bank's target for 2009 is 12.3%; (d) 10% - a comparison of the Bank's capital adequacy (ratio of capital to risk assets) compared with the weighted ratio (according to the weighted shareholders' equity for the year) at the other four large banks in Israel for the assessed year; (e) 20% - the Bank's adjusted BSC (Balanced Score Card) grade for the assessed year.

2.4 The Manner of Calculating the Personal Bonus for each of the Senior Managers –

2.4.1 Chairman of the Board of Directors- The size of the bonus for the Chairman of the Board of Directors will be determined on the basis of: (1) the weighted personal grade, which is comprised as follows: 60% based on the Bank's BSC grade and 40% based on the personal evaluation grade given to him by the Board of Directors, and (2) the Chairman's relative normative[2] share of the Overall Bonus, established by the Board of Directors at the rate of 16.7%.

2.4.2 CEO- The size of the bonus for the CEO will be determined on the basis of: (1) the weighted personal grade, which is comprised as follows: 60% based on the Bank's BSC grade and 40% based on the personal evaluation grade given to him by the

[2] The relative normative share - the Senior Manager's share of the overall bonus, assuming that all of the Senior Managers received a grade of 100.

Note 15 – Employee Rights (cont'd)

Board of Directors, and (2) the relative normative share of the Overall Bonus, established by the Board of Directors at the rate of 20.8%.

2.4.3 The remaining Senior Managers- The size of the bonus for the remaining Senior Managers will be determined on the basis of:
(1) the weighted personal grade, which is comprised as follows: 60% based on the BSC grade of the unit headed[3] by the Senior Manager and 40% based on the personal evaluation grade given to the manager by the CEO. The following may be examined, among the criteria to be used for the purpose of determining the personal evaluation grade for the senior management: the contribution to ongoing business activity and results; the contribution to the control of the risk level; attainment of targets regarding compliance with laws, regulations and regulatory provisions; audit reports; contribution to the Bank's strategic planning and implementation, execution and promotion of strategic plans and targets; leading efficiency programs and compliance with targets derived from them; implementation, execution and promotion of significant investment and/or acquisition plans (including acquisitions which may reduce current profitability); leading, implementation, promotion and execution of projects regarding the maintenance of the quality of the environment and safety; leading, implementation and execution of various types of enforcement programs including processes and standards with which the company is required to comply (SOX, offerings, etc.); and leading of projects and processes in the field of the Bank's ethics and guidelines.

(2) The relative normative share of the Overall Bonus established in advance by the Board of Directors, according to the CEO's recommendation, with the relative normative share of the remaining Senior Managers being 62.5%.

The bonus to the Chief Internal Auditor, the Chief Accountant and the CRO (when one is appointed) will be determined separately by the Audit Committee, which may rely on, *inter alia*, the calculation according to this Bonus Program.

2.4.4 The weighted personal grade (divided by 100) will be multiplied by the Senior Manager's relative normative share.

2.4.5 The Overall Bonus will be divided pro-rata among the Senior Managers according to the proportions obtained by the multiplication of the said parameters.

2.4.6 The Bonus Program has been established with respect to 13 Senior Managers. If the number of Senior Managers is less than 13, the program will be adjusted and the scope of the bonus will be reduced by the value of the normative bonuses of the Senior Managers who have been subtracted. If the number of Senior Managers exceeds 13, the program will be adjusted pursuant to a resolution of the Board of Directors.

3. Upon the occurrence of one of the following events during the assessed year, the Senior Managers will not be granted a positive annual bonus:

3. 1 The Adjusted Rate of Return for the assessed year is less than 8%.

3.2. Failure to comply with the ratio of capital to risk assets set in Directive 311 of the Proper Banking Management Directives, or in any other directive which replaces it.

[3] Other than the BSC for the Senior Deputy CEO, for whom the Bank's entire BSC grade will be used.

Note 15 – Employee Rights (cont'd)

Additionally, a Senior Manager will not be entitled to a positive annual bonus upon the occurrence of an event which would allow the Bank to dismiss him without severance pay, and such a Senior Manager will not be entitled to receive the balance of the as yet unpaid (net) positive bonus from previous years.

4. In the event that the Bank's Adjusted Rate of Return is less than 7%, a negative bonus will be charged to the Senior Managers, as described below:

   4.1 The Overall Negative Bonus to all of the Senior Managers – The scope of the overall negative bonus will be set at 1% of the "Determinative Return Differential" as stated below, multiplied by the Bank's weighted capital.

   The scope of the overall negative bonus in respect of a calendar year shall not in any event exceed NIS 20 million.

   The Determinative Return Differential shall be determined as follows:

   4.1.1 If the actual rate of return on capital is negative, the Determinative Return Differential will be calculated as follows: (1) the differential between the actual rate of return and 7%; (2) the Bank's weighted grade will be adjusted through its deduction from a fixed number – 200 (such that a grade of 70 will become a grade of 130); and (3) the negative differential will be adjusted by multiplying it by the Bank's weighted grade, adjusted as stated above.

   4.1.2 If the actual rate of return on capital before the adjustment is higher than 7%, but less than 7% afterwards, the Determinative Return Differential will be the differential between the adjusted rate of return and 7%.

   4.1.3 If the actual rate of return on capital is positive and less than 7%, the Determinative Return Differential will be the higher (in absolute values) of the calculations described in sub-sections (a) and (b) above.

   However, it is noted that if the actual return after the adjustment is higher than 7%, no negative bonus will be calculated, even if the unadjusted rate of return is less than 7%.

   4.2 Determination of the Scope of the Personal Negative Bonus Rate for Each of the Senior Managers:

   4.2.1 The weighted grade of each Senior Manager will be determined in accordance with section 2.4 above. Because of the negative bonus, the weighted grade will be converted into an adjusted weighted grade, through its deduction from a fixed number – 200 (such that, for example, a grade of 80 will become a grade of 120). The reversal is required such that to the extent that a particular Senior Manager's grade is lower, his share of the negative bonus will be greater.

   4.2.2 The adjusted weighted grade (divided by 100) will be multiplied by the particular Senior Manager's relative normative grade, as described in section 2.4 above.

   4.2.3 The negative bonus will be divided pro-rata among the Senior Managers according to the proportions obtained by the multiplication of the said parameters.

Note 15 – Employee Rights (cont'd)

5. Payment of the Bonus to be Spread Out over the Long-Term

5.1 The payment of a bonus for a particular year will be spread out over three years, as follows:

5.1.1 50% of the bonus will be paid close to the reporting of the financial results for the relevant year (the "Bonus Year").

5.1.2 25% of the bonus will be paid close to the reporting of the financial results for the year following the Bonus Year (the "Second Year").

5.1.3 25% of the bonus will be paid close to the reporting of the financial results for the year following the Second Year.

5.2 The deferred payments in respect of the bonus will be linked to the Consumer Price Index, such that the base index will be the CPI known at the time of the first payment.

5.3 A negative bonus which is determined in respect of a particular year will be offset from any positive bonus payment to which a Senior Manager will be entitled in a particular year in respect of previous years, and if necessary, it will be offset against any positive bonus to which the Senior Manager is entitled in later years. The amount of the negative bonus will be linked to the Consumer Price Index, beginning at the time of its having been charged.

6. Retirement of a Senior Manager

6.1 A Senior Manager who retires from the Bank upon reaching retirement age, or who retires from the Bank other than on his own initiative, will receive, at the time of his retirement, the balance of the as yet unpaid (net) positive bonus in respect of previous years. In addition, if the Senior Manager served in his position for a period of at least six actual work months during the calendar year in which he retired (the "Retirement Year"), the Board of Directors will conduct a detailed examination of his entitlement to a partial bonus in respect of the period during which he served, and will determine the amount of the bonus to be paid for such, if at all. The bonus amount, to the extent one is determined, will be paid in full at the closest time established for the purpose of the payment of the bonus to the Senior Managers. Note that a member of Management who retires will not be entitled to a bonus in respect of an actual period of work during the Retirement Year which was shorter than six months. If the balance of the bonus in respect of the previous years is negative, it will be offset against amounts due to the Senior Manager from the Bank, beyond the amounts that are owed to him by law, provided that the offset amount does not exceed the bonus amounts that the Senior Manager received during the two years preceding his retirement, and against the bonus amount which is determined for him in respect of the period of his service in his position during the Retirement Year. A Senior Manager who was dismissed due to the occurrence of an incident which allows him to be dismissed without severance pay will not be entitled to a positive annual bonus in respect of that year and will not be entitled to receive the balance of the as yet unpaid (net) positive bonus in respect of previous years.

6.2 A Senior Manager who retires voluntarily (other than upon reaching retirement age) will not be entitled to the balance of the as yet unpaid positive bonus in respect of previous years and/or to the bonus in respect of the period of his service during the Retirement Year. If the bonus balance is negative, it will be offset against amounts due to the employee beyond the amounts to which he is entitled by law, provided that the offset amount does not exceed the bonus amounts that the Senior Manager received during the two years preceding his retirement.

Note 15 – Employee Rights (cont'd)

7. The Bonus Program and its components will be re-examined by the Bank's Board of Directors in 2010 in order to examine the need to make changes and adjustments to the program. Additionally, the Board of Directors may at any time change the conditions established in the Bonus Program or its components.

8. The Bonus Program does not constitute a commitment on the part of the Bank to grant bonuses, and does not create any obligation and/or absolute right for any of the Senior Managers to receive bonuses in respect of the year 2009 or for any other year.

9. The bonus for Senior Managers pursuant to this Bonus Program, to the extent that the Senior Managers are entitled to bonuses pursuant to this Bonus Program, does not constitute a part of the salary paid to any of the Senior Managers, and will not be taken into consideration for the purpose of deducting social benefits, severance pay, or retirement allowances, and will not be considered to be an accompanying condition of employment of any kind whatsoever for any of the Senior Managers.

10. The Bonus Program does not refer to bonuses for extraordinary activities. The Board of Directors reserves the right either to grant or not to grant, at its discretion, special bonuses in respect of extraordinary activities.

The appropriate provisions have been made in the Financial Statements.

Note 16 - Assets and Liabilities Classified According to Linkage Basis (cont'd)

Reported Amounts

	31 December 2009						
	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	26,348	446	9,792	3,944	2,401	2	42,933
Securities	18,193	9,665	15,195	10,134	1,731	2,587	57,505
Securities borrowed or purchased under agreements to resell	744	-	-	-	-	-	744
Credit to the public (b)	105,910	49,318	32,494	6,578	10,349	20	204,669
Credit to governments	-	259	148	-	-	-	407
equity basis	8	-	-	-	-	2,170	2,178
Buildings and equipment	-	-	-	-	-	3,553	3,553
Other assets	3,846	134	3,016	302	1,713	775	9,786
Total assets	155,049	59,822	60,645	20,958	16,194	9,107	321,775
Liabilities							
Deposits of the public	119,050	26,976	70,868	23,787	9,675	62	250,418
Deposits from banks	2,115	439	776	212	243	-	3,785
Deposits from governments	55	471	179	7	-	-	712
Securities loaned or sold under agreements to repurchase	216	-	57	-	-	-	273
Debentures, bonds and subordinated notes	3,214	20,329	1,718	-	-	-	25,261
Other liabilities	9,719	3,942	2,211	536	2,040	734	19,182
Total liabilities	134,369	52,157	75,809	24,542	11,958	796	299,631
Difference (d)	20,680	7,665	(15,164)	(3,584)	4,236	8,311	22,144
Effect of hedging derivative instruments:							
Derivative instruments (except options)	-	-	-	-	-	-	-
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)	(1,989)	(7,238)	11,120	3,477	(5,370)	-	-
Options in the money, net (in terms of underlying asset)	(576)	(9)	299	188	98	-	-
Options out of the money, net (in terms of underlying asset)	(474)	-	393	(31)	112	-	-
Total	17,641	418	(3,352)	50	(924)	8,311	22,144
Options in the money, net (discounted par value)	(1,021)	(16)	706	262	69	-	-
Options out of the money, net (discounted par value)	(1,358)	(3)	1,270	(114)	205	-	-

(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.
(d) Equity includes minority interest.

Note 16 - Assets and Liabilities Classified According to Linkage Basis (cont'd)

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
equity basis	8	-	-	-	-	1,834	1,842
Buildings and equipment	-	-	-	-	-	3,445	3,445
Other assets	4,559	141	5,092	(d) 1,011	2,090	(d) 636	13,529
Total assets	130,841	60,377	73,795	20,260	16,280	9,239	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	124,968	49,285	81,895	23,611	11,456	660	291,875
Difference (e)	5,873	11,092	(8,100)	(3,351)	4,824	8,579	18,917
Effect of hedging derivative instruments:							
Derivative instruments (except options)	-	-	8	(8)	-	-	-
Derivative instruments (except options)	8,733	(8,619)	4,751	(d) 986	(d) (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	(3,786)	(1,485)	(859)	8,579	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.
(d) Reclassified.
(e) Equity includes minority interest.

Note 17 - Assets and Liabilities Classified According to Maturity Date and Linkage Basis (a)

Reported Amounts

31 December 2009	Estimated future contractual cash flows											Balance sheet balance (d)		
	Upon demand and up to one month (e)	One month to three months (e)	Thre 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	Contractual rate of return (g)
NIS millions														
Israeli currency – unlinked:														
Assets	56,551	19,239	34,856	13,855	10,286	6,365	4,342	13,705	7,872	2,560	169,631	2,398	155,049	5.96
Liabilities	72,583	28,541	18,410	7,732	2,717	3,126	379	1,135	1,263	123	136,009	330	134,369	2.91
Difference	(16,032)	(9,302)	16,446	6,123	7,569	3,239	3,963	12,570	6,609	2,437	33,622	2,068	20,680	
Derivative instruments (except options)	(17)	(516)	(3,583)	1,639	145	327	661	(477)	41	-	(1,780)	-	(1,989)	
Options (in terms of underlying asset)	(404)	(47)	(499)	(39)	(16)	7	-	-	-	-	(998)	-	(1,050)	
Israeli currency - linked to the CPI:														
Assets	906	1,678	10,241	8,947	8,730	6,106	5,998	16,747	11,780	2,626	73,759	95	59,822	3.88
Liabilities	794	1,542	6,510	6,283	8,796	4,698	5,071	21,836	5,649	1,519	62,698	310	52,157	3.69
Difference	112	136	3,731	2,664	(66)	1,408	927	(5,089)	6,131	1,107	11,061	(215)	7,665	
Derivative instruments (except options)	(412)	(147)	(1,408)	(1,567)	(1,102)	(1,013)	(1,416)	(1,268)	(128)	-	(8,461)	-	(7,238)	
Options (in terms of underlying asset)	-	-	(2)	-	-	(8)	-	-	-	-	(10)	-	(9)	
Foreign currency- Local operations (c):														
Assets	18,709	6,255	10,157	11,113	7,295	4,345	3,478	3,746	782	2	65,882	269	61,095	5.31
Liabilities	44,961	16,008	15,984	1,548	613	537	407	370	105	-	80,533	-	79,730	2.74
Difference	(26,252)	(9,753)	(5,827)	9,565	6,682	3,808	3,071	3,376	677	2	(14,651)	269	(18,635)	
Derivative instruments (except options)	429	663	4,991	(72)	957	686	755	1,745	87	-	10,241	-	9,227	
Options (in terms of underlying asset)	404	47	501	39	16	1	-	-	-	-	1,008	-	1,059	
Foreign currency - integrated foreign operations:														
Assets	13,247	3,769	8,781	3,455	3,579	1,626	1,177	2,101	160	99	37,994	251	36,702	3.18
Liabilities	18,413	3,922	5,209	2,219	2,953	12	4	2	3	183	32,920	230	32,579	3.05
Difference	(5,166)	(153)	3,572	1,236	626	1,614	1,173	2,099	157	(84)	5,074	21	4,123	

See notes on page 404.

Note 17 - Assets and Liabilities Classified According to Maturity Date and Linkage Basis (a)

Reported Amounts

31 December 2009

	Estimated future contractual cash flows											Balance sheet balance (d)		
	Upon demand and up to one month (e)	One month to three months (e)	Thre 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	Contractual rate of return (g)
NIS millions														
Non-monetary items:														
Assets	-	-	-	-	-	-	-	-	-	-	-	9,107	9,107	
Liabilities	-	-	-	-	-	-	-	-	-	-	-	796	796	
Difference	-	-	-	-	-	-	-	-	-	-	-	8,311	8,311	
Total:														
Assets	89,413	30,941	64,035	37,370	29,890	18,442	14,995	36,299	20,594	5,287	347,266	12,120	321,775	4.79
Liabilities	136,751	50,013	46,113	17,782	15,079	8,373	5,861	23,343	7,020	1,825	312,160	1,666	299,631	3.20
Difference (f)	(47,338)	(19,072)	17,922	19,588	14,811	10,069	9,134	12,956	13,574	3,462	35,106	10,454	22,144	

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)	Thre 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	87,723	29,202	55,286	39,978	23,838	20,292	13,866	40,989	21,108	5,302	337,584	12,694	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 notes on next page.

Note 17 - Assets and Liabilities Classified According to Maturity Date and Linkage Basis (cont'd) (a)

Reported Amounts

(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 955 million (31 December 2008 – NIS 1,266 million).
(c) Including linked to 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 within limit of facilities of NIS 11.3 billion (31 December 2008 - NIS 14.4 billion). Over-limit credit in the amount of NIS 0.5 billion (31 December 2008 - NIS 0.4 billion) is classified as without repayment date.
(f) The above difference does not necessarily reflect the exposure to interest and/or linkage basis.
(g) The contractual rate of return is the interest rate discounting future anticipated contractual cash flows reported in this Note to the balance sheet figure.

Note: Total memorandum liabilities against which short-term credit was granted in the Bank amount to NIS 8.0 billion as at 31 December 2009 (31 December 2008 - NIS 5.1 billion).

Note 18 - Contingent Liabilities and Special Commitments

Reported Amounts

	31 December 2009	31 December 2008
	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	**1,773**	1,631
Credit guarantees	**6,199**	6,821
Guarantees to apartment purchasers	**9,250**	8,117
Other guarantees and liabilities	**14,509**	14,454
Unutilized credit card facilities	**18,348**	16,651
Other unutilized revolving credit facilities and credit facilities in accounts on demand	**14,211**	16,967
Irrevocable commitments to provide credit which has been approved and not yet granted	**17,827**	19,627
Commitments to issue guarantees	**7,793**	7,361
Unutilized facilities for activity in derivative instruments	**4,060**	-

(a) Of which: credit exposures in respect of the obligation to provide liquidity to securitization structures under the auspices of others not utilized in the amount of NIS 377 million (31 December 2008 - NIS 380 million).

B. Off-balance sheet commitments for transactions based on extent of collection (a)		
Balance of credit from deposits on collection basis (b)		
Israeli currency unlinked	**1,112**	1,520
Israeli currency linked to the CPI	**6,771**	7,535
Foreign currency	**555**	628
Total	**8,438**	9,683

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

Cash 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 tewnty years	More than twenty years	Total 2009	Total 2008
	NIS millions							
1. CPI linked sector (c)								
Cash flows of futures contracts	32	60	55	129	104	4	384	485
Expected future cash flows net of Management's estimate of early repayments	35	62	53	127	95	-	372	467
Discounted expected future cash flows net of Management's estimate of early repayments (d)	34	57	46	97	60	-	294	336
2. Unlinked shekel sector								
Cash flows of futures contracts	5	5	5	11	6	5	37	40
Expected future cash flows net of Management's estimate of early repayments	5	5	5	11	6	5	37	40
Discounted expected future cash flows net of Management's estimate of early repayments (d)	5	5	4	8	4	2	28	31

(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 671 million (31 December 2008 - NIS 831 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 3.66% (2008 – 4.36)

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

	2009	2008
	NIS millions	
B. Off-balance sheet commitments for transactions based on collection (cont'd)		
Information on loans granted during the year by mortgage banks:		
Loans from deposits on collection basis	**58**	201
Standing loans	**4**	7
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	**228**	170
Second year	**145**	132
Third year	**123**	105
Fourth year	**100**	89
Fifth year	**65**	54
After five years	**203**	117
Total	**864**	667
(2) Commitments to purchase securities	**399**	371
(3) Commitments to invest in and acquire buildings and equipment	**123**	214
(4) 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 commitment		
Details of amounts of future deposits and deposit dates as determined in the terms of the transactions:		
First year	**17**	17
Second year	**17**	17
Third year	**17**	17
Fourth year	**17**	17
Fifth year	**17**	17
Sixth and subsequent years	**15**	32
Total future deposits	**100**	117

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

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

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 operational segment 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 2009 by NIS 140 million.

The fair value of current account balances classified as problematic loans was calculated in accordance with an estimate of their average duration and based on 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.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

Financial liabilities:

Deposits of the public - the balance of the deposits is classified according to a number of categories according to operational segments, 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.

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)

Reported Amounts

D. Fair values of financial instruments (cont'd)

(3) Balances and estimated fair value of financial instruments

	31 December 2009				31 December 2008			
	Balance sheet value				Balance sheet value			
	(a)	(b)	Total	Fair value	(a)	(b)	Total	Fair value
	NIS millions							
Financial assets								
Cash and deposits with banks	29,628	13,305	42,933	42,902	6,132	26,998	33,130	33,210
Securities	56,653	852	57,505	57,528	43,464	1,446	44,910	44,939
Securities borrowed or purchased under agreements to resell	744	-	744	744	125	76	201	203
Credit to the public	24,023	180,646	204,669	206,714	29,389	183,826	213,215	214,030
Credit to governments	-	407	407	426	-	520	520	516
Other financial assets	7,306	-	7,306	7,306	10,647	2	10,649	10,649
Total financial assets	118,354	195,210	313,564	315,620	89,757	212,868	302,625	303,547
Financial liabilities								
Deposits of the public	68,846	181,572	250,418	252,712	51,598	193,185	244,783	246,507
Deposits from banks	2,050	1,735	3,785	3,933	2,372	1,370	3,742	3,778
Deposits from governments	59	653	712	754	128	703	831	866
Securities loaned or sold under agreements to repurchase	216	57	273	279	376	173	549	558
Debentures, bonds and subordinated notes	-	25,261	25,261	27,168	34	20,602	20,636	21,100
Other financial liabilities	9,877	4,006	13,883	13,865	16,087	214	16,301	16,294
Total financial liabilities	81,048	213,284	294,332	298,711	70,595	216,247	286,842	289,103
Off-balance sheet financial instruments								
Transactions in which the balance the balance reflects a credit risk	313	-	313	313	358	-	358	358

(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 fair value was calculated.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

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 2009	Interest contracts Shekel – index	Interest contracts Other	Foreign currency contracts	Contracts in respect of shares	Commodities and other contracts
	NIS millions				
(1) Nominal amount of derivative instruments					
a) Hedged instruments (1)					
Swaps	-	1,409	-	-	-
Total	-	1,409	-	-	-
Of which: interest-rate swap contracts in which the banking institution agreed to pay a fixed rate of interest	-	526	-	-	-
b) ALM derivatives (1)(2)					
Futures contracts	-	7,920	189	381	851
Forward contracts	9,030	18,450	103,622	-	1,230
Exchange-traded options					
Put options	-	-	3,394	7,144	47
Call options	-	-	3,875	7,144	53
Other options					
Put options	21	17,440	26,033	495	11
Call options	50	14,007	26,220	673	22
Swaps	1,169	102,226	11,811	-	-
Total	10,270	160,043	175,144	15,837	2,214
Of which: interest-rate swap contracts in which the banking institution agreed to pay a fixed rate of interest	-	53,500	-	-	-
c) Other derivatives (1)					
Swaps	-	-	-	-	-
Total	-	-	-	-	-
d) Credit derivatives and foreign exchange spot contracts					
Credit derivatives in which the banking institution is a guarantor	-	-	-	-	831
Foreign exchange spot contracts	-	-	11,765	-	-
Total	-	-	11,765	-	831
Grand Total	10,270	161,452	186,909	15,837	3,045

(a) Except credit derivatives and foreign exchange spot contracts.
(b) 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)

a. Scope of activity

31 December 2009	Interest contracts Shekel – index	Interest contracts Other	Foreign currency contracts	Contracts in respect of shares	Commodities and other contracts
	NIS millions				
(2) Gross fair value of derivative instruments					
a) Hedged derivatives (1)					
Gross positive fair value	-	37	-	-	10
Gross negative fair value	-	21	-	-	10
b) ALM derivatives (1)(2)					
Gross positive fair value	60	2,159	3,347	295	532
Gross negative fair value	366	2,764	3,627	299	530
c) Other derivatives (1)					
Gross positive fair value	-	-	-	-	-
Gross negative fair value	-	-	-	-	-
d) Credit derivatives					
Credit derivatives in which the banking institution is a guarantor					
Gross positive fair value	-	-	-	-	-
Gross negative fair value	-	-	-	-	2

(a) Except credit derivatives.
(b) 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 in respect of	Commodities and other
	Shekel – index	Other	contracts	shares	contracts
	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	85,754 (3)	-	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	177,624	12,405	1,545
Of which: interest-rate swap contracts in which the banking institution agreed to pay a fixed rate of interest	-	38,505 (3)	-	-	-
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
Grand total	12,701	148,457	185,159	12,405	1,792

(1) Excluding credit derivatives and Spot foreign currency exchange contracts.
(2) Derivatives constituting part of the Bank's system of management of assets and liabilities, not intended for hedging.
(3) Reclassified.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

F. Activity in derivatives - scope, credit risks and repayment dates (cont'd)

a. Scope of activity (cont'd)

	31 December 2008				
	Interest contracts		Foreign currency contracts	Contracts in respect of shares	Commodities and other contracts
	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	-	-	-	-	-
d) Credit derivatives					
Credit derivatives in which the banking institution is a guarantor					
Gross positive fair value	-	-	-	-	-
Gross negative fair value	-	-	-	-	10

(1) Except credit derivatives.
(2) Derivatives constituting part of the Bank's system of management of assets and liabilities, not intended for hedging.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

F. Activity in derivatives - scope, credit risks and repayment dates (cont'd)

b. Credit Risk in Respect of Derivative Instruments According to Counterparty to the Contract

	31 December 2009					
	Stock Exchanges	Banks	Dealers/ brokers	Govern-ments and central banks	Others	Total
	NIS millions					
Balance sheet balances of assets derived from derivative instruments (1) (2)	**861**	**3,286**	**0**	**0**	**2,293**	**6,440**
Off-balance sheet credit risk in respect of derivative instruments (3)	**842**	**20,098**	**2**	**0**	**9,080**	**30,022**
Total credit risk in respect of derivative instruments	**1,703**	**23,384**	**2**	**0**	**11,373**	**36,462**

	31 December 2008					
	Stock Exchanges	Banks	Dealers/ brokers	Govern-ments and central banks	Others	Total
	NIS millions					
Balance sheet balances of assets derived from derivative instruments (1) (2)	653	5,058	18	1	4,317	10,047
Off-balance sheet credit risk in respect of derivative instruments (3)	2,463	15,955 (4)	207	2	6,813	25,440
Total credit risk in respect of derivative instruments	3,116	21,013	225	3	11,130	35,487

(1) Net accounting arrangements do not exist.
(2) Of which a balance sheet amount of standalone derivative instruments in the sum of NIS 6,440 million (31 December 2008 – NIS 10,047 million) included under other assets..
(3) Off-balance sheet credit risk in respect of derivative instruments(including in respect of derivative instruments with negative fair value) as calculated for purposes of borrower limitations.
(4) Reclassified.

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 2009				
	Up to three months	From three months to one year	From one year to five years	More than five years	Total
	NIS millions				
Interest contracts:					
Shekel – index	**1,213**	**5,823**	**3,134**	**100**	**10,270**
Other	**29,861**	**41,476**	**52,545**	**37,570**	**161,452**
Foreign currency contracts	**123,054**	**48,972**	**6,955**	**7,928**	**186,909**
Contracts in respect of shares	**14,961**	**743**	**133**	**-**	**15,837**
Commodities and other contracts	**2,049**	**939**	**57**	**-**	**3,045**
Total	**171,138**	**97,953**	**62,824**	**45,598**	**377,513**

	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 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	126,977 (a)	44,088	7,231	6,863	185,159
Contracts in respect of shares	10,074	1,269	1,061	1	12,405
Commodities and other contracts	1,037	665	52	38	1,792
Total	186,690	81,748	48,776	43,300	360,514

(a) Reclassified.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

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 87 million.

(1) The following are details of claims in material amounts:

A. 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 of the respondents. 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 a 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 ten years. 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. On 31 January 2010, the Tel Aviv-Jaffa District Court decided to delay proceedings in the claim until judgment is given in the petition for leave to appeal to the Supreme Court.

B. 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 of credit to the household sector, the banks collect interest at a rate that is much higher than that collected from the commercial sector and from the corporate sector, in spite of the fact that the risk in extending credit to the household sector is significantly lower than the risk for those sectors, and that this excessive interest rate derives from the exploitation of the low 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.

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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.

The petitioners allege that the damage incurred by 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 C above. The Supreme Court has 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 aforesaid claim.

C. On 3 January 2008, 260 identical claims were filed in the Tel Aviv-Jaffa Magistrates' 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 abovementioned claims were combined, and they will be heard as one claim. The total amount of the claims is some NIS 276 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 financing the guarding fees, 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 grounds, and are being heard separately. The total amount of all the claims in connection with this project is some NIS 288.6 million. On 10 August, 2009, the Tel Aviv-Jaffa District Court rejected one of the additional claims submitted against the Bank, which had been submitted separately by 3 purchasers and was identical to the abovementioned 260 claims. The plaintiffs appealed the ruling. The court has ordered a stay of proceedings in the claims until a judgment is given in the appeal submitted on the aforesaid rulingt.

D. 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, which were managed by managers of funds 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, acted unlawfully.

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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 damage that reflects the reduction in the value of the mutual fund units due to the alleged over-charging. The Bank has not yet filed its response to the petition for the approval of the claim as a class action.

E. 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 amount, 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.

F. 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.

G. 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 that 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

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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. On 18 October, 2009, the District Court approved the claim as a class action.

On 15 November 2009, the District Court ordered a delay in carrying out its decision to approve the claim as a class action, until the decision of the Supreme Court in the appeal of the Bank. On 18 November 2009, the Bank filed a petition with the Supreme Court for leave to appeal the decision of the district Court to approve the claim as a class action. In a decision on 1 December, 2009 the Supreme Court decided that the petition for leave to appeal requires a response, and ordered the claimant to submit her response to the petition for leave to appeal. The claimant's response was submitted on 14 January 2010. A decision has not yet been given on the petition itself for leave to appeal.

H. 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 class action claimed 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. The Bank has submitted its response to the petition for approval of the claim as a class action.

I. 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

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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. The Bank has submitted its response to the petition for approval of the claim as a class action.

J. 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 and Insurance (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 “another 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. Accordingly, this is a profit which 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 NIS 149.5 million. The petitioner bases the claim *inter alia*, on a breach of the Supervision of Financial Services (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. On 30 June 2009, the Court ruled that Kahal was wrongfully added as a respondent and dismissed the petition against it. The Bank has submitted its response to the petition for approval of the claim as a class action.

K. 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 and Insurance (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 "other 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 that 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, *inter alia*, on a breach of the Control of Financial Services (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 and Insurance 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. The Bank has submitted its response to the petition for approval of the claim as a class action.

L. 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 "other 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, *inter alia*, on a breach 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. The Bank has submitted its response to the petition for approval of the claim as a class action.

M. On 2 August 2009, a financial claim was filed against the Bank in the Haifa District Court for NIS 100 million. The plaintiff claims that the Bank had breached its commitment to finance a construction project that had been initiated by a company in which the plaintiff held shares at that time, that the Bank transferred funds from the company's account to the account of one of the plaintiff's partners in violation of the agreements and the instructions given to the Bank and that the Bank had unreasonably refused to make credit available to the company. The damages claimed by the plaintiff include various lost profits, loss of investment, loss of the plaintiff's share in the company and damage to reputation.

N. On 29 October 2009, a claim was filed in the Central District Court for declaratory judgments to the effect that the seven respondent banks (the Bank, Bank Hapoalim, Israel Discount Bank, the First International Bank of Israel, Mizrahi Bank, Mercantile Discount Bank and Union Bank) are not entitled to charge the petitioners with "default" interest differentials, as defined in the claim, and that the amount of the default interest differentials must be reduced from an amount of NIS 841 million to an amount of NIS 37 million. Alternatively, they request a ruling that the banks are entitled to charge the petitioners with interest differentials in accordance with the Adjudication of Interest and Linkage Law, 1961 only, this being with regard to the petitioners' debt that had accrued from 12 May 2003 and thereafter. The petitioners claim is, *inter alia,* that the "default interest" is nothing other than "agreed compensation" as defined in Section 15(A) of the Contracts Law (Remedies), 1970, which a court may reduce "if it finds that the compensation was established without any reasonable relation to the damage that had been foreseeable as being the reasonable result of a breach at the time the contract was made"; that the reduction of the default interest amounts is also required in accordance with the interpretation of the loan agreement and according to the intention of the parties; that the charging of the petitioners with default interest will constitute unjustified enforcement of the loan agreement; that the banks' insistence on charging the petitioners with default interest constitutes a lack of good faith; and that the banks' charging of default interest will constitute unjust enrichment on their part. The claim does not make a monetary attribution of a specific claimed share of each of the banks in the amount of the default interest differentials, but details are provided of each bank's participation in the financing, with the Bank's share being claimed to be 24%.

O. 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 Tefahot Ltd. The claim is based on damages claimed in the amount of about NIS 68,125,000 (according to the plaintiff's calculations), which was incurred by all the customers of the banks from whose profits tax was deducted

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at source from interest in respect of bonds and/or dividends in respect on shares, 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. 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 is also claimed that the banks caused the group damage and monetary loss and that their behavior is tantamount to negligence, breach of statutory duties and unjust enrichment.

(2) In addition, there are legal claims pending against the Bank, including petitions for the 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 details of the legal claims are as follows:

A. 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 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 which 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%. 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%. The Bank submitted its response to the petition for approval of the claim as a class action. On 1 June 2009, the petitioners filed a petition to attach as evidence, within the framework of the petition for approval as a class action, the Antitrust General Director’s determination dated 26 April 2009, pursuant to which the Banks (Leumi, Hapoalim, Discount, Mizrahi and the International) had maintained restrictive trade agreements regarding the transfer of information concerning commissions. The respondent

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Banks opposed this and, on 6 October 2009, the Court decided that the hearing on the petition to attach the Director’s determination is superfluous in view of its decision to incorporate the hearing on the claim with a later claim (for details see Paragraph B. below), to which the Director’s determination would be attached anyway. On 29 November 2009, the Court decided to stay proceedings in the claim for two years (subject to the provisions set out in that decision) in view of the respondents' intention to submit a petition for leave to appeal the Director’s determination in the Antitrust Court. 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.

B. On 27 April 2009, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, Bank Hapoalim, Israel Discount Bank, Mizrahi Bank and the First International Bank. The petition is based on the Antitrust General Director’s determination of 26 April 2009. The petitioners allege that in accordance with the determination, the banks made restrictive arrangements regarding the exchange of information concerning commissions, which harmed the competition between them and caused damage to the members of the group whose representation is sought in the petition, and that such was reflected in over-payments of commissions. The petitioners estimate the amount of the claim sought in the class action against all the respondents at NIS 1 billion, while noting that this is merely an estimate and reserving their right to amend the amount at a later time. The petition does not make any clear attribution of a specific claimed amount to each of the respondents and the matter of requesting provisions for linkage and interest is not sufficiently addressed. The petitioners claim that they have a cause of action because of the existence of the said restrictive arrangements between the banks, which could harm and have harmed competition. These arrangements, they argue, fall both within Section 2(a) of the Restrictive Trade Practices Law and within Section 2(b)(1) of the Restrictive Trade Practices Law. Proceedings in the petition for approval have been delayed for two years, as stated in the decision of 29 November 2009 described in paragraph A. above. In the opinion of the Bank's Management, which is based on the opinion of the Bank's legal advisors, it is not possible, at this early stage, to estimate the chances of the petition.

C. On 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.

On 4 March and 18 September, 2008 and February 11, 2009, the Company made three requests to the Company for payment of amounts in respect “the assets of the Holocaust Victims”, as defined in the Law, which allegedly, are being held or were held by the Bank (“the requirements”). The Bank responded to these three requests while rejecting the claim that it has any financial liability with respect to the majority of the assets included in therein.

However, 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

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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

As a result of the Bank's response to the demands, on 24 June 2009, the Company filed an originating motion was filed against the Bank in the Jerusalem District Court, pursuant to which the Court was asked to make various declarations relating to the "assets of the Holocaust Victims" as defined in the Assets of Holocaust Victims (Restitution to Heirs and Endowment for the Purposes of Assistance and Commemoration) Law, 2006, and, *inter alia*, to declare as follows: (a) that the Bank has financial obligations regarding the assets of Holocaust victims in an aggregate amount of NIS 246,845,410, as at 31 May 2009; and that (b) the Bank's financial obligations also apply to assets of Holocaust victims that the Bank held in the past, but which the Bank transferred to third parties prior to the Law's enactment; and (c) that, in the cases in which there is evidentiary doubt, including doubt as to whether a particular asset is an "asset of a Holocaust victim" or as to whether a particular asset is currently held by the Bank, the burden of proof should be borne by the Bank. No response has yet been given by the Bank to the originating motion, an arbitration agreement has been signed between the bank bearing the date February 26, 2010, with the object of bringing to a speedy and effective arbitration of the disputes between the parties. Pursuant thereto, the Company will submit an amended claim and the Bank will submit a defense accordingly. As part of the arbitration agreement, the Company's ability to make further monetary demands on the Bank in the future was restricted, subject to the conditions and reservations set forth in the arbitration agreement.

In the Bank's opinion, based on the opinions of the Bank's legal advisors, at this early stage (prior to the submission of the amended claim and prior to the submission of a response on behalf of the Bank to what is claimed in the originating motion), it is not possible to assess the chances of the originating motion and whether there is a necessity for the provision that has been made in the past by the Bank, *inter alia*, iro the demands.

(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

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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.

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, including carrying out a number of actions for examining of the approval of the agreement and the appointment of an examiner.

(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 in 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 within 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

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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.

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 rather 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. No judgment has yet been handed down.

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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.

(5) The following is a description of petitions for approval of class actions that have been submitted against the Bank Leumi le-Israel Trust Company ("the Trust Company"), as will be set forth below. In the opinion of the Bank's Management, which is based on the opinion of the Trust Company's legal advisors, it is not possible at this early stage to estimate the chances of these petitions, and for this reason, no provision was made for them.

A. On 5 April 2009, a petition for approval of a class action was filed with the Tel Aviv-Jaffa District Court against Standard & Poor's Ma'alot Ltd., World Currencies Ltd., the Bank Leumi le-Israel Trust Company, Eran Fuchs, Rony Biram, Yaakov Harpaz and Excellence Investments Ltd. The amount claimed against all the respondents in the class action stands at NIS 84 million. The complaint makes no clear attribution of a specific claimed amount against any of the respondents. According to the petitioner, Ma'alot failed in its rating of debentures issued by World Currencies Ltd., in that it reduced the rating of the debentures from AAA to D only after the insolvency of the Lehman Group, despite information regarding the Lehman Group's difficulties that had been previously publicized, and that Ma'alot created a false and misleading representation to the debenture-holders, to the effect that there was no change in the level of the debentures' risk and/or that the deterioration of the Lehman Group's condition was not relevant to the level of the debentures' risk. The petition alleged that World Currencies was required to report to the debenture-holders regarding the financial entity backers and the mechanism according to which the Notes' risks were divided amongst them. It further alleged that World Currencies should have reported to the debenture-holders regarding the implications of the Lehman Group's deterioration with respect to the chances that the debentures would be repaid, and regarding the fact that the Lehman Bank was in significant business difficulty. It was further claimed that World Currencies unlawfully refrained from publishing immediate reports regarding these matters, and that, as a result, the debenture-holders suffered massive damage. Excellence is a shareholder and a controlling shareholder of World Currencies. Regarding the Trust Company, which served as the trustee for the holders of the debentures issued by World Currencies, the petitioner alleges that it did not do all that it could in order to ensure the fulfillment of World Currencies' obligations to the debenture-holders as established in the prospectus, because it should have requested that World Currencies inform the debenture-holder public regarding the identity of the financial entities with which World Currencies had contracted regarding the purchase of the Notes and the mechanism according to which the risks were divided amongst them, and that it should have demanded that World Currencies provide information regarding consequences of the Lehman Group's condition for the rating of the debentures and/or regarding the ability of World Currencies to repay the debentures. The petitioner further alleges that once the Trust Company became aware of the difficulties that the Lehman Bank was encountering, it should have demanded of World Currencies that it replace the Notes with notes of other financial entities, in order to reduce the scope of the damage caused to the debenture-holders. The Court decided that this claim will be combined with a petition for approval of a previous claim as a class action filed in relation to the issue of those debentures. In the opinion of the Bank's Management, on the basis of the opinion of the management of the Trust Company, which is based on the opinion of the Trust

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Company's legal advisors, it is not possible, at this early stage, to estimate the chances of the petition.

B. On 23 June 2009, a petition for approval of a class action was filed with the Tel Aviv-Jaffa District Court against Standard & Poors Ma'a lot Ltd., Keshet Debentures Ltd. ("Keshet"), Bank Leumi le-Israel Trust Company, Aaron Biram, Eran Fuchs, Moti Ma'aravi, Rami Ordan, Excellence Nessuah Underwriting (1993) Ltd. and Expert Finances Ltd. The amount claimed against all the respondents in the class action stands at NIS 220 million. The complaint makes no clear attribution of a specific claimed amount against any of the respondents. According to the petitioner, Ma'alot failed in its rating of the debentures issued by Keshet, in that it reduced the rating of the debentures from AA+ to D only after the Lehman Group's insolvency, despite information regarding the Lehman Group's difficulties that had been previously publicized, and that Ma'alot created a false and misleading representation to the debenture-holders, to the effect that there was no change in the level of the debentures' risk and/or that the deterioration of the Lehman Group's condition was not relevant to the level of the debentures' risk. The petition alleged that Keshet was required to report to the debenture-holders regarding the implications of the Lehman Group's business deterioration with respect to the chances that the debentures would be repaid, and regarding the fact that the Lehman Bank was in significant business difficulty. It was further alleged that Keshet should have published an immediate report regarding the absolute dependence on the income from the Notes backing the debentures and regarding the tangible danger concerning its ability to make payments with respect to the debentures. It was further claimed that Keshet had been negligent to the point of being in breach of trust in failing to take measures to prevent a failure to pay the debenture holders, including in failing to do the following: take measures to replace the Notes that backed the debentures; requesting that Ma'alot update and/or adjust and/or change the debentures' rating. It was further alleged that Keshet failed in not insuring the deposits and in issuing debentures that were backed in full by the assets of only one bank. In addition, it was alleged that Keshet significantly reduced the scope of its assets through a significant change in the service agreement between it and Excellence Investments (which controls Excellence Nessuah). Excellence Nessuah Underwriting (1993) Ltd. and Expert Financing Ltd. are the owners, in equal parts, of Keshet. Regarding the Trust Company, which served as the trustee for the holders of the debentures issued by Keshet, the petitioner alleges that it did not do all that it could have done in order to ensure the fulfillment of Keshet's obligations to the debenture-holders as established in the prospectus, because it should have asked Keshet to inform the debenture-holder public regarding the implications of the Lehman Bank's deterioration for the debentures' rating and/or for the company's ability to repay the debentures at the time set for their repayment. The petitioner further alleges that once the Trust Company became aware of the difficulties that the Lehman Bank was encountering, it should have demanded that Keshet replace the Notes with notes of other financial entities, in order to reduce the scope of the damage incurred by the debenture-holders. It is further alleged that the Trust Company should have requested that Keshet insure the deposits, for the purpose of guaranteeing the funds that the public had effectively invested in the Lehman Bank. The response of the company has been submitted for a petition for approval and the response of the petitioner to the response. In the opinion of the Bank's Management, on the basis of the opinion of the management of the Trust Company, which is based on the opinion of the Trust Company's legal advisors, it is not possible, at this early stage, to estimate the chances of the petition.

(6) On 14 January 2010, a claim and a petition for approval as a class action was filed in the Tel Aviv District Court for the sum of NIS 73.9 million against Leumi Card and Leumi Card Credits.

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The claimant claims that the plaintiffs charged him commissions in full and on all the business that they conducted with him in an agreement for the provision of settlement services in the last 7 years (members of the group), in respect of cancelled transactions, even though the claimant and the members of the group did not get any service and returned the monies to their customers. In the opinion of the Bank's Management, on the basis of the opinion of the management of Leumi Card, which is based on the opinion of Leumi Card's legal advisors, with regard to the chances of the claim, it is not possible, at this early stage, to estimate its chances, and for this reason, no provision has been made.

(H) The Bank is a guarantor for some of the members of the provident funds that were managed by Leumi Capital Market Services Ltd. (formerly Leumi Gemel Ltd.), whose operations were sold to Prizma Provident Funds Ltd. ("Prizma"). The guarantee secures the repayment of the original principal amounts that were deposited which, at 31 December 2009, amounted in nominal values to NIS 3,403 million. The value of the assets of the aforesaid funds as of 31 December 2009 amounted to NIS 6,550 million. In addition, this guarantee does not apply to deposits in accounts that were opened in the above funds from 22 January 2007. As of December 31, 2009, the amounts accumulated in the provident funds credited to the aforesaid members are higher than the total of their nominal deposits.

Against the aforesaid liability, Prizma undertook that that, in the event the guarantees or any part of them are realized, it would pay the Bank participation in an amount not exceeding NIS 35 million per calendar year, this amount being linked to the Israeli CPI of 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) Consolidated companies 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 2002 (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, 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 acts of commission or omission by the Bank (No limit was determined for these indemnities.).

The Bank has undertaken in advance to grant to directors and the other officers of the Bank indemnification 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

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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. ("the Company") 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 until 16 May 2007 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 until 1 December 2005 as directors of Gambit Computer Communications Ltd. in which the Bank holds approximately 16.9% of the means of control. The maximum amount payable under the indemnification shall be the total amount of the directors and officers liability insurance policy of the Bank which existed on 1 July 1998 (including the amounts which may be reinstated under that policy). The maximum indemnification is NIS 200 million.

(4) The Bank has undertaken in advance to indemnify its officers as a result of fulfillment of their duties in the Bank and in subsidiaries and other companies on behalf of the Bank, and in respect of a list of events as generally accepted practice in the banking system in Israel, including, *inter alia*, the regular course of business of the Bank, offerings to the public pursuant to a prospectus and reports to the public and to the supervisory 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 all officers of the subsidiaries, in respect of monetary liability which may be imposed on any of them, 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 incurred 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.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

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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 similarly to 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 general manager and above who are not officers of the Bank and who 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 generally accepted practice in the banking system in Israel, similarly to the Bank's indemnity undertaking in paragraph (4) above. The actual fulfillment of the indemnity commitment is subject to the two following conditions being met: (1) the maximum amount of the actual indemnification to all the officers of the Bank, the officers of the subsidiaries and the personal contract employees, in respect of monetary liability which may be imposed on any of them and in respect of reasonable legal fees, in connection with the above events, will not exceed in aggregate 10% (ten percent) of the shareholders' equity of the Bank as defined in Directive 313 of the Supervisor of Banks, as stated in the last financial statements of the Bank published immediately prior to the date of the actual indemnification; and (2) the maximum amount of the actual indemnification does not impair the minimum capital requirement in accordance with Directive 311 of the Supervisor of Banks.

(6) The Bank has undertaken in advance to indemnify officers of Leumi France (formerly, “Banque Leumi France”) in respect of a list of events including, *inter alia*, the regular course of business of Leumi France, a 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 General Manager and the employees of the Fund, in respect of any monetary liability that may be 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 General Manager and employees of the Fund does not exceed, in aggregate, NIS 20 million, linked to the Consumer Price Index 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 does 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 vis-à-vis 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

Reported Amounts

of the amounts of the limitation of responsibility agreed between the parties (three times the amount of the professional fees) and undertook 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 (No maximum indemnification has been determined.).

(10) The Bank has undertaken to indemnify Goldman Sachs International ("Goldman Sachs") in respect of any liability or loss imposed on or incurred by them and in respect of legal and other expenses derived from a claim, proceeding or investigation submitted against them by any third party (including shareholders in the Bank), all in connection with the appointment of Goldman Sachs as the Bank's financial consultant in connection with sale of the Bank's subsidiaries operating in the capital market (No maximum indemnification has been determined.).

(11) The Bank has undertaken in advance to indemnify the underwriters to the Group's insurance policies (including banking, liability, directors and other officers and professional liability insurance) in respect of losses they incurred as a result of application of the Israeli law on such policies relating to foreign subsidiaries of the Bank (No maximum indemnification has been determined.).

(12) The Bank has undertaken to indemnify Tali Basket Certificates Ltd. (formerly Ofek Leumi Financial Instruments Ltd.) and Pagot Foreign Currency 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, only in respect of 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, does not exceed 10% (ten percent) of the Bank's shareholders' equity, as 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 required pursuant to Directive 311 to the Directives of the Supervisor of the Banks.

(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") pursuant to 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 may accrue to the buyer as a result of the claims by third parties that are attributed to the period prior to the date on which the transaction was consummated, from a breach of specific representations 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 of tax liabilities is directly imposed on the holders of units in the trust funds is stipulated on the issuance of a ruling or a definitive decision by a court and/or a competent authority, pursuant to which the one or more of the sellers must bear these liabilities (No maximum indemnification has been determined.).

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

In addition, the Bank has undertaken to guarantee the financial liabilities of the member companies of the Psagot Ofek Group (the sellers) vis-à-vis the buyer in accordance with the sale agreement.

(14) The Bank has undertaken to indemnify Promontory Financial Group LLC ("Promontory") in respect of a liability or loss that may be imposed on or realized by them, as well as in respect of legal and other expenses stemming from a claim that may be filed against them by any third party whomsoever in connection, *inter alia*, with actions by the Bank, Bank Leumi USA, a potential buyer of the Bank, their employees or officers, that stems from Promontory's services as a consultant for the strategic matters of the Leumi Group USA. No maximum indemnification has been 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.

(16) The Bank has undertaken to indemnify Tamir Fishman Trusteeships 2004 Ltd. ("Tamir Fishman") in connection with the option plan and the plan to offer 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 whomsoever, in connection with or as a result of the fulfillment of its duties in accordance with the trust agreements signed pursuant to the above plans, and in accordance with any law (No maximum indemnification has been determined.).

(17) The Bank has undertaken to indemnify Visa International (Europe) and Mastercard in respect of its fulfillment of the obligations of Bank Leumi Romania S.A. concerning "Visa" and "Mastercard" credit card activity, whichever is applicable (No maximum indemnification has been determined.).

(18) The Bank has undertaken to indemnify Visa Europe regarding the fulfillment of the obligations of Leumi Card Ltd. in connection with opening new accounts by Leumi Card Ltd. for the purposes of multi-currency clearing.

(19) The Bank has given an undertaking in the amount of Euro10 million in favor of the European Bank for Reconstruction and Development (hereinafter: "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 Bank's former representative in Brazil, for a judgment verdict and reasonable lawyers' fees which may be imposed on him as a result of an investigation or legal proceedings against him relating to the activities of the representative office during his period of duty (No maximum indemnification has been determined.).

(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.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

(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. *Inter alia*, these letters of indemnity are extended pursuant to agreements 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.

(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.

(24) The Bank is a participant in an arrangement for the guarantee of the finality of the clearing in situations of failure where there is insufficient balance in the clearing account of one or more of the other participants, this, as a participant in the Zahav System and clearing account holder in the system and member of the system for clearinghouse payments and the bank clearinghouse ("participant"). In the event of a failure, each participant that has not failed ("surviving participant") will bear the charges of a participant that has failed in accordance with the surviving participant's proportional share divided by the difference between 100% and the proportional share of the participant that has failed.

The Bank's proportional share as at 31 December, 2009 is 16.15% in the clearinghouse and 24.45% in the bank clearinghouse. (This percentage is updated once every six months according to the relative weight of the charges of each participant transferred in the relevant payment system in the previous six months.) An overall ceiling for participation stands at NIS 300 million in the clearinghouse and NIS 150 million in the bank clearinghouse.

In the event of a failure, on the business day following the day of failure, immediately after starting the system, the Bank of Israel will send a multilateral payment instruction to the debit of the failing participant's clearing account and to the credit of the clearing accounts of the surviving participants in the amount paid by each surviving participant as part of the arrangement, with the addition of Bank of Israel interest.

The failure arrangement is not intended to deal with a situation of known or almost certain insolvency. Cases of insolvency are sent to the Supervisor of Banks to be dealt with.

K. 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") may be obliged 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) (hereinafter - "the Decision"), that would be paid by those using the acquiring services to the issuers of Visa cards, following a request filed with the Tribunal to approve the restrictive arrangement signed between the Bank,

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

Leumi Card Ltd. ("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 of approving the transaction, the cost of securing the payment and the cost of 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 of securing the payments for the various transactions, the cost of approving the transaction and in deriving the benefit from securing the payment.

In arriving at the Decision, the Tribunal also determined that the rate for all of the costs comprising the issuer's commission be set 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 of the Supreme Court.

On 27 December, 2009, the Supreme Court handed down a ruling approving an agreement between those requesting the approval of the Antitrust Commissioner, according to which the clarification of the claims of those requesting the approval of an appeal regarding the methodology for the determination of the cross-commission would be deferred to a hearing within the framework of another appeal (if any) on the ruling that may be handed down in connection with the cross-clearing arrangement signed on 30 October, 2006 (as set forth below).

On 30 October 2006, an arrangement was reached between Isracard Ltd., Leumi Card Ltd. and ICC and the banks controlling each one of these companies, to regulate the cross-clearing for the Visa credit card and Mastercard (hereinafter - "the arrangement"). The arrangement, which is in force for six and a half years, allows for the first time 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 till then, which only arranged the Visa segment.

The arrangement, *inter alia*, includes determinations with regard to the issuer's commission rates, the blueprint for a gradual reduction in the issuer's commission over the term of the arrangement, and a 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 period of the arrangement, should the parties wish, they will take steps to continue the cross-clearing among them, as well as rules intended to assure that fair competition is maintained and the preclusion of cross-subsidization of the competition between the credit card companies.

On 30 October 2006, the arrangement was submitted for the approval of the Antitrust Tribunal and for the receipt of a provisional permit. On 31 October 2007, the Tribunal decided to grant a temporary permit for the arrangement after a provisional permit for the arrangement had been previously granted.

Between December 2006 and February 2007, a number of objections to the approval of the restrictive arrangement were submitted on behalf of five companies. In addition, MasterCard

Reported Amounts

International was joined to the process and informed the Tribunal that it supports approving the arrangement, conditioning and restricting its courses of action if it wishes to involve itself in 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 clearing services to the cross-clearing agreement, subject to the same conditions applying to those clearing 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 to appoint an expert to examine the estimate of the competitive implications of the rate of cross-commission determined in the arrangement. The decision provided that an expert will be appointed, to be directly supervised 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 the methodology determined in Antitrust File 4630/01. After the expert has been questioned on his opinion, he will have to continue carrying out the examination, including checking the rate of cross-commission that is obtained when implementing the methodology.

As a result of 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, determining the methodology in implementing the methodology determined.

Further thereto, the expert continued in the implementation of the examination leading up to the issuance of a final opinion. In December 2009, notice was received from the Commissioner, according to which the expert would be prevented from completing his final opinion and that various alternatives are currently being examined that would enable the termination of the expert’s work.

Total issuer's commissions received by the Bank in 2009 amounted to NIS 72 million, compared with NIS 73 million during the corresponding period last 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 its commitment and to notify Visa International immediately in writing regarding any material change in the agreement between the Bank and Leumi Card.

(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 Articles of World MasterCard and its principles and to indemnify these entities for any loss, cost, expense or debt in respect of an 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 an opinion of the 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)

Reported Amounts

(N) Paz Oil Company Ltd.

Legal claims have been made against Paz Oil Company Ltd. (hereinafter - “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. With regard to 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 2009.

(O) Israel Corporation Ltd.

(1) Legal claims been made against certain consolidated companies of the Israel Corporation Ltd. contending that personal and property damage suffered by the plaintiffs resulted from the pollution of the Kishon River, which the plaintiffs contend, the abovementioned consolidated companies had a part in this process and with regard to the demand of the Ministry of Environmental Protection to bear the costs of removing polluting sediments from the Kishon River.

The managements of the above companies, based on the opinions of their legal advisers, cannot estimate the amount of the exposure from the said claims and demand, if any, and therefore, no provision has been made in this regard in the financial statements of the Israel Corporation Ltd. and of its consolidated companies.

(2) A consolidated company of the Israel Corporation is dependent on receiving services from infrastructure companies in order to carry on its activities.

(3) A consolidated company of the Israel Corporation Ltd., Zim Integrated Shipping Services Ltd. (hereinafter - “Zim”) has a deficit in its working capital as 31 December, 2009, which resulted primarily from a classification of short-term liabilities, due to the failure to comply with financial standards provided in the loan agreements. The financial statements of the Israel Corporation Ltd. include details of the understandings and agreements reached with creditors, suppliers and service providers, as well as with the shareholders, before and after the balance sheet date (and to some extent, even signed in a binding manner before the publication of these financial statements). These agreements and understandings mainly lay down the deferment, waiver and/or scheduling for the debts, as well as an injection of capital by the shareholders, and which, in the opinion of the management and board of directors of Zim, will allow Zim to finance its activities and comply with its commitments for the twelve months from the balance sheet date.

For a further explanation of the matter of these proceedings, see the financial statements of the Israel Corporation Ltd. as at 31 December, 2009.

(P) On 26 April 2009, a ruling of the Antitrust General Director was received by the Bank pursuant to Section 43(A)(1) of the Antitrust Law, 1988, according to which restrictive trade agreements, relating to the transfer of information regarding commissions, had existed between the Bank, Bank Hapoalim B.M., Israel Discount Bank Ltd., Mizrahi Tefahot Bank Ltd. and the First International Bank of Israel Ltd., during the period from the beginning of the 1990s until the commencement of the Antitrust Authority's investigation of the matter, in November 2004. This is a civil ruling, which constitutes *prima facie* evidence of the matters therein determined in any legal proceedings. The Bank has decided to appeal the ruling in the Antitrust Tribunal. At this early stage, the effects of the ruling cannot be assessed.

Note 19 - Interested and Related Parties of the Bank and its Subsidiaries

Reported Amounts

A. General

The State of Israel became a shareholder of the Bank on 31 October 1993, under the Bank Shares Arrangement and the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993 (the "Bank Shares Law"). As determined in the Bank Shares Law, the transfer of the shares in the Bank to the State and the exercise of the rights by virtue of the shares under this Law do not require a permit under the Banking (Licensing) Law, 1981.

On 31 December 2009 and on 10 March 2010, the State of Israel held 11.46% of the issued share capital of the Bank and 14.20% of the voting rights in the Bank.

On 14 June 2006, the Bank Leumi Group employees (including the Chairman of the Board of Directors) purchased 40,333,691 shares of the Bank's capital from the State. The shares are blocked until 13 June 2010. (The Chairman of the Board of Directors purchased his shares on 5 July 2006, and those shares are blocked until 4 July 2010). During the blocked period, the State has a power of attorney to vote the shares that were purchased and to use the right to appoint directors by virtue of the shares. The blocked shares constitute 2.74% of the voting rights.

The Bank Shares Law authorized the shares committee of the Bank to exercise the voting rights granted by virtue of the State's holding in the Bank in the name of the State and on its behalf.

The Bank Shares Law determines that "the use of the voting rights granted by virtue of the shares will be made by a committee functioning in the name of the State and on its behalf" (Section 3 of the Bank Shares Law).

In August 2009, the Bank received a letter from counsel for Shlomo Eliahu Holdings Ltd. ("Eliahu Holdings") according to which Eliahu Holdings is of the view that given the percentage of the State's present shareholding in the Bank, it is not possible to view the State as having control of the Bank, and under present circumstances the Bank does not in practice have a controlling shareholder as defined by law.

In light of this letter, the Bank asked M.I. Holdings Ltd. and the Bank Supervision Department for their positions on the matter. The Bank Supervision Department advised the Bank that it views the Bank as a banking corporation, in which at least one of the holders of means of control is the holder of a control permit, so long as the Board of Directors is appointed in accordance with the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993 and the regulations promulgated thereunder.

It should be noted that to the best of the Bank's knowledge, none of the holders of means of control in the Bank has been granted a control permit.

M.I. Holdings on behalf of the State of Israel replied to the Bank in a letter dated 27 August 2009 as follows:

"1. According to your above request and telephone conversations, the subject of the control of the Bank was raised during the preparation of the Bank's shelf prospectus. You have advised us that the Bank intends to state in the shelf prospectus, which it plans to publish in August 2009, that as long as over 50% of the Bank's directors are appointed in accordance with the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993 (the "Bank Shares Law") then according to the presumption determined in the Securities Law, the State holds control of the Bank, for the purposes of the requirement of Regulation 44C of the Securities Regulations

Note 19 - Interested and Related Parties of the Bank and its Subsidiaries (cont'd)

Reported Amounts

(Details, Structure and Form of Prospectus and Draft Prospectus), 1969. We have no objection to this interpretation.

2. We request you to ensure that the prospectus includes a description of the manner in which the State holds shares in the Bank, including the rules and restrictions applying to these holdings under the Bank Shares Law, including, *inter alia*, the restrictions on the State's ability to intervene in the management of the Bank's business and its decision-making process.

3. We would emphasize that nothing in the above may prevent the State from raising any claim regarding any matter concerning the State's responsibility under the securities laws or any other laws, and may not detract from or affect such claims."

All the directors serving on the Board of Directors of the Bank were appointed in accordance with the Bank Shares Law, and all the directors were proposed to the General Meetings of the Bank by the Bank's shares committee, and the committee voted for them by virtue of the State's shares in the Bank. As mentioned above, under the Bank Shares Law, the committee votes at General Meetings in the name of the State and on its behalf.

The Bank's current shares committee was appointed by virtue of the Bank Shares (Arrangement Shares) (Temporary Provision) Law (Appointment of Committees and Terms of Office) Directives, 2009, which were published on 12 March 2009. The committee's appointment is valid through 31 October 2011 but will end earlier if and when one of the following events takes place: (1) no other party holds a control permit pursuant to section 34(b) of the Banking (Licensing) Law, 1981 and the State's holding of shares in the Bank has fallen below a percentage which does not exceed 5%, or (2) there is another party who olds a control permit pursuant to section 34(b) of the Banking (Licensing) Law, 1981 and the percentage of the shares in the Bank held by the State has fallen below a percentage which does not exceed 10%.

In conclusion
The directors currently holding office in the Bank were all proposed by the shares committee and all were elected with its support at the Bank's General Meeting. The shares committee acts as mentioned above in the name of the State of Israel and votes on behalf of the State at the General Meetings.

From this it may be learned that as long as over 50% of the directors of the Bank are appointed in accordance with the Bank Shares Law, then the State of Israel holds over 50% of one of the means of control of the Bank and in accordance with the presumption regarding the definition of control in the Securities Law, it holds control of the Bank, subject to the restrictions determined in the Bank Shares Law. It should be noted that there exists another interpretation, as detailed above.

On 1 March 2010, a petition by Shlomo Eliahu, Shlomo Eliahu Holdings Ltd., and Eliahu Insurance Co. Ltd., an interested party in the Bank, to the Supreme Court was received at the Bank's offices for the granting of a conditional order against the Minister of Finance, the Government of Israel, M.I. Holdings Ltd., and the Bank. In this petition, the Court is requested to grant a conditional order obliging the respondents to give reasons why they should not sell immediately the shares of the Bank owner by the Government and why ann. immediate and defined timetable should not be set immediately for the sale of the said shares. The Court was further requested to make the order absolute if there was nothing in the respondents answer to comply with the provisions of the law and the obligation imposes on them, and to set an immediate defined and recognized time table for the sale of the shares of the Bank.

Note 19 - Interested and Related Parties of the Bank and its Subsidiaries (cont'd)

Reported Amounts

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.

On 25 November 2009, M.I. Holdings notified the Bank that it was making preparations for the sale of the remainder of the State's holdings in the Bank's shares, but at this stage no defined plan had been formulated.

Excellence Investments Ltd., Phoenix Holdings Ltd. and Delek Group Ltd. ("the Delek Group of companies") notified the Bank on 6 August 2009 that they had become interested parties in the Bank, due to the aggregate holdings of companies in the Excellence Group, the Phoenix Group and the Delek Group. In addition, the Bank was informed that all of the above companies were under the control of Mr. Yitzchak Sharon (Teshuva) indirectly by means of companies under his control. The Delek Group of companies notified the Bank on 4 January 2010 that they had ceased to be interested parties in the Bank as of 31 December 2009.

Clal Insurance Enterprises Holdings Ltd., Clal Finance Ltd. and Epsilon Investment House Ltd., all three companies in IDB Holding Corporation Ltd. ("the IDB Group of companies"), notified the Bank on 26 August 2009 that they had become interested parties in the Bank, due to the aggregate holdings of companies in the IDB Group and/or their subsidiaries and/or related parties. The IDB Group of companies notified the Bank on 31 August 2009 that they had ceased to be interested parties in the Bank as of 30 August 2009.

On 31 December 2009 and on 10 March 2010 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.
On 31 December 2008 the Eliahu Group held 9.59% of the Bank's issued capital and voting rights (9.44% fully diluted).

Note 19 - Interested and Related Parties of the Bank and its Subsidiaries (cont'd)

Reported Amounts

B. Balances on consolidated basis

	31 December 2009									
	Interested Parties						Related parties held by the Bank			
	Shareholders		Directors and CEO (a)(b)		Others (f)		Companies included on equity basis		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	-	-	12	432
Credit to the public	-	237	3	3	-	721	1,453	1,453	2,254	5,519
Investments in companies included on equity basis (d)	-	-	-	-	-	-	2,178	2,178	-	-
Other assets	-	-	-	-	-	201	10	62	20	302
Liabilities:										
Deposits of the public	55	243	8	9	-	620	999	1,523	553	879
Deposits from banks	-	-	-	-	-	193	-	-	-	-
Debentures, bonds and subordinated notes	-	7	-	-	-	-	-	-	-	-
Other liabilities	-	-	-	-	-	208	410	484	141	389
Credit risk in off-balance sheet items (e)	-	-	3	3	-	181	730	730	1,417	2,414

(a) Including their spouses and minor children and companies controlled by them.

(b) As at 31 December 2009 the directors and the CEO held Bank shares with a par value of NIS 411,441 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 equity basis.

(e) Credit risk in respect of off-balance sheet financial instruments as calculated for purposes of per borrower debt limitations.

(f) Including corporations included on equity basis in which an interested party holds 25% or more of the issued share capital or the voting rights or is entitled to appoint 25% or more of their directors.

(g) Including corporations in which the Bank holds 10% or more of the issued share capital or the voting rights or is entitled to appoint 10% or more of their directors or is entitled to appoint the CEO, and other corporations in which related parties hold 25% or more of the issued share capital or the voting rights or of the authority to appoint directors.

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 2008									
	Interested Parties						Related parties held by the Bank			
	Shareholders		Directors and CEO (a)(b)		Others (f)		Companies included on equity basis		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 equity basis.
(e) Credit risk in respect of off-balance sheet financial instruments as calculated for purposes of per borrower debt limitations.
(f) Including corporations included on equity basis in which an interested party holds 25% or more of the issued share capital or the voting rights or is entitled to appoint 25% or more of their directors.
(g) Including corporations in which the Bank holds 10% or more of the issued share capital or the voting rights or is entitled to appoint 10% or more of their directors or is entitled to appoint the CEO, and other corporations in which related parties hold 25% or more of the issued share capital or the voting rights or of the authority to appoint directors.

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

2009

	Interested parties			Related parties held by the Bank	
	Shareholders	Directors and CEO	Others	Companies included on equity basis	Others
	NIS millions				
Net interest income (expense) before provision for doubtful debts (a)	-	-	26	(183)	70
Provision for doubtful debts	-	-	-	-	(44)
Operating and other income	-	-	25	13	18
Operating and other expenses (b)	-	(29)	-	(18)	(49)
Total	-	(29)	51	(188)	(5)

2008

	Interested parties			Related parties held by the Bank	
	Shareholders	Directors and CEO	Others	Companies included on equity basis	Others
	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

(a) See details in section E below.
(b) See details in section D below.

Note 19 - Interested and Related Parties of the Bank and its Subsidiaries (cont'd)

Reported Amounts

D. Benefits to interested parties

	2009		2008	
	Directors and CEO		Directors and CEO	
	Total benefits	Number of recipients	Total benefits	Number of recipients
	NIS millions			
Interested parties employed in the Bank or on its behalf (a) (b)	16	2	7	2
Directors not employed in the Bank or on its behalf (b)	10 (c)	15	9 (c)	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 and investee companies. The aggregate insurance premium amounts to NIS 2,559 thousand (2008 – NIS 3,417 thousand).

(b) Does not include VAT on salaries.

(c) The amounts: NIS 10,179 thousand in 2009 compared with NIS 8,972 thousand in 2008.

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 consolidated companies with interested parties and related parties

	2009		2008		2007	
	Consolidated	Including: companies included on equity basis	Consolidated	Including: companies included on equity basis	Consolidated	Including: companies included on equity basis
	NIS millions		NIS millions		NIS millions	
a) Income on assets						
Credit to the public	182	13	259	21	336	68
b) Income on liabilities						
Deposits of the public	(47)	(41)	(55)	(41)	(62)	(31)
Deposit with banks	-	-	(4)	-	(3)	-
Debentures and subordinated notes	-	-	-	-	(5)	-
c) Income on derivative financial instruments						
Net income (expenses) in respect of ALM derivatives	(227)	(155)	42	32	(95)	5
d) Other						
Financing commissions	3	-	4	-	3	-
Other financing incomes	2	-	-	-	-	-
Other financing expenses	-	-	(1)	-	(1)	-
Net interest income before provision for doubtful debts	(87)	(183)	245	12	173	42

Note 20 - Net Interest Income before Provision for Doubtful Debts

Reported Amounts

	2009	2008	2007
	NIS millions		
A. Income on assets (a)			
Credit to the public	**10,956**	11,483	9,145
Credit to governments	**31**	24	3
Deposits with Bank of Israel and cash	**142**	535	(154)
Deposits with banks	**897**	(1,110)	(604)
Debentures	**1,557**	914	667
Interest income from securities borrowed or purchased under agreement to resell	**7**	31	14
Total income on assets	**13,590**	11,877	9,071
B. Expenses on liabilities (a)			
Deposits of the public	**(4,915)**	(2,536)	(1,322)
Deposits from governments	**(45)**	(40)	(66)
Deposits from Bank of Israel	**1**	(55)	(137)
Deposits from banks	**(133)**	(287)	11
Debentures, bonds and subordinated notes	**(1,774)**	(1,682)	(957)
Interest expense from securities loaned or sold under agreement to repurchase	**(9)**	(27)	1
Total expenses on liabilities	**(6,875)**	(4,627)	(2,470)
C. Income on derivative financial instruments and hedging activities			
Ineffective part of hedge ratios (b)	**-**	-	3
Net income (expenses) in respect of ALM derivatives (c)	**(1,217)**	(509)	21
Net income (expenses) in respect of other derivatives	**13**	(97)	(15)
Total from derivatives and hedging activities	**(1,204)**	(606)	9
D. Other			
Financing commissions	**345**	337	308
Other financing income (expenses) (d)	**1,167**	(601)	730
Total other	**1,512**	(264)	1,038
Total net interest income before provision for doubtful debts	**7,023**	6,380	7,648
Of which: net exchange rate differences	**(57)**	(26)	16

(a) Including effective component of hedge relationships.

(b) Excluding effective component of hedge relationships.

(c) Derivative instruments which constitute part of the Bank's assets and liability management system and were not designated for hedging relationships.

(d) Including collections and interest reductions in respect of doubtful debts in the amount of NIS 380 million (2008 - NIS 507 million, 2007 - NIS 461 million).

(e) Including negative interest and exchange difference in respect of mortgage-backed bonds (MBS) in the amount of NIS 127 million (2008 - NIS 24 million, 2007 - NIS 216 million).

Note 20 - Net Interest Income before Provision for Doubtful Debts (cont'd)

Reported Amounts

	2009	2008	2007
	NIS millions		
E. Details of operating results of investments in debentures			
Interest on debentures, on accrual basis:			
Held to maturity	**36**	66	72
Available for sale	**1,376**	565	247
Held for trading	**145**	283	348
Total, included in interest income on assets	**1,557**	914	667
Other financing income (expenses):			
Gain on sale of debentures available for sale	**499**	59	138
Losses on sale of debentures available for sale (b)	**(205)**	(1,396)	(30)
Realized and unrealized profits (losses) from adjustments to fair value of debentures held for trading, net (a)	**232**	82	(22)
Total, included in other financing income (expenses)	**526**	(1,255)	86
Total from investments in debentures	**2,083**	(341)	753
F. Net effect of hedging derivative instruments on income from financing activity			
Interest income in respect of assets	**-**	(11)	(6)
Interest expenses in respect of liabilities	**2**	26	18

(a) Of which part of the profits (losses) related to bonds held for trading still held as of balance sheet date in the amount of NIS 84 million (2008 - NIS (23) million, 2007 - NIS (60) million).

(b) Including provision for impairments not of a temporary nature.

Note 21 – Operating Commissions

Reported Amounts

	2009	(a) 2008	(a) 2007
	NIS millions		
Ledger fees	**843**	832	828
Payment transfer services	**289**	309	271
Handling of credit and preparing agreements	**249**	339	353
Computerized services, information and confirmations (b)	**182**	172	248
Foreign trade transactions and special foreign currency services	**115**	118	131
Income from securities transactions	**862**	791	865
Income from credit cards	**767**	765	672
Interest margin and collection commission on deposits and credit from deposits on collection basis:			
Collection commissions on credit out of treasury funds	**49**	54	62
Other commissions and interest margins (c)	**48**	49	43
Management fees and commissions on life assurance and on housing insurance	**47**	45	48
Other	**60**	64	72
Total operating commissions	**3,511**	3,538	3,593

(a) Reclassified.
(b) Mainly distribution costs and mutual funds.
(c) Mainly operation of provident funds.

Note 22 – Profits (Losses) from Investments in Shares (a), net

Reported Amounts

	2009	2008	2007
	NIS millions		
Gains on sale of shares available for sale	**600**	141	250
Losses on sale of shares available for sale (b)	**(18)**	(656)	(32)
shares held for trading, net (c)	**8**	(528)	(2)
Dividend on shares available for sale and held for trading shares	**117**	131	245
Total from investments on shares	**707**	(912)	461

(a) Including mutual funds.
(b) Including provision for impairment not of a temporary nature.
(c) Of which part of the profits (losses) related to shares held for trading still held as of balance sheet date in the amount of NIS (2) million (2008 - NIS (326) million, 2007 - NIS (1) million).

Note 23 - Other Income

Reported Amounts

	2009	(a) 2008	(a) 2007
	NIS millions		
Profits from severance pay funds	**237**	-	63
Other, net	**108**	174	105
Total other income	**345**	174	168

(a) Reclassified.

Note 24 - Salaries and Related Expenses

Reported Amounts

	2009	2008	2007
	NIS millions		
Salaries	**2,753**	2,474	2,788
Severance pay, provident fund, continuing education fund, pension, vacation and long service bonus	**523**	589	445
Expense (income) deriving from share-based payment transactions	**32**	(65)	250
National insurance and VAT on salaries	**578**	339	524
Other related expenses	**161**	171	162
Adjustment of provisions for related expenses as a result of changes in salaries in the current year	**5**	607	49
Voluntary retirement	**-**	3	-
Total salaries and related expenses	**4,052**	4,118	4,218
Of which: Salaries and related expenses abroad	**528**	525	514

Note 25 - Other Expenses

Reported Amounts

	2009	2008	2007
	NIS millions		
Marketing and advertising	**215**	271	265
Legal, audit and professional consultancy	**276**	287	270
Communications - postage, telephone, delivery services, etc.	**150**	158	152
Computers (a)	**196**	232	219
Office expenses	**79**	92	92
Insurance	**14**	29	26
Training	**27**	32	36
Amortization of goodwill	**21**	17	15
Other (b)	**393**	370	370
Total other expenses	**1,371**	1,488	1,445

(a) The item includes outsourcing expenses and does not include the Bank's computer expenses since the Operations 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

	2009	2008	2007
	NIS millions		
Current taxes -			
In respect of current year	**1,090**	342	1,660
In respect of prior years	**(65)**	46	39
Total current taxes	**1,025**	388	1,699
Add (deduct) changes in deferred taxes -			
In respect of current year	**20**	29	9
In respect of prior years	**146**	4	14
Total deferred taxes	**166**	33	23
Provision for taxes on income	**1,191**	421	1,722
Of which: Provision for foreign taxes	**47**	(27)	166

Note 26 - Provision for Taxes on Operating Profit (cont'd)

Reported Amounts

B. Reconciliation between the theoretical amount of tax applicable if the operating profit would be taxable at the statutory tax rate in Israel, and the provision for taxes on the operating profit appearing in the statement of profit and loss:

	2009	2008	2007
Statutory tax rate applying to a banking corporation in Israel	**36.21%**	36.80%	38.53%
	NIS millions		
Tax at the statutory tax rate	**1,134**	12	1,744
Tax (tax saving) resulting from:			
General and supplementary provisions for doubtful debts	**(1)**	27	(51)
Other non-deductible expenses	**14**	(a) 143	26
Income of foreign consolidated companies	**(10)**	88	142
Income of Israeli consolidated companies	**(44)**	(33)	(44)
Depreciation adjustment differences	**(3)**	1	(22)
Inflationary deduction	**-**	-	(140)
Tax exempt and at preferred rates	**(15)**	(22)	(39)
Timing differences for which deferred taxes have not been provided	**(1)**	43	1
Profit tax on VAT on salaries, net	**-**	(32)	35
Change in deferred taxes due to change in tax rates	**17**	21	4
Taxes in respect of prior years * (b)	**81**	50	53
Other	**19**	(c) 123	13
Provision for taxes on operating profit	**1,191**	421	1,722

(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.
(b) Including adjustment of the deferred taxes due to change in tax rates in the amount of NIS 146 million (see C. below).
(c) Effect of losses transferred for tax purposes which are not recognized for purposes of profits tax.

C. On 1 July 2009, the Value Added Tax (Tax Rate for Non-Profit Organizations and Financial Institutions) Order, 2009 was published in the government Gazette (*Reshumot*), raising the rates of salary tax and profit tax applying to financial institutions from 15.5% to 16.5%, from 1 July 2009 to 31 December 2010.

On 31 December 2009, the Value Added Tax (Tax Rate for Non-Profit Organizations and Financial Institutions) Order, 2009 was published in the government Gazette (*Reshumot*), reducing the rates of salary tax and profit tax applying to financial institutions from 16.5% to 16%, from 1 January 2010 to 31 December 2010.

On 14 July 2009, the Knesset passed the Income Tax Ordinance (Amendment No. 147 and Temporary Provision) Law, 2009 (the "Amendment"), determining *inter alia* a gradual reduction of the tax rate for companies from 25% from 2010 to 18% in 2016 and thereafter. The rates of companies tax applicable from the 2009 tax year and thereafter are as follows: for the 2009 tax year the tax rate was 26%, for 2010 it will be 25%, for 2011 it will be 24%, for 2012 it will be 23%, for 2013 it will be 22%, for 2014 it will be 21%, for 2015 it will be 20%, and from 2016 and thereafter the tax rate will be 18%.

Note 26 - Provision for Taxes on Operating Profit (cont'd)

Reported Amounts

The Bank as a "financial institution" for the purposes of the Value Added Tax Law pays profit tax. The rate of profit tax in 2009 and 2010 is 16% and in 2011 and thereafter – 15.5%. 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 2009 the overall tax rate was 36.21%, for 2010 – 35.34%, for 2011 – 34.20%, for 2012 – 33.33%, for 2013 – 32.47%, for 2014 – 31.60%, for 2015 – 30.74% and from 2016 and thereafter the overall tax rate will be 29.0%.

The effect of the changes in rates of tax increased tax expenses in 2009 by the amount of NIS 146 million, in relation to the balance of deferred taxes at the beginning of the year.

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.

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.

E. Final assessments have been issued to the Bank for all years up to and including the 2006 tax year. Principal consolidated companies have final assessments for the years up to and including 2005.

F. Amendment 11 to the Income Tax (Inflationary Adjustments) Law, 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 1999-2007.

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.

Notwithstanding the limitation of the application of the Income Tax (Inflationary Adjustments) Law as described in paragraph D. above, the Bank, in coordination with the tax authorities, is continuing to act 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:

	31 December 2009	31 December 2008	31 December 2007
	NIS millions		
Balance at the beginning of the year	**190**	203	217
Change in the current year (a)	**(14)**	(13)	(14)
Balance at the end of the year	**176**	190	203

Note 26 - Provision for Taxes on Operating Profit (cont'd)

Reported Amounts

(a) This includes amounts not admitted as deductible in respect of depreciation and amounts amortized in respect of assets sold.

H. Certain consolidated companies have losses and other deductions which were claimed for tax purposes and in respect of which no future tax saving was included in the balance sheet, amounting in the consolidated companies to approximately NIS 17 million (31 December 2008 - approximately NIS 26 million). Utilization of these amounts in the future will be possible if the consolidated companies for which the amounts are recorded will have taxable income.

I. Components of deferred tax assets and deferred tax liabilities are as follows:

	31 December 2009	31 December 2008	**31 December 2009**	31 December 2008
	NIS millions		Average tax rate in percent	
Deferred tax assets				
From specific provision for doubtful debts	**187**	173	**37%**	40%
From provision for unutilized vacations and long service bonus	**243**	273	**31%**	35%
From excess of provision for severance pay and pension over funds allocated	**773**	1,006	**30%**	35%
From interest not credited to current income	**70**	59	**37%**	38%
From tax loss carry forward	**47**	366	**11%**	26%
From activity abroad	**4**	11	**35%**	36%
From adjustment of depreciable non-monetary assets	**36**	34	**44%**	44%
Other – from non-monetary assets	**22**	39	**15%**	24%
Share-based payment transactions	**80**	2	**35%**	27%
Total	**1,462**	1,963		
Reserve for deferred taxes				
From securities	**(161)**	(26)	**33%**	34%
From investments in investee companies	**(130)**	(137)	**11%**	12%
From adjustment of depreciable non-monetary assets	**(106)**	(89)	**29%**	31%
Other – from monetary assets	**(16)**	(12)	**35%**	36%
Other – from non-monetary assets	**(16)**	(21)	**18%**	27%
Total	**(429)**	(285)		
Deferred taxes receivable, net	**1,033**	1,678		
Deferred taxes included: (a)				
In "Other assets"	**1,107**	1,745		
In "Other liabilities"	**(74)**	(67)		
Deferred tax assets, net	**1,033**	1,678		

Note 26 - Provision for Taxes on Operating Profit (cont'd)

Reported Amounts

(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.

Average tax rate in percent

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 (524) million (2008 - NIS 634 million; 2007 - NIS 89 million) derive from securities available for sale and have been charged to a separate item in shareholders' equity.

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, 2009 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

	2009	2008	2007
	NIS millions		
Net gain on realization of investments in investee companies and sale of activities (a)	-	258	564
Elimination of extraordinary provisions in connection with fixed assets	-	1	7
Net gain (loss) from sale of buildings	36	(2)	28
Net profit before taxes	36	257	599
Provision for taxes on profit from extraordinary items:			
Current taxes	8	7	222
After-tax profit from extraordinary items	28	250	377
Share of profits of minority shareholders of consolidated companies, net of extraordinary items after taxes	-	-	(4)
After-tax profit from extraordinary items	28	250	373

(a) In 2008 the profit derives mainly from the allocation of 20% of the share capital of Leumi Card to Kanit Co. As a result of the above allocation the net profit of the Bank was about NIS 234 million. In 2007 the profit was derived from the sale of the capital market activities.

Note 28 – Operational Segments and Geographic Areas

The Bank in Israel is organized in five business lines, operating through five divisions, each headed by a member of the Management of the Bank. Each business line specializes in providing 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 providing 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 Bank of Israel 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 in 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 above characteristics are as follows:

1.	Households	-	providing 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 major and international companies in the economy for their operations in Israel and abroad.
4.	Commercial Banking	-	providing banking and financial services to middle market companies in the economy and to interested parties in these companies.
5.	Private Banking	-	providing domestic and global financial services and solutions comprehensive to private customers resident in Israel and overseas with large financial asset portfolios.
6.	Financial Management and Capital Market	-	nostro and trading rooms activities and provision of services to institutional customers and foreign financial institutions. Includes the results of activity of investments in (real) companies included on equity basis.
7.	Others*	-	activities not assigned to other segments.

Segmented operations also include inter-segmental activity, such as services provided to customers in another segment and also activities (deriving from products) such as mortgage loans, credit cards and the capital market.

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

Note 28 – Operational Segments and Geographic Areas (cont'd)

Until 2007 a Construction and Real-Estate segment was shown separately. From 2008 the Segment was reallocated between other segments and shown as a product in each of the segments in which there is such activity.

Allocation to a specific operational segment is carried out according to quantitative criteria and additional 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 in five business lines, and its policy is to allocate the customers, as much as possible, to the business line/operational segment appropriate for them, in accordance with their characteristics and activities. It should however be emphasized that segmental allocation is determined according to the sector in which the customer's account is actually operated; and until segmentation is carried out between the segments, i.e. until the customer receives service from the segment to which he should be allocated under the above criteria, there is no change to the segmental classification.

Financial Measurement System

To provide administrative support for 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 profitability of the different profit centers;
- Measurement of the volume of business activity of the different profit centers according to various classifications;
- Measurement of performance against targets in the work plan;
- Uniformity in analyzing business activity;
- Overall control of business activity and profitability from such activity;
- Directing the branches and other business units to achieving 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 system in the Bank is the "data warehouse" that centralizes all the Bank's transactions and, with the aid of an appropriate index, enables transactions to be sorted and classified between the different profit centers.

The data presented below regarding operational segments includes the Bank's data in accordance with the principles of the "Bachan" system 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, exchange rate differentials, net of tax, arising from financing investments in overseas subsidiaries, are allocated to the net interest income of the overseas units.

The attribution of income and expenses according to operational segments in the Bank is done as follows:

Note 28 – Operational Segments and Geographic Areas (cont'd)

Income

Net Interest Income

The profit center is credited with interest received from loans that it granted or is debited with 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. Transfer prices are usually determined in accordance with market prices with certain adjustments, and generally reflect the risk-free return or marginal costs of raising funds with the same linkage sector and currency and for a similar term. The effects of exchange rate differentials between the shekel/foreign currencies, including adjustments from translating data of overseas units, and also changes in the CPI on surplus uses and/or sources of funds are attributed in the Group to the financial management segment. Under the method described above, the profit centers bear credit risks but do not bear market risks.

The profit and loss account of each of the segments also takes into account the capital allocated to the segment. Each profit center is credited for Tier I capital allocated to it in respect of the risk assets in accordance with risk-free return, and is charged for the additional cost of Tier II capital. Under this method 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 management of the nostro is reflected in the financial management and capital markets segment.

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 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 pay fund and dividends received by the Bank are credited to the financial management and capital market profit center.

Expenses

The Bank's expenses are attributed to the different operational segments based on an "operations pricing" system and in accordance with the volume of activity (number of operations of the profit center).

Pricing is multi-dimensional - the pricing system calculates the cost per transaction after considering the transaction type, line of business and distribution channel. The system prices some 6,400 transactions of vaious types.

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

Measuring Return on Equity

For every operational segment a calculation is made of the segment's risk assets, and Tier I and Tier II capital is allocated to the segment according to the results of the calculation. Return on equity for the segment is calculated according to the results received.

Note 28 – Operational Segments and Geographic Areas (cont'd)

Reported Amounts

A. Information on operational segments

Statement of profit and loss for the year ended 31 December 2009

	Households Sector	Small Business Sector	Corporate Sector	Commercial Sector	Private Banking Sector	Financial Management Sector	Other	Total consol-idated
	NIS millions							
Net interest income (loss)								
before provision for doubtful debts								
From outside entities -	1,064	1,036	3,028	1,747	(203)	333	18	7,023
Intersegmental -	1,017	(180)	(1,136)	(336)	638	13	(16)	-
Total	2,081	856	1,892	1,411	435	346	2	7,023
Operating and other income:								
From outside entities -	1,701	459	937	418	438	460	150	4,563
Intersegmental -	233	(59)	(120)	(39)	16	3	(34)	-
Total	1,934	400	817	379	454	463	116	4,563
Total income	4,015	1,256	2,709	1,790	889	809	118	11,586
Provision for doubtful debts	281	228	579	383	35	11	-	1,517
Operating and other expenses	3,472	739	568	932	676	524	26	6,937
Operating profit before taxes	262	289	1,562	475	178	274	92	3,132
Provision for taxes on operating profit	73	101	549	164	57	84	163	1,191
Operating profit (loss) after taxes	189	188	1,013	311	121	190	(71)	1,941
Group equity in after-tax operating profits (losses) of companies included on equity basis, net of tax basis, net of tax effect	-	-	-	-	-	86	(5)	81
Minority interest in after-tax operating profits of consolidated companies	(28)	-	-	-	(5)	(3)	-	(36)
Net operating profit (loss)	161	188	1,013	311	116	273	(76)	1,986
After-tax profit from extraordinary items	-	-	-	-	-	-	28	28
Net profit (loss)	161	188	1,013	311	116	273	(48)	2,014
Return on capital (percentage of profit from the proportionate capital according to share of sector in risk assets)	3.61%	16.44%	14.44%	8.95%	18.85%	10.49%	(11.09%)	10.20%

Note 28 – Operational Segments and Geographic Areas (cont'd)

Reported Amounts

A. Information on operational segments (cont'd)

Statement of profit and loss for the year ended 31 December 2009 (cont'd)

	Households Sector	Small Business Sector	Corporate Sector	Commercial Sector	Private Banking Sector	Financial Management Sector	Other	Total consol-idated
	NIS millions							
Average balance of assets	64,609	17,608	77,712	46,738	11,104	94,434	6,513	318,718
Including: investments in companies included on equity basis	8	-	-	-	-	1,871	88	1,967
Average balance of liabilities	125,741	15,690	34,411	33,542	41,735	45,671	1,533	298,323
Average balance of risk assets	57,304	14,687	90,120	44,629	7,903	33,417	5,558	253,618
Average balance of assets of mutual funds and training funds	37,588	1,541	709	2,921	4,122	435	-	47,316
Average balance of securities	45,369	3,282	66,751	32,864	59,140	100,160	-	307,566
Average balance of other managed assets	7,433	373	256	616	296	-	92	9,066
Margin on credit-granting activities	1,023	643	1,435	964	64	5,992	(15)	10,106
Margin on deposit-taking activities	834	91	44	217	260	(6,469)	77	(4,946)
Other	224	122	413	230	111	823	(60)	1,863
Total interest income before provision for doubtful debts	2,081	856	1,892	1,411	435	346	2	7,023

Note 28 – Operational Segments and Geographic Areas (cont'd)

Reported Amounts

A. Information on operational segments (cont'd)

Statement of profit and loss for the year ended 31 December 2008 (a)

	Households Sector	Small Business Sector	Corporate Sector	Commercial Sector	Private Banking Sector	Financial Management Sector	Other	Total consol-idated
	NIS millions							
Net interest income (loss) before provision for doubtful debts								
From outside entities -	300	1,208	3,905	2,362	(617)	(779)	1	6,380
Intersegmental -	2,337	(302)	(2,022)	(839)	906	(65)	(15)	-
Total	2,637	906	1,883	1,523	289	(844)	(14)	6,380
Operating and other income:								
From outside entities -	1,689	434	335	401	385	(612)	168	2,800
Intersegmental -	237	(26)	(164)	(32)	15	2	(32)	-
Total	1,926	408	171	369	400	(610)	136	2,800
Total income	4,563	1,314	2,054	1,892	689	(1,454)	122	9,180
Provision for doubtful debts	340	182	1,070	487	8	58	-	2,145
Operating and other expenses	3,158	708	512	900	571	1,112	42	7,003
Operating profit (loss) before taxes	1,065	424	472	505	110	(2,624)	80	32
Provision for taxes(benefit) on operating profit	436	190	178	206	50	(902)	263	421
Operating profit (loss) after taxes	629	234	294	299	60	(1,722)	(183)	(389)
Group equity in after-tax operating profits (losses) of companies included on equity basis, net of tax basis, net of tax effect	-	-	-	1	-	252	(4)	249
Minority interest in after-tax operating profits of consolidated companies	(13)	-	-	-	(2)	(3)	-	(18)
Net operating profit (loss)	616	234	294	300	58	(1,473)	(187)	(158)
After-tax profit (loss) from extraordinary items	202	18	2	26	3	-	(1)	250
Net profit (loss)	818	252	296	326	61	(1,473)	(188)	92
Return on capital (percentage of profit from the sector in risk assets)	19.75%	20.69%	4.48%	8.50%	10.44%	(46.85%)	(42.40%)	0.46%

(a) Reclassified.

Note 28 – Operational Segments and Geographic Areas (cont'd)

Reported Amounts

A. Information on operational segments (cont'd)

Statement of profit and loss for the year ended 31 December 2008 (cont'd) (a)

	Households Sector	Small Business Sector	Corporate Sector	Commercial Sector	Private Banking Sector	Financial Management Sector	Other	Total consol-idated
NIS millions								
Average balance of assets	60,319	18,027	72,320	50,676	10,061	82,019	5,972	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	31,577	38,059	41,890	2,237	279,625
Average balance of risk assets	52,202	15,348	83,285	48,359	7,365	39,624	5,588	251,771
Average balance of assets of mutual	32,689	1,346	746	2,833	4,677	339	-	42,630
funds and training funds	42,523	3,345	70,602	39,677	61,191	105,148	-	322,486
Average balance of other managed assets	8,077	464	290	963	292	-	122	10,208
Margin on credit-granting activities	1,051	635	1,275	969	42	6,377	(12)	10,337
Margin on deposit-taking activities	1,353	166	80	283	228	(6,099)	(16)	(4,005)
Other	233	105	528	271	19	(1,122)	14	48
Total interest income (loss) before provision for doubtful debts	2,637	906	1,883	1,523	289	(844)	(14)	6,380

(a) Reclassified.

Note 28 – Operational Segments and Geographic Areas (cont'd)

Reported Amounts

A. Information on operational segments (cont'd)

Statement of profit and loss for the year ended 31 December 2007

	Households Sector	Small Business Sector	Corporate Sector	Commercial Sector	Private Banking Sector	Financial Management Sector	Other	Total consol-idated
	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
Intersegmental -	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
Group equity in after-tax operating profits of companies included on equity basis, net of tax basis, net of tax effect	-	-	-	5	-	179	-	184
Minority interest in after-tax operating profits (losses) of consolidated companies	-	-	-	-	(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)	22.14%	15.40%	16.51%	12.23%	33.44%	14.00%	41.87%	17.38%

Note 28 – Operational Segments and Geographic Areas (cont'd)

Reported Amounts

A. Information on operational segments (cont'd)

Statement of profit and loss for the year ended 31 December 2007 (cont'd)

	Households Sector	Small Business Sector	Corporate Sector	Commercial Sector	Private Banking Sector	Financial Management Sector	Other	Total consol-idated
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	34,899	1,242	459	2,744	5,635	245	-	45,224
funds and training funds	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 on credit-granting activities	932	572	1,151	891	83	4,335	(62)	7,902
Margin on deposit-taking 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

Note 28 – Operational Segments and Geographic Areas (cont'd)

Reported Amounts

B. Information on activity by geographic area (a)

31 December 2009

	Israel	U.S.A.	U.K.	Switzerland	Luxembourg	Romania	Others	Total outside of Israel	Total consoli-dated
	NIS millions								
Total income (b)	9,818	678	425	244	275	146	-	1,768	11,586
Net profit (loss)	1,881	17	50	37	6	(7)	30	133	2,014
Total assets	285,399	19,295	8,091	5,458	1,260	1,698	574	36,376	321,775
Credit to the public	181,935	12,268	6,825	1,837	249	1,129	426	22,734	204,669
Deposits of the public	220,194	14,822	5,603	4,178	4,157	919	545	30,224	250,418

31 December 2008

	Israel	U.S.A.	U.K.	Switzerland	Luxembourg	Romania	Others	Total outside of Israel	Total consoli-dated
	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

31 December 2007

	Israel	U.S.A.	U.K.	Switzerland	Luxembourg	Romania	Others	Total outside of Israel	Total consoli-dated
	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

(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 2009	31 December 2008
	NIS millions	
Credit and deposits from earmarked deposits		
Total credit to the public	**419**	432
Earmarked deposits		
Deposits of the public	**14**	16
Deposits from banks	**48**	29
Deposits from the Government	**575**	677
Total	**637**	722

Note 30 - Condensed Financial Statements of the Bank

Reported Amounts

A. Balance sheet of the Bank as at 31 December 2009

	31 December 2009	31 December 2008
	NIS millions	
Assets		
Cash and deposits with banks	**71,953**	58,355
Securities	**48,627**	37,056
Securities borrowed or purchased under agreement to resell	**744**	125
Credit to the public	**132,620**	144,574
Credit to governments	**407**	520
Investments in investee companies	**14,269**	12,518
Buildings and equipment	**3,134**	3,011
Other assets	**8,247**	11,547
Total assets	**280,001**	267,706
Liabilities and equity capital		
Deposits of the public	**230,223**	221,409
Deposits from banks	**4,838**	3,481
Deposits from governments	**603**	733
Securities loaned or sold under agreement to repurchase	**216**	374
Subordinated notes	**5,526**	4,637
Other liabilities	**16,733**	18,400
Total liabilities	**258,139**	249,034
Shareholders' equity	**21,862**	18,672
Total liabilities and equity capital	**280,001**	267,706

Note 30 - Condensed Financial Statements of the Bank (cont'd)

Reported Amounts

B. Condensed statements of profit and loss for the year ended 31 December 2009

	2009	2008	2007
	NIS millions		
Net interest income before provision for doubtful debts	**5,254**	4,972	6,062
Provision for doubtful debts	**1,269**	1,751	318
Net interest income after provision for doubtful debts	**3,985**	3,221	5,744
Operating and other income	**3,211**	1,628	2,756
Operating and other expenses	**4,992**	5,085	5,059
Operating profit (loss) before taxes	**2,204**	(236)	3,441
Provision for taxes on operating profit	**988**	217	1,314
Operating profit (loss) after taxes	**1,216**	(453)	2,127
Bank's equity in after-tax operating profits of investee companies, net of related tax effect	**770**	295	857
Net operating profit (loss)	**1,986**	(158)	2,984
	28	250	373
Net profit	**2,014**	92	3,357

Note 30 - Condensed Financial Statements of the Bank (cont'd)

Reported Amounts

C. Statements of cash flows for the year ended 31 December 2009

	2009	2008	2007
	NIS millions		
Cash flows generated by operating activities			
Net profit for the year	**2,014**	92	3,357
Adjustments required to show cash flows generated by operating activities:			
Equity of Bank in undistributed losses (profits) of investee companies including extraordinary profits less divided received	**(677)**	(324)	1,078
Other, net (including provisions for doubtful debts and impairment of securities	**492**	4,999	633
Net cash inflow generated by operating activities	**1,829**	4,767	5,068
Cash flows generated by activities in assets			
Additional investments in shares of consolidated companies	**(235)**	(123)	(219)
Other	**7,373**	(17,608)	(21,966)
Net cash outflow generated by activities in assets	**7,138**	(17,731)	(22,185)
Cash flows generated by activities in liabilities and capital			
Issue of debentures and subordinated notes	**1,000**	917	134
Dividend paid to shareholders	**-**	(1,684)	(2,500)
Issue of shares to employees	**-**	614	-
Other	**8,239**	14,312	12,316
Net cash inflow generated by activities in liabilities and capital	**9,239**	14,159	9,950
Increase (decrease) in cash	**18,206**	1,195	(7,167)
Balance of cash at beginning of year	**34,183**	32,988	40,155
Balance of cash at end of year	**52,389**	34,183	32,988

D. Information on the basis of nominal values for tax purposes

	31 December 2009	31 December 2008
	NIS millions	
Total assets	**278,299**	266,175
Total liabilities	**258,102**	248,984
Shareholders equity	**20,197**	17,191
Net profit (loss) for the year ended (a)	**2,064**	(69)

(a) Not including profits (losses) of companies included on equity basis, as required according to accepted accounting principles in Israel.

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 2009
(U.S. $ millions)

	2009	2008
Assets		
Cash and deposits with banks	**320**	743
Securities	**1,278**	1,147
Loans	**3,200**	3,582
Buildings and equipment	**15**	18
Other assets	**287**	270
Total assets	**5,100**	5,760
Liabilities and Equity Capital		
Deposits	**4,276**	4,871
Other liabilities	**250**	335
Capital notes	**90**	90
Capital resources	**484**	464
Total liabilities and capital resources	**5,100**	5,760

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2009
(U.S. $ millions)

	2009	2008
Income from financing operations before provision for doubtful debts	**115**	127
Provision for doubtful debts	**24**	15
Income from financing operations after provision for doubtful debts	**91**	112
Operating and other income	**44**	44
Operating and other expenses	**125**	133
Operating profit before taxes	**10**	23
Provision for taxes	**4**	4
Net profit	**6**	19

Bank Leumi (Switzerland) ltd.

Chairman of the Board: G. Maor
General Manager: A. Zaindenberg

Condensed Consolidated Balance Sheet as at 31 December 2009
(CHF millions)

	2009	2008
Assets		
Cash and deposits with banks	**798**	278
Loans	**498**	549
Securities	**171**	186
Other assets	**40**	100
Total assets	**1,507**	1,113
Total Customers' Investments (off-balance sheet)	**4,738**	4,878
Liabilities and Equity Capital		
Deposits from banks	**114**	381
Deposits and other accounts	**1,164**	515
Subordinated capital notes	**50**	50
Capital resources and reserves	**179**	167
Total liabilities and capital resources	**1,507**	1,113

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2009
(CHF millions)

	2009	2008
Net interest income	19	15
Other operating income	41	39
Expenses	48	49
Operating profit before taxes	12	5
Provision for taxes	3	1
Net profit	9	4

Bank Leumi (UK) plc

Chairman of the Board: E. Raff
Director and General Manager: L. Weiss

Condensed Consolidated Balance Sheet as at 31 December 2009
(Pounds sterling millions)

	2009	2008
Assets		
Cash and deposits with banks	**108**	235
Loans	**1,115**	1,151
Securities	**86**	103
Equipment and buildings	**4**	4
Other assets	**10**	80
Total assets	**1,323**	1,573
Liabilities and Equity Capital		
Deposits	**938**	1,086
Deposits from banks	**195**	231
Subordinated capital notes	**73**	73
Other liabilities	**16**	87
Capital resources	**101**	96
Total liabilities and capital resources	**1,323**	1,573

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2009
(Pounds sterling millions)

	2009	2008
Net interest income before provision for doubtful debts	**28**	31
Recoveries of doubtful debts	**18**	24
Net interest income after provision for doubtful debts	**10**	7
Operating and other income	**18**	8
Operating and other expenses	**25**	21
Operating profit (loss) before taxes	**3**	**(6)**
Provision for taxes	**(1)**	2
Net profit (loss)	**2**	(4)

Bank Leumi (Luxembourg) S.A.

Chairman of the Board: Z. Itskovitch
General Manager: Y. Moscovitz

Condensed Balance Sheet as at 31 December 2009
(Euro millions)

	2009	2008
Assets		
Cash and deposits with banks	**350**	534
Securities	**157**	173
Credit to the public	**45**	21
Other assets	**9**	12
Total assets	**561**	740
Liabilities and Shareholders' Equity		
Deposits of the public	**475**	498
Deposits from banks	**52**	212
Other liabilities	**6**	10
Total liabilities	**533**	720
Shareholders' equity	**28**	20
Total liabilities and shareholders' equity	**561**	740

Condensed Statement of Profit and Loss for the Year Ended 31 December 2009
(Euro millions)

	2009	2008
Net Interest income	**5**	5
Operating and other income	**6**	5
Operating and other expenses	**7**	24
Net profit (loss)	**4**	(14)

Leumi Mortgage Bank Ltd.

Chairman of the Board: A. Zeldman
General Manager: J. Burshtein

Condensed Balance Sheet as at 31 December 2009
Reported amounts (NIS millions)

	2009	2008
Assets		
Cash and deposits with banks	**13**	11
Credit to the public	**43,697**	39,783
Buildings and equipment	**62**	57
Other assets	**203**	219
Total assets	**43,975**	40,070
Liabilities and Shareholders' Equity		
Deposits of the public	**6,230**	6,980
Deposits from banks	**31,038**	26,795
Deposits from the government	**33**	33
Debentures	**41**	63
Subordinated notes	**3,831**	3,803
Other liabilities	**321**	246
Total liabilities	**41,494**	37,920
Shareholders' equity	**2,481**	2,150
Total liabilities and shareholders' equity	**43,975**	40,070

Condensed Statement of Profit and Loss for the Year Ended 31 December 2009
Reported amounts (NIS millions)

	2009	2008
Net interest income before provision for doubtful debts	**310**	430
Provision for doubtful debts	**(20)**	103
Net interest income after provision for doubtful debts	**330**	327
Operating and other income	**123**	121
Operating and other expenses	**240**	241
Operating profit before taxes	**213**	207
Provision for taxes on operating profit	**82**	81
Net profit	**131**	126

The Arab Israel Bank Ltd.

Chairman of the Board: S. Sussman
General Manager: Y. Eyal

Condensed Balance Sheet as at 31 December 2009
Reported amounts (NIS millions)

	2009	2008
Assets		
Cash and deposits with banks	**998**	1,003
Securities	**709**	794
Credit to the public	**2,958**	2,885
Buildings and equipment	**49**	50
Other assets	**45**	40
Total assets	**4,759**	4,772
Liabilities and Shareholders' Equity		
Deposits of the public	**3,161**	3,217
Deposits from banks	**938**	931
Subordinated notes	**154**	100
Other liabilities	**176**	180
Total liabilities	**4,429**	4,428
Shareholders’ equity	**330**	344
Total liabilities and shareholders' equity	**4,759**	4,772

Condensed Statement of Profit and Loss for the Year Ended 31 December 2009
Reported amounts (NIS millions)

	2009	2008
Net interest income before provision for doubtful debts	**232**	235
Provision for doubtful debts	**26**	27
Net interest income after provision for doubtful debts	**206**	208
Operating and other income	**102**	102
Operating and other expenses	**177**	188
Operating profit before taxes	**131**	122
Provision for taxes on operating profit	**52**	48
Net profit	**79**	74
Dividend Paid	**80**	80

Leumi Card Ltd.

Acting Chairman of the Board: B. Lederman
General Manager: D. Cohen

Condensed Consolidated Balance Sheet as at 31 December 2009
Reported amounts (NIS millions)

	2009	2008
Assets		
Cash and deposits with banks	**22**	31
Receivable in respect of credit card activity	**6,976**	6,456
Investment in companies included on the equity basis	**9**	9
Equipment	**136**	122
Other assets	**25**	24
Total assets	**7,168**	6,642
Liabilities and Shareholders' Equity		
Credit from banks	**977**	853
Payables in respect of credit card activity	**5,242**	4,977
Other liabilities	**115**	116
Total liabilities	**6,334**	5,946
Shareholders' equity	**834**	696
Total liabilities and shareholders' equity	**7,168**	6,642

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2009
Reported amounts (NIS millions)

	2009	2008 (a)
Income from credit card transaction	**695**	680
Net interest income before provision for doubtful debts	**118**	109
Other income	**7**	-
Provision for doubtful debts	**29**	29
Operating and other expenses	**600**	581
Net operating profit before taxes	**191**	179
Provision for taxes on operating profit	**53**	51
Net operating profit after taxes	**138**	128
Company's equity in the net profit of companies included on the equity basis	**-**	1
Net profit from unregular action	**-**	17
Net profit	**138**	146

(a) Reclassified.

Leumi Partners Ltd.(formerly Leumi & Co. Investment House Ltd.)

Chairman of the Board: Z.Nahari *
General Manager: A. Zeldman

Condensed Consolidated Balance Sheet as at 31 December 2009
Reported amounts (NIS millions)

	2009	2008
Assets		
Cash and deposits with banks	**179**	412
Securities	**1,261**	550
Investment in companies included on the equity basis	**133**	57
Fixed assets	**5**	4
Other assets	**11**	4
Total assets	**1,589**	1,027
Liabilities and Shareholders' Equity		
Other liabilities	**53**	33
Subordinated notes	**1,072**	672
Shareholders’ equity	**464**	322
Total liabilities and shareholders' equity	**1,589**	1,027

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2009
Reported amounts (NIS millions)

	2009	2008
Net interest income	**1**	-
Operating and other income (expenses)	**85**	(3)
Operating and other expenses	**36**	25
Operating profit (loss) before taxes	**50**	(28)
Provision for taxes on operating profit	**5**	16
Net operating profit (loss) after taxes	**45**	(44)
Company’s equity in the net profit (loss) of companies included on the equity basis	**(2)**	(4)
Net profit (loss)	**43**	(48)

* On 10 March 2010, Mr. Z. Nahari was appointed chairman of the Board of Directors.
The previous Chairman, Mr. E.Raff, resigned on 24 January 2010.

Leumi Finance Company Ltd.

Chairman of the Board: M. Eisenthal
General Manager: O. Shulman (*)

Condensed Balance Sheet as at 31 December 2009
Reported amounts (NIS millions) (a)

	2009	2008
Assets		
Cash and deposits with banks	**14,831**	10,792
Other assets	**2**	-
Total assets	**14,833**	10,792
Liabilities and Shareholders' Equity		
Debentures and subordinated notes	**14,676**	10,633
Other liabilities	**-**	2
Total liabilities	**14,676**	10,635
Shareholders' equity	**157**	157
Total liabilities and shareholders' equity	**14,833**	10,792

Condensed Statement of Profit and Loss for the Year Ended 31 December 2009
Reported amounts (NIS millions)

	2009	2008
Net interest income	**16**	19
Operating and other expenses	**2**	2
Operating profit before taxes on income	**14**	17
Provision for taxes on income	**5**	6
Net profit	**9**	11
Dividend Paid	**9**	10

* Until 1 April 2009, Mr. Z.B. Davidovich served as General Manager.
(a) The Financial Statements were prepared by the company in accordance with International Financial Reporting Standards (IFRS).

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 2009
Reported amounts (NIS millions)

	2009	2008
Assets		
Cash and deposits with banks	143	84
Investments	12	27
Credit to the public	932	948
Other assets	4	3
Total assets	1,091	1,062
Liabilities and Shareholders' Equity		
Deposits from banks	187	236
Other liabilities	15	10
Total liabilities	202	246
Shareholders' equity	889	816
Total liabilities and shareholders' equity	1,091	1,062

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2009
Reported amounts (NIS millions)

	2009	2008
Net interest income before provision for doubtful debts	**62**	80
Other income	**1**	2
Impairment of investment	**-**	5
Net income before provision for doubtful debts	**63**	77
Provision for doubtful debts	**3**	1
Net income after provision for doubtful debts	**60**	76
Operating expenses	**10**	9
Operating profit before taxes	**50**	67
Provision for taxes on operating profit	**13**	18
Net operating profit after taxes	**37**	49
Net profit from unregular action	**36**	-
Net profit	**73**	49